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Executive Office of the President
Office of Management and Budget

ACCOUNTING FOR SELECTED ASSETS AND LIABILITIES

STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NUMBER 1

March 30, 1993

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CONTENTS

PREFACE	Paragraph numbers a-e
INTRODUCTION	
Objective	Paragraphs 1-4
Approach	Paragraphs 5-9
Scope	Paragraphs 10-11
Materiality	Paragraphs 12-13
Applicability	Paragraph 14
Effective date	Paragraph 15
RECOMMENDED STANDARDS	
Explanation	Paragraphs 16-17
General Standards	Paragraphs 18-26
Specific Standards	
Cash	Paragraphs 27-30
Fund Balance with Treasury	Paragraphs 31-39
Accounts Receivable	Paragraphs40-52
Interest Receivable	Paragraphs 53-56
Advances and Prepayments	Paragraphs 57-61
Investments in Treasury Securities	Paragraphs 62-73
Accounts Payable	Paragraphs 74-80
Interest Payable	Paragraphs 81-82
Other Current Liabilities	Paragraphs 83-86
APPENDICES	
Appendix A: Basis of the Board's Conclusions	Paragraphs 87-161
Appendix B: Illustration of the Interest Method for Amortization	
Appendix C: Glossary	

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PREFACE

a In this Statement, the Board recommends accounting standards for selected assets and liabilities. The assets are cash, fund balance with Treasury, accounts receivable, interest receivable, advances and prepayments, and investments in Treasury securities. The liabilities are accounts payable, interest payable, and other current liabilities.

b The Board's focus in this Statement is on setting accounting standards for the individual federal entity, the level at which financial statements are often prepared. A federal entity, as the term is used in this document, is a unit within the federal government, such as a department, agency, bureau, or program. An entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts. The standards proposed in this Statement are applicable to federal entities performing either governmental or commercial-type functions and to the federal government as a whole, unless otherwise noted.

c The recommended standards distinguish between intragovernmental and governmental assets and liabilities. An entity may have intragovernmental assets and liabilities that arise from transactions among entities within the federal government. Intragovernmental assets represent claims of an entity of the federal government against other federal entities. Intragovernmental liabilities are amounts that a federal entity owes to other federal entities. An entity may also have governmental assets and liabilities that arise from transactions with entities outside the federal government. Governmental assets are claims of the federal government or an entity within the federal government against nonfederal entities. Governmental liabilities are amounts that the federal government or an entity within the federal government owes to nonfederal entities.

d The standards recommended in this Statement were previously proposed in the Exposure Draft, Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities, November 18, 1991. Comments were

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received from sixty-nine organizations and individuals. Comments also were presented to the Board at a public hearing on February 28, 1992. The Board considered the comments and incorporated changes, as appropriate. Substantive comments and changes adopted are discussed in Appendix A, Basis of the Board's Conclusions.

e The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

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INTRODUCTION

OBJECTIVE

1 In this Statement, the Board recommends accounting standards for selected assets and liabilities of the federal government and its entities. The standards apply to both governmental and commercial-type functions of the federal government.

2 The selected assets and liabilities are among the fundamental elements of federal accounting and financial reporting. By recommending these standards in the Board's first Statement, the Board's objective is to provide definitive accounting and reporting guidance to federal agencies in these fundamental areas at the earliest stage of the Board's consideration and development of federal accounting standards.

3 In a separate project, the Board is identifying users' needs and federal accounting and reporting objectives. Although the Board's deliberation on objectives has not been finalized, there is a general consensus that one overall objective for accounting and financial reporting is to assure accountability of federal government entities. The Board believes that issuing these selected standards will help in fostering that overall objective.

4 Specifically, the recommended standards would assist users of financial statements in:

-- assessing the efficiency and effectiveness of the government's management of its assets and

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liabilities, and

-- determining whether the government's financial position improved or deteriorated over the reporting period.

APPROACH

5 The Board's initial approach to developing accounting standards was to review the existing accounting standards prescribed by the General Accounting Office (GAO) in its "Policy and Procedures Manual for the Guidance of Federal Agencies," Title 2 Accounting, (Title 2). The purpose of the review was to determine whether some of the <MI>Title 2<M> standards, with any necessary modifications, could be recommended by the Board to the principals of the Joint Financial Management Improvement Program (JFMIP).

6 Although the Title 2 standards had not been fully implemented by federal agencies, they represented a starting point for further analysis. The Title 2 standards were reviewed in light of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the same time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and objectives of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

7 These selected assets and liabilities involve less complex issues than other assets and liabilities to be considered by the Board in the future. The Board also believes that the selected assets and liabilities are so basic to financial reporting that they will not conflict with any conceptual framework that the Board may develop.[Footnote 1.]

[Footnote 1: The Board is also addressing other assets and liabilities. It has issued a proposed standard for direct loans and loan guarantees (see Exposure Drafts entitled Accounting for Direct Loans and Loan Guarantees, September 15, 1992, and Accounting for Inventory and Related Property, December 1992).]

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8 The standards on the selected assets and liabilities were proposed in the Board's first Exposure Draft issued in September 1991, entitled Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities. A total of 69 respondents submitted their comments to the Board on the Exposure Draft. A public hearing on the Exposure Draft was held on February 28, 1992.

9 In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and objectives of federal financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, "Basis of the Board's Conclusions."

SCOPE

10 The selected assets addressed in this Statement are:

- Cash
- Fund Balance with Treasury
- Accounts Receivable
- Interest Receivable
- Advances and Prepayments
- Investments in Treasury Securities

11 The selected liabilities addressed in this Statement are:

- Accounts Payable
- Interest Payable
- Other Current Liabilities

MATERIALITY

12 Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

13 The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the

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judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

APPLICABILITY

14 The accounting standards recommended in this Statement are applicable to the federal government and its departments and agencies in the executive branch that fall within the definition of executive agency as defined in 31 U.S.C. 102 and 3501.

EFFECTIVE DATE

15 The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

EXPLANATION

16 The Board's focus in this Statement is on setting accounting standards for the individual federal entity level of reporting. In this Statement, the standards are also applicable to financial reporting by the U.S. government as a whole, except for those standards related to intragovernmental assets and liabilities, which are defined in the general standards and noted in specific standards.

17 The word entity refers to a unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements will be prepared. The word entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements are prepared in accordance with OMB guidance on the form and content of financial statements.

GENERAL STANDARDS

Intragovernmental vs. Governmental Assets and Liabilities

INTRAGOVERNMENTAL ASSETS AND LIABILITIES 18 arise from transactions among federal entities. Intragovernmental

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assets are claims of a federal entity against other federal entities. Intragovernmental liabilities are claims against the entity by other federal entities.

19 Among the assets covered by this Statement, intragovernmental assets include an entity's fund balance with Treasury, investments in Treasury securities, accounts and interest receivable from federal entities, and advances and prepayments to federal entities.

20 Intragovernmental liabilities include accounts and interest payable to federal entities and other current liabilities due to federal entities, such as receipt of federal advances and prepayments.

GOVERNMENTAL ASSETS AND LIABILITIES 21 arise from transactions of the federal government or an entity of the federal government with nonfederal entities. Governmental assets are claims of the federal government or an entity within the federal government against nonfederal entities. Governmental liabilities are amounts that the federal government or an entity within the federal government owes to nonfederal entities. The term nonfederal entities encompasses domestic and foreign persons and organizations outside the U.S. government. The term public is also used in this Statement to represent nonfederal entities.

22 Among the assets covered by this Statement, governmental assets that would be reported by a federal entity include cash, accounts and interest receivable from nonfederal entities, and advances and prepayments made to nonfederal entities.

23 Governmental liabilities include accounts and interest payable to nonfederal entities, other liabilities due to nonfederal entities, and advances and prepayments received from nonfederal entities.

24 Intragovernmental assets and liabilities should be reported separately from governmental assets and liabilities. This requirement applies to all of the selected assets and liabilities addressed in this document.

Entity Assets vs. <R>Non-entity Assets

ENTITY ASSETS 25 are those assets which the reporting

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entity has authority to use in its operations."Non-entity assets" are those assets that are held by an entity but are not available to the entity. An example of non-entity assets are customs duty receivables that the Customs Service collects for the U.S. government but has no authority to spend. A similar example is federal income tax receivable that the Internal Revenue Service collects for the U.S. government.

26 Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements. Non-entity assets reported in an entity's financial statements should be segregated from entity assets. An amount equal to non-entity assets should be recognized as a liability (due to Treasury or other entities) in the entity's financial statements.

SPECIFIC STANDARDS

Cash

27 Cash, including imprest funds, should be recognized as an asset. Cash consists of:

(a) coins, paper currency and readily negotiable instruments, such as money orders, checks, and bank drafts on hand or in transit for deposit;

(b) amounts on demand deposit with banks or other financial institutions; and

(c) foreign currencies, which, for accounting purposes, should be translated into U.S. dollars at the exchange rate on the financial statement date.

ENTITY CASH. 28 Entity cash is the amount of cash that the reporting entity holds and is authorized by law to spend.

NON-ENTITY CASH. 29 Non-entity cash is cash that a federal entity collects and holds on behalf of the U.S. government or other entities. In some circumstances, the entity deposits cash in its accounts in a fiduciary capacity for the U.S. Treasury or other entities. Non-entity cash should be reported separately from entity cash.

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Restricted cash. 30 Cash may be restricted. Restrictions are usually imposed on cash deposits by law, regulation, or agreement. Non-entity cash is always restricted cash. Entity cash may be restricted for specific purposes. Such cash may be in escrow or other special accounts. Financial reports should disclose the reasons and nature of restrictions.

Fund Balance with Treasury

31 A federal entity's fund balance with the Treasury is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund balance with Treasury is an intragovernmental item. From the reporting entity's perspective, a fund balance with Treasury is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability.

32 A federal entity's fund balance with Treasury includes clearing account balances and the dollar equivalent of foreign currency account balances. Foreign currency account balances should be translated into U.S. dollars at exchange rates determined by the Treasury and effective at the financial reporting date. A federal entity's fund balance with Treasury <R>also includes balances for direct loan and loan guarantee activities held in the credit reform program, financing, and liquidating accounts.

33 An entity's fund balance with Treasury is increased by (a) receiving appropriations, reappropriations, continuing resolutions, appropriation restorations, and allocations, and (b) receiving transfers and reimbursements from other agencies. An entity's fund balance with Treasury is also increased by amounts borrowed from Treasury, Federal Financing Bank, or other entities, and amounts collected and credited to appropriation or fund accounts that the entity is authorized to spend or use to offset its expenditures.

34 An entity's fund balance with Treasury does not include contract authority or unused authority to borrow. Contract authority is a statutory authority under which

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contracts or other obligations may be entered into prior to receiving an appropriation for the payment of obligations. The later enacted appropriation provides cash to liquidate obligations. [Footnote 2] Thus, contract authority merely permits a federal entity to incur certain obligations but does not, in itself, add funds to the agency's accounts with Treasury.
[Footnote 2: Source of definition: OMB Circular A-34.]

35 Authority to borrow is a statutory authority that permits a federal agency to incur obligations and make payments for specific purposes out of borrowed funds. Authority to borrow adds funds to an agency's accounts with Treasury only after the agency actually uses the authority to borrow a specific amount of funds. Thus, authority to borrow is included in an entity's <R>fund balance with Treasury only to the extent that funds are actually borrowed under the authority.

36 An entity's fund balance with Treasury is reduced by (a) disbursements made to pay liabilities or to purchase assets, goods, and services, (b) investments in U.S. securities (securities issued by Treasury or other federal government agencies), (c) cancellation of expired appropriations; (d) transfers and reimbursements to other entities or to the Treasury, and (e) sequestration or rescission of appropriations.

37 Disclosure should be made to distinguish two categories of funds within the entity's fund balance with Treasury: the obligated balance not yet disbursed and the unobligated balance. The obligated balance not yet disbursed is the amount of funds against which budgetary obligations have been incurred, but disbursements have not been made.

38 The unobligated balance is the amount of funds available to an entity against which no claims have been recorded. Unobligated balances are generally available to a federal entity for specific purposes stipulated by law. Unobligated balances may also include balances in expired/canceled accounts that are available only for approved adjustments to prior obligations. Certain unobligated balances may be restricted to future use and are not apportioned for current use. Disclosure should be provided on such restrictions.

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39 Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared.) Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year.

Accounts <R>Receivable

40 Accounts receivable arise from claims to cash or other assets. The accounting standard for accounts receivable is set forth below.

RECOGNITION OF RECEIVABLES. [Footnote 3] 41 A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due), or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made.

[Footnote 3: The word recognition used in this document bears the same meaning as used by the Financial Accounting Standards Board (FASB) in its conceptual statements. It means the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item. FASB Statement of Financial Accounting Concepts No. 5, par. 6.]

SEPARATE REPORTING. 42 Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities.

ENTITY VS. NON-ENTITY RECEIVABLES. 43 Receivables should be distinguished between entity receivables and non-entity receivables. "Entity receivables" are amounts

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that a federal entity claims for payment from other federal or nonfederal entities and that the federal entity is authorized by law to include in its obligational authority or to offset its expenditures and liabilities upon collection.[Footnote 4] Non-entity receivables are amounts that the entity collects on behalf of the U.S. government or other entities, and the entity is not authorized to spend. [Footnote 5] > Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity.
[Footnote 4: An entity may have receivables that, once collected, can be used as offsets to the entity's budget authority and outlays only when authorized by Congress. Before receiving the authorization, however, those receivables are non-entity receivables.]

[Footnote 5: Governmental receipts include collections arising from the sovereign and regulatory powers unique to the federal government, e.g., income tax receipts, customs duties, court fines, certain license fees, etc. A federal entity may be responsible for collecting these receipts on behalf of the U.S. government, but is not authorized to use the monies collected to offset its expenditures.]

RECOGNITION OF LOSSES DUE TO UNCOLLECTIBLE AMOUNTS. 44 Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase more likely than not means more than a 50 percent chance of loss occurrence.

45 An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value.[Footnote 6] The allowance for uncollectible amounts should be reestimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct.

[Footnote 6: In the Board's Exposure Draft, Accounting for Direct Loans And Loan Guarantees, September 15, 1992, receivables are accounted for on a net present value basis.]

Measurement of losses. 46 Losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of

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both individual accounts and a group of accounts as a whole.

Individual account analysis. 47 Accounts that represent significant amounts should be individually analyzed to determine the loss allowance. Loss estimation for individual accounts should be based on (a) the debtor's ability to pay, (b) the debtor's payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

48 The allowance for losses generally cannot be based solely on the results of individual account analysis. In many cases, information may not be available to make a reliable assessment of losses on an individual account basis or the nature of the receivables may not lend itself to individual account analysis. In these cases, potential losses should be assessed on a group basis.

Group analysis. 49 To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics.

50 The groups should reflect the operating environment. For example, accounts receivable can be grouped by: (a) debtor category (business firms, state and local governments, and individuals), (b) reasons that gave rise to the receivables (tax delinquencies, erroneous benefit payments, trade accounts based on goods and services sold, and transfers of defaulted loans to accounts receivable), or (c) geographic regions (foreign countries, and domestic regions). Within a group, receivables are further stratified by risk characteristics. Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables.

51 Statistical estimation by modeling or sampling is one appropriate method for estimating losses on groups of receivables. Statistical estimation should take into consideration factors that are essential for estimating the level of losses, including historical loss experience, recent economic events, current and forecast economic conditions, and inherent risks.

Disclosure. 52 Agencies should disclose the major categories of receivables by amount and type, the

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methodology used to estimate the allowance for uncollectible amounts, and the total allowance.

Interest <R>Receivable

53 Interest receivable should be recognized for the amount of interest income earned but not received for an accounting period. Interest receivable should be recognized as it is earned on investments in interest-bearing securities. Interest also should be recognized on outstanding accounts receivable and other U.S. government claims against persons and entities in accordance with provisions in 31 U.S.C. 3717, Interest and Penalty Claims. (See also Federal Claims Collection Standards, 4 CFR Part 103, paragraph 102.13.)[Footnote 7]

[Footnote 7: Accounting for imputed interest, interest on long-term leases, interest on loans, and interest on amounts deposited in credit reform accounts will be addressed when the Board considers accounting standards in these areas.]

54 No interest should be recognized on accounts receivable or investments that are determined to be uncollectible unless the interest is actually collected. Payments received from the debtor are required to be applied first to penalty and administrative cost charged, second to interest receivable, and third to outstanding debt principal, per Federal Claims Collection Standards, 4 C.F.R. 102.13(f).

55 However, until the interest payment requirement is officially waived by the government entity or the related debt is written off, interest accrued on uncollectible accounts receivable should be disclosed.

56 Interest receivable from federal entities should be accounted for and reported separately from interest receivable from the public.

Advances and Prepayments

57 Advances are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed

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to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee.

58 Prepayments are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred. Typical prepaid expenses are rents paid to a lessor at the beginning of a rental period. Progress payments made to a contractor based on a percentage of completion of the contract are not advances or prepayments.

59 Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire. A travel advance, for example, should be initially recorded as an asset and should be subsequently reduced when travel expenses are actually incurred. Amounts of advances and prepayments that are subject to refund (for example, a settled travel claim indicating the traveler owes part of the advance to the government) should be transferred to accounts receivable.

60 Advances and prepayments paid out by an entity are assets of the entity. On the other hand, advances and prepayments received by an entity are liabilities of the entity (see the recommended standard for other current liabilities). In financial reports of an entity, advances and prepayments the entity paid out (assets) should not be netted against advances and prepayments that the entity received (liabilities).

61 Advances and prepayments made to federal entities are intragovernmental items and should be accounted for and reported separately from those made to nonfederal entities.

Investments in Treasury Securities

Scope. 62 This standard applies to investment by federal entities in Treasury securities, including (a) nonmarketable par value Treasury securities, (b) market-based Treasury securities expected to be held to maturity, and (c) marketable Treasury securities expected to be held to maturity. This standard does not apply to investments by federal entities in securities (debt and

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equity) and other financial instruments issued by other than the U.S. Treasury.

63 Nonmarketable par value Treasury securities are special series debt securities that the U.S. Treasury issues to federal entities at face value (par value). The securities are redeemed at face value on demand; thus investing entities recover the full amounts invested.

64 Market-based Treasury securities are debt securities that the U.S. Treasury issues to federal entities without statutorily determined interest rates. Although the securities are not marketable, their terms (prices and interest rates) mirror the terms of marketable Treasury securities.

65 Marketable Treasury securities, including Treasury bills, notes, and bonds, are initially offered by Treasury to the marketplace and can then be bought and sold on securities exchange markets. Their bid and ask prices are publicly quoted by the marketplace.

Treasury securities expected to be held to maturity. 66 Aside from nonmarketable par value Treasury securities, this standard applies to market-based and marketable Treasury securities that are expected to be held to maturity. An investment in securities is expected to be held to maturity only if the investing entity has the intent and ability to hold those securities to maturity. An investment in Treasury securities should not be considered as expected to be held to maturity if the investing entity is likely to sell the securities in response to short-term cash needs, changes in market interest rates, or for other reasons.

Separate accounting and reporting for federal and

nonfederal securities. 67 Investments of a federal entity in U.S. securities (securities issued by Treasury and federal agencies) are intragovernmental investments. These U.S. securities also represent intragovernmental liabilities of the Treasury Department or other federal entities that issue the securities. Investments in securities issued by the U.S. Treasury or other federal entities should be accounted for and reported separately from investments in securities issued by nonfederal entities.

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Initial recording. 68 The three types of Treasury securities covered by this standard (nonmarketable par value Treasury securities, market-based Treasury securities expected to be held to maturity, and marketable Treasury securities expected to be held to maturity) should be recognized at their acquisition cost. If the acquisition is made in exchange for nonmonetary assets, the acquired securities should be recognized at the fair market value of either the securities acquired or the assets given up, whichever is more definitively determinable.

69 If the acquisition cost differs from the face (par) value, the security should be recorded at the acquisition cost, which equals the security's face value plus or minus the premium or discount on the investment. A discount is the excess of the security's face amount over its purchase price. A premium is the excess of the purchase price over the security's face value. The balance in the valuation account is treated as a contra account to the debt security.

Valuation subsequent to acquisition. 70 Subsequent to their acquisition, investments in Treasury securities should be carried at their acquisition cost, adjusted for amortization, if appropriate, as explained below.

71 If an amount of premium or discount exists, the carrying amount of the investments should be adjusted in each reporting period to reflect the amortization of the premium or the discount. Premiums and discounts should be amortized over the life of the Treasury security using the interest method. Under the interest method, the effective interest rate (the actual interest yield on amounts invested) multiplied by the carrying amount of the Treasury security at the start of the accounting period equals the interest income recognized during the period (the carrying amount changes each period by the amount of the amortized discount or premium). The amount of amortization of discount or premium is the difference between the effective interest recognized for the period and the nominal interest for the period as stipulated in the Treasury security. (See Appendix B for an illustration of the interest method of amortization.)

Disclosure of market value. 72 For investments in market-based and marketable Treasury securities, the market

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value of the investments should be disclosed. For purposes of determining a market value, investments should be grouped by type of security, such as marketable or market-based Treasury securities. The market value of investments in a group is calculated by the market price of securities of that group at the financial reporting date multiplied by the number of notes or bonds held at the financial reporting date.

Investment reclassification. 73 In rare instances, significant unforeseeable circumstances may cause a change in an entity's intent or ability to hold to maturity certain securities that are initially classified as expected to be held to maturity. In these circumstances, the affected securities should be reclassified as securities available for sale or early redemption (redemption before the security's maturity). Once a security is reclassified it is no longer subject to this standard.

Accounts Payable

74 Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities.

75 Accounts payable are not intended to include liabilities related to on-going continuous expenses such as employees' salary and benefits, which are covered by other current liabilities. (See recommended standard for Other Current Liabilities.)

76 Amounts owed for goods or services received from federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public.

77 When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.

78 When a contractor provides the government with goods that are also suitable for sale to others, the

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liability usually arises when the contractor physically delivers the goods and the government receives them and takes formal title. However, when a contractor builds or manufactures facilities or equipment to the government's specifications, formal acceptance of the products by the government is not the determining factor for accounting recognition. Constructive or de facto receipt occurs in each accounting period, in accordance with the following paragraph.

79 For facilities or equipment constructed or manufactured by contractors or grantees according to agreements or contract specifications, amounts recorded as payable should be based on an estimate of work completed under the contract or the agreement. The estimate of such amounts should be based primarily on the federal entity's engineering and management evaluation of actual performance progress and incurred costs.

80 The reporting entity should disclose accounts payable not covered by budgetary resources.

Interest Payable

81 Interest payable should be recorded for the amount of interest expense incurred and unpaid. Interest incurred results from borrowing funds from Treasury, Federal Financing Bank, other federal entities, or the public. Interest also should be recorded on late payment of bills by the federal entity (see provisions in 31 U.S.C. 3901 through 3907, Prompt Payment) and on refunds <R>(see provisions in 26 U.S.C. 6611). Interest payable of an entity on borrowed funds and unpaid bills should be recognized at the end of each period.

82 Interest payable to federal entities is an intragovernmental liability and should be accounted for separately from interest payable to the public.

Other Current<R> Liabilities

83 The term other current liabilities is used to report current liabilities that are not recognized in specific categories such as accounts payable; interest payable; debt owed to the public, Treasury, or other entities; and liabilities for loan guarantee losses. Other

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current liabilities may include unpaid expenses that are accrued for the fiscal year for which the financial statements are prepared and are expected to be paid within the fiscal year following the reporting date.

84 Typical examples of other current liabilities to be recognized are: (a) accrued employees' wages, bonuses, and salaries for services rendered in the current fiscal year for which paychecks will be issued in the following year; (b) accrued entitlement benefits payable, such as Old Age Survivors Insurance (OASI) and Veterans Compensation and Pension benefits applicable to the current period but not yet paid, and (c) annuities for the current fiscal year administered by trust, pension, or insurance programs for which payment would be made in the following fiscal year. Such liabilities may be presented on the face of the financial reports as Other Current Liabilities or as one or more separate categories depending on the materiality of the amounts.

85 Federal entities may receive advances and prepayments from other entities for goods to be delivered or services to be performed. Before revenues are earned, the current portion of the advances and prepayments should be recorded as other current liabilities. After the revenue is earned (goods or services are delivered, or performance progress is made according to engineering evaluations), the entity should record the <R>appropriate amount as a revenue or financing source and should reduce the liability accordingly. Other current liabilities due to federal entities are intragovernmental liabilities that should be reported separately from those due to employees and the public.

86 The reporting entity should disclose the amount of current liabilities not covered by budgetary resources.

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RECOMMENDED STANDARDS FOR
FINANCIAL ACCOUNTING AND REPORTING

OBJECTIVE

In this Statement, the Board recommends accounting standards for selected assets and liabilities of the federal government and its entities. The standards apply to both

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governmental and commercial-type functions of the federal government.

The selected assets and liabilities are among the fundamental elements of federal accounting and financial reporting. By recommending these standards in the Board's first Statement, the Board's objective is to provide definitive accounting and reporting guidance to federal agencies in these fundamental areas at the earliest stage of the Board's consideration and development of federal accounting standards.

In a separate project, the Board is identifying users' needs and federal accounting and reporting objectives. Although the Board's deliberation on objectives has not been finalized, there is a general consensus that one overall objective for accounting and financial reporting is to assure accountability of federal government entities. The Board believes that issuing these selected standards will help in fostering that overall objective.

Specifically, the recommended standards would assist users of financial statements in:

-- assessing the efficiency and effectiveness of the government's management of its assets and liabilities, and

-- determining whether the government's financial position improved or deteriorated over the reporting period.

APPROACH

The Board's initial approach to developing accounting standards was to review the existing accounting standards prescribed by the General Accounting Office (GAO) in its Policy and Procedures Manual for the Guidance of Federal Agencies, Title 2 Accounting, (Title 2). The purpose of the review was to determine whether some of the <MI>Title 2<M> standards, with any necessary modifications, could be recommended by the Board to the principals of the Joint Financial Management Improvement Program (JFMIP).

Although the Title 2 standards had not been fully implemented by federal agencies, they represented a starting

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point for further analysis. The Title 2 standards were reviewed in light of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the same time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and objectives of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

These selected assets and liabilities involve less complex issues than other assets and liabilities to be considered by the Board in the future. The Board also believes that the selected assets and liabilities are so basic to financial reporting that they will not conflict with any conceptual framework that the Board may develop.<$FThe Board is also addressing other assets and liabilities. It has issued a proposed standard for direct loans and loan guarantees (see Exposure Drafts entitled Accounting for Direct Loans and Loan Guarantees, September 15, 1992, and Accounting for Inventory and Related Property, December 1992).>

The standards on the selected assets and liabilities were proposed in the Board's first Exposure Draft issued in September 1991, entitled Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities. <R>A total of 69 respondents submitted their comments to the Board on the Exposure Draft. A public hearing on the Exposure Draft was held on February 28, 1992.

In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and objectives of federal financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, Basis of the Board's Conclusions.

SCOPE

The selected assets addressed in this Statement are:

Cash

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Fund Balance with Treasury
Accounts Receivable
Interest Receivable
Advances and Prepayments
Investments in Treasury Securities

The selected liabilities addressed in this Statement are:

Accounts Payable
Interest Payable
Other Current Liabilities

MATERIALITY

Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

APPLICABILITY

The accounting standards recommended in this Statement are applicable to the federal government and its departments and agencies in the executive branch that fall within the definition of executive agency as defined in 31 U.S.C. 102 and 3501.

EFFECTIVE DATE

The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

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APPENDIX A: BASIS OF THE BOARD'S CONCLUSIONS

87 This Appendix provides a discussion on the substantive comments that the Board received from

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respondents to Exposure Draft No. 1, "Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities" (November 18, 1991) and from testimony at a public hearing on the Exposure Draft held February 28, 1992. The Appendix explains the basis of the Board's conclusions on issues raised by the respondents.

BASIC CONCEPTS

Net financial resources. 88 In the Exposure Draft, the Board proposed the concept of net financial resources . The term net financial resources was referred to as an entity's total financial resources less its total funded liabilities (Exposure Draft, page 11). The Exposure Draft stated that the amount of net financial resources provides a general measure of an entity's financial sufficiency before new appropriations are provided. The Exposure Draft further stated that information on the components of an entity's net financial resources (obligated and unobligated balances of budget authority and other items) can provide additional insight into an entity's financial situation.

89 Many respondents do not see convincing evidence that the concept of net financial resources is useful. They point out that there are no concrete examples to illustrate how the information can be used. Some respondents also do not believe that the measure of net financial resources is well defined. They point out that one of the elements missing from the concept is the amount of unfunded liabilities. They state that without measuring unfunded liabilities, the measure of net financial resources is incomplete and can be misleading.

90 The Board has decided to postpone consideration of the net financial resources concept. The Board believes that the usefulness of the concept can be further explored after it completes its project on users' needs and objectives for financial accounting and reporting.

ENTITY FINANCIAL RESOURCES. 91 In the Exposure Draft, the Board discussed the concept of entity financial resources. The concept was defined as assets of a federal entity that consist of (a) the entity's cash and funds authorized and available for disbursement (excluding contract authority and unused authority to borrow), (b) resources of the entity that are expected to be converted

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into cash to satisfy liabilities, and (c) conversion of cash into another form (for example prepayments) that would be consumed. Under this definition, the Exposure Draft identified as financial resources: cash, funds with Treasury, claims to cash (for example accounts receivable and loans receivable), claims to goods and services (for example advances and prepayments), inventories held for sale, and investments.

92 As indicated in the Exposure Draft, financial resources are a subset of assets that provide liquidity (cash and assets that can be converted to cash) to meet a federal entity's operational needs. The concept was considered useful because federal entities obtain resources from the budget to finance their operations and are held accountable for the use of the financial resources.

93 The Board has decided not to use the term financial resources in this document. However, a definition of the term financial resources and its usefulness will be further considered by the Board in its conceptual framework project. In the absence of the term, the items that would provide future economic benefits to the government and its entities are referred to as assets. The term asset as used in this document means an item that embodies a probable future economic benefit that can be obtained or controlled by the federal government or a reporting entity as a result of past transactions or events. (The definition of assets will be considered by the Board in the future.)

FUNDED LIABILITIES. 94 The Exposure Draft proposed the definition of funded liabilities as liabilities for which the federal entity has received budget authority to cover the related expenditure or expense.

95 The term funded liabilities would limit the recognition of liabilities to the extent that they are funded. The Board believes that the liabilities addressed in this document should be recognized when they are incurred, regardless of whether they are funded. The Board therefore decided not to use the term funded liabilities in this document. However, the Board recommends that disclosure be made for liabilities that are not covered by budgetary resources.

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96 The word liability used in this document means a probable and measurable future outflow of resources arising from past transactions or events.<$FA comprehensive definition of liabilities is being considered by the Board in its project concerning liabilities in general.> However, this document addresses only those selected liabilities that routinely recur in normal operations and that are due within a fiscal year. These liabilities are accounts payable, interest payable, and other current liabilities. The category of other current liabilities includes salary and entitlement benefit expenses that are accrued and would be paid within a fiscal year.

GENERAL STANDARDS

97 The recommended standards apply to reporting by the federal government and its entities for both governmental assets and liabilities and intragovernmental assets and liabilities reported at the entity level.

98 An entity may have two categories of assets and liabilities intragovernmental and governmental assets and liabilities. The difference between intragovernmental and governmental assets and liabilities is explained below:

(1) Intragovernmental assets and liabilities. These assets and liabilities arise from intragovernmental transactions. For example, investments held by a federal entity in Treasury securities are reported by the entity as an asset. However, the Treasury securities also are liabilities of the Department of the Treasury. Thus, the securities represent intragovernmental assets and liabilities. Another example is fund balance with Treasury. An entity's fund balance with Treasury of an entity will be reported as an asset by the entity. However, it is not an asset of the federal government; rather, it is a commitment of the U.S. government to provide funds to a federal entity. (See discussion, which follows, on Fund balance with Treasury .)

(2) Governmental assets and liabilities. These are assets and liabilities that arise from transactions of the federal government with nonfederal entities (persons and organizations outside the U.S. government, either foreign or domestic). For example, income taxes to be

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collected from the public are reported on IRS financial statements as receivables. These receivables are assets of the federal government.

99 The recommended standards require that intragovernmental assets and liabilities be reported separately from governmental assets and liabilities.

100 Assets reported by an entity also are distinguished between entity and non-entity assets.

(1) Entity assets. Entity assets are assets that are available to an entity for its use. Entity assets include both intragovernmental and governmental assets. Supplies inventory held by an entity for consumption in its operations is an entity asset as well as a governmental asset. A receivable of a federal entity from another federal entity is an entity asset if the receiving entity has authority to use the amount collected.

(2) Non-entity assets. An entity may have assets under its custody and management that the entity is not authorized to use. In this Statement, these assets are called non-entity assets, as distinguished from entity assets that the entity is authorized to use in its operations. For example, customs duty receivables to be collected by the Customs Service is a non-entity asset that would be reported by the Customs Service.

101 The Board recommends that both entity assets and non-entity assets under an entity's custody or management be recognized in the entity's financial statements. Non-entity assets should be separately reported in an entity's financial statements.

102 The following exhibit, using receivables as an example, illustrates the relationship between entity and non-entity assets on one hand and intragovernmental and governmental assets on the other hand.

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ACCOUNTS RECEIVABLE

	Entity Assets	Non-entity assets
Intra-governmental Assets	Amounts receivable from a federal entity for goods or services delivered that will be available to the receiving entity to spend.	Amounts to be collected from a federal entity that will not be available to the receiving entity to spend.
Governmental Assets	Amounts receivable from a nonfederal entity for goods or services delivered that will be available to the receiving entity to spend.	Amounts (such as taxes) to be collected from a nonfederal entity that will not be available to the receiving entity to spend.

SPECIFIC STANDARDS

Cash

103 The Board has retained from the Exposure Draft the requirement for separate reporting of restricted and unrestricted cash. However, after considering comments on the Exposure Draft, the Board has modified the definition of restricted cash.

104 The Exposure Draft proposed that unrestricted cash include amounts in demand deposits. However, whether an amount of cash is restricted does not depend on where the cash is kept. For example, federal entities may hold cash in demand deposit accounts on behalf of Treasury. Since the entities have no authority to spend the cash, from the entities' perspective, these amounts of cash are restricted.

105 The recommended standard in this document redefines restricted cash as (1) amounts of cash that an entity holds on behalf of Treasury or other entities and does not have authority to spend, and (2) amounts of cash that are legally restricted to specific purposes.

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Fund Balance with Treasury

106 The recommended standard provides guidance on the composition of fund balance with Treasury. Events that cause an entity's fund balance to increase include receiving appropriations, allocations, transfers, receipts that the entity is authorized to spend (or to use to offset its expenditures) and borrowing from Treasury. An entity's fund balance is reduced by amounts disbursed to pay liabilities and expenditures, amounts invested in securities, amounts of appropriations canceled or rescinded, and amounts transferred to other agencies or to the Treasury.

107 With respect to fund balance with Treasury, the Board has considered the following issues:

(1) IS FUND BALANCE WITH TREASURY AN ASSET?

108 The Board believes that from the perspective of a federal entity (such as a bureau, a program, or a fund), fund balance with Treasury is an asset. In fact, it is the most important source against which an entity can make expenditures and incur liabilities.

109 However, the Board recognizes that a fund balance with Treasury is an intragovernmental item. It represents a entity's authorized claim to the federal government's resources on one hand, and the government's commitment to supply resources to the entity on the other hand. The claims and commitments would not be reported when financial reports of individual entities are consolidated on a government-wide level. Thus, from the perspective of the federal government as a whole, fund balances with Treasury are not assets of the federal government.

(2) HOW DOES FUND BALANCE WITH TREASURY RELATE TO BUDGETARY RESOURCES?

110 A fund balance is created by budget authority. An appropriation is the major form of budget authority that creates a fund balance with Treasury for an entity. Thus, the relationship between fund balance with Treasury and budget authority cannot be ignored.

111 However, an entity's fund balance with Treasury

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does not necessarily equal its budgetary resources. The difference between these two concepts may be clarified by examining their definitions. A fund balance represents the sum of amounts that is actually available in an entity's accounts with Treasury. Budgetary resources on the other hand encompass all authorities for an entity to incur obligations. Some of the authorities do not in themselves provide funds to the entity. Contract authority, for example, allows an entity to incur obligations under a contract. However, it does not, in itself, provide funds to the entity's accounts with Treasury. An appropriation is necessary for the entity to have funds to liquidate obligations incurred under contract authority.

112 Authority to borrow does not in itself place funds into an entity's accounts with Treasury. In order to increase its fund balance with Treasury, an entity must actually borrow under its borrowing authority.

113 For these reasons, the recommended standard states that fund balance with Treasury does not include contract authority and unused authority to borrow.

(3) SHOULD THE FUND BALANCE EXCLUDE FUNDS DESIGNATED FOR SPECIAL PURPOSES?

114 Some respondents to the Exposure Draft believe that the standard should identify funds held with Treasury that are not available to the entity's operations. For example, the Department of Energy collects fines levied under the Emergency Petroleum Allocation Act of 1973, deposits those funds in an escrow account with Treasury, and ultimately disburses those funds to injured parties or for other uses as directed by court decisions.

115 It is not unusual that funds in certain accounts are held and restricted to specific purposes. Amounts of trust funds, for example, are held for the specific purpose of making benefit payments to eligible recipients. The restriction on funds held for the Department of Energy to pay persons injured by oil pricing and allocation violations is another example. The Board believes that the fund balance of a reporting entity should include funds held in all accounts of the entity regardless of whether they are designated for specific purposes.

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Accounts Receivable

116 Respondents raised issues related to the recognition and measurement of losses due to uncollectible amounts. Before addressing the Board's actions in relation to respondents' comments, however, the terms recognition and measurement as used in this Statement are explained below:

117 Recognition means formally recording or incorporating an item into the records and financial statements as an asset, liability, expense, revenue, or similar element. For assets or liabilities, recognition encompasses subsequent changes to the amounts of assets and liabilities.

118 Measurement is the process of expressing an asset or liability in monetary units. Measuring an item requires selecting an appropriate measurement attribute such as historical cost, current market value, net realizable value, or present value of future cash flows.

119 In the proposed standard and the discussion of accounts receivable, the term recognition concerns the timing of recording an asset or the impairment of an asset in the financial records. The term measurement concerns the valuation basis and the dollar amount of the asset that should be reported.

120 Detailed discussions of respondents' comments and the Board's actions are provided in the following paragraphs.

121 Timing of receivable recognition. The Exposure Draft states that a receivable should be recorded when events (e.g., payment due dates) or transactions occur that entitle an entity to accrue revenue or receive a reimbursement or fund transfer. Some respondents questioned the use of payment due dates as a criterion for recognizing receivables. These respondents stated a receivable should be recognized when an entity is owed an amount or earns a revenue, and that due dates are irrelevant.

122 Some receivables result from exchange transactions. For example, receivables may result from goods

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and services provided to other entities. However, claims to cash or other assets also result from the federal government's legal authority to levy taxes and impose duties, fees and fines. These receivables are not related to revenue-earning functions or exchange transactions, but are based on the federal government's authority to collect the payments and a party's liability to pay cash or provide other assets to cover the claims. For the accrual of taxes, the tax due date represents the date that the government demands payment. The payment due date is a definitive criterion for accruing taxes.

123 The Board, therefore, recommends that a receivable be recognized when a claim to cash or other assets is established based either on goods or services provided or the government's legal authority to levy and collect. The Board is not recommending a revenue recognition standard at this time.

124 Loss recognition. In the Exposure Draft, it was proposed that a loss be recognized when it is more likely than not that a receivable has been impaired. The phrase more likely than not means a greater than 50 percent probability of occurrence.

125 Several respondents questioned why the Board used the more likely than not criterion for loss recognition instead of the probable criterion used in the private sector under generally accepted accounting principles (GAAP).[Footnote]

[Footnote: FASB Statement of Standards No.5, Accounting for Contingencies.]

126 The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However, the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors are not relevant to the federal government.

127 In the case of loss recognition on receivables, the Board believes that there should be a definitive guideline for recognizing government credit losses. The word probable is subject to broad interpretation (often being

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interpreted as meaning a virtual certainty of occurrence) and could allow for belated recognition of losses.

128 The Board proposed the more stringent criterion of more likely than not, which requires the recognition of losses when there is more than a 50 percent chance that some receivables will not be collected. In recommending the more likely than not criterion, the Board's intent is to achieve unbiased, consistent, and reliable loss recognition in federal government accounting.

129 The more likely than not criterion can be applied to both individual accounts and groups of accounts. Both significant individual accounts receivable (e.g., unusually large refunds due from contractors, medicaid reimbursements from third parties, substantial tax delinquencies, or other large claims) and groups of small accounts should be analyzed and losses recognized if it is more likely than not that some or all of the amounts owed will not be collected.

130 When applying the loss recognition criterion, the Board believes it is appropriate to recognize the nature of federal receivables. Many of the federal government's receivables, unlike trade accounts of private firms or loans made by banks, are not created through credit screening procedures. These receivables arise because of activities such as fines from regulatory violations, refunds from erroneous benefit payments, reimbursements, and overdue taxes and duties. In these circumstances, historical experience and economic factors indicate that the receivables frequently are not fully collectible. These receivables meet the loss recognition test because of their inherent risk. Therefore, an appropriate amount of allowance for losses should be recognized at their inception.

131 Loss measurement. Because of the large volume of federal transactions, accounts receivable generally exist in large groups. Some groups may consist of several hundred thousand accounts. In such cases, losses on uncollectible amounts should be assessed on a group basis using statistical sampling techniques. Statistical sampling should be supplemented by historical trend experience, adjusted for current conditions.

132 On the other hand, some government receivables

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arise from transactions of significant amounts. These receivables should be individually analyzed to assess losses due to risks specifically attributable to the individual accounts. The assessment of impairment of individual accounts may not always provide a valid basis to estimate the impairment of the entire group. Often, losses may exist for the group that are not currently identifiable on an individual basis. The Board believes that the federal government's receivables are generally subject to losses due to inherent risks. Therefore, allowances for receivables should be viewed in the context of the overall risk of the receivables being assessed.

133 Based on the above considerations, the recommended standard provides that, for reporting purposes, losses on accounts receivable should be determined by evaluating accounts on both a group and an individual basis.

Interest Receivable

134 In the Exposure Draft, the proposed standard requires that interest be recognized on a receivable until the receivable is repaid or written off. At the same time, the proposed standard requires that an allowance for uncollectible interest be provided. The intent of the proposed standard is to establish the debtor's liability for the accrued interest.

135 Some respondents expressed concern that there is usually a lengthy period from the time a receivable is determined to be uncollectible until it is written off. It would be burdensome to recognize interest on the uncollectible receivable and, at the same time, offset the amount of interest recognized by an allowance for uncollectible interest.

136 The initial intent of this procedure was to maintain a correct amount of the debtor's liability. This purpose can be achieved by record-keeping procedures rather than financial reporting. Therefore, for financial reporting, the Board has concurred that (a) interest receivable should be recognized only on collectible accounts, and (b) interest receivable on uncollectible accounts should be recognized only when it is actually received.

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Advances and Prepayments

137 There were no comments on the substance of the recommended accounting standard for advances and prepayments since the standard does not contain significant changes from the current accounting practice within federal government agencies. Some respondents requested that the Board clarify that prepayments do not include progress payments made on long-term contracts. Since progress payments are made based upon percentage of completion of a contract, the Board concluded that progress payments are not advances or prepayments.

138 Comments were also received questioning whether advances and prepayments should be included within the definition of financial resources (as proposed in the Exposure Draft) since advances and prepayments are not usually converted to cash or budget authority available for use by the entity.

139 The Board recognizes that, as in the case of inventories held for consumption, advances and prepayments convert into goods and services, but do not convert into cash. However, since the term financial resources is not used in this Statement, the issue is now moot. Advances and prepayments normally benefit current operations and, therefore, are normally considered current assets.

Investments in Treasury Securities

140 The recommended standard applies to investments in Treasury securities, including (1) nonmarketable par value Treasury securities, (2) market-based Treasury securities held to maturity, and (3) marketable Treasury securities held to maturity.

141 In the future, the Board will address investments that are not covered by this standard. In the interim, federal entities should continue their current accounting practices for those investments not covered by this standard.

142 Federal entities, particularly the Social Security and the retirement trust funds, invest available funds in excess of their current needs in special Treasury securities issued in the government account series. The terms of the

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Treasury securities are usually designed to meet the cash needs of government accounts. The vast majority of the investments are in nonmarketable Treasury securities issued exclusively to federal agencies. Most of them are par value securities, and some are market-based securities whose prices and interest rates reflect market terms. Thus, although the scope of the recommended standard is limited, it covers more than 90 percent of federal entities' investments.

143 A few federal entities are permitted to buy and sell marketable Treasury securities on the open market. Some federal entities which conduct business with the public or provide insurance to the private sector may acquire marketable Treasury securities as a part of a rescue and takeover transaction. This standard applies to marketable Treasury securities only to the extent that they are expected to be held to maturity.

144 In the Exposure Draft, the Board proposed that investments in par value nonmarketable Treasury securities be reported at cost. The Board also proposed that marketable securities and market-based Treasury securities be reported at market value as of the reporting date.

145 A number of respondents, however, expressed concern with the recognition of increases and decreases in assets based on market value, and the recognition of associated gains or losses. These respondents believe these are unrealized gains and losses which do not represent actual increases or decreases in assets. Some respondents also indicated that market value fluctuations generally do not affect an entity's investments in securities intended to be held to their maturity.

146 In this Statement, the Board continues to use the cost based valuation for nonmarketable par value Treasury securities. The cost basis is appropriate for this type of security because the invested amounts will be fully recovered at redemption.

147 The Board also recommends the cost or amortized cost basis for the valuation of market-based Treasury securities and marketable Treasury securities that are to be held to maturity. The Board believes that the cost basis is appropriate because the invested amounts can be fully

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recovered when the Treasury securities mature. During the time periods when the securities are outstanding, the market prices of the securities may fluctuate due to interest rate changes or other temporary causes. However, so long as the securities are not to be sold to the market, the investing entity would not be affected by such market price fluctuations. For this reason, the Board decided to recommend the cost based approach rather than market value approach for marketable Treasury securities expected to be held to maturity.

148 The Board considered the valuation issues related to securities not covered by this standard. The Board has concluded that the use of a fair value approach pertains to a broad conceptual issue that needs to be addressed in its conceptual framework. Until the Board reaches decisions on the conceptual framework, it is premature to recommend a valuation basis for securities beyond those covered by this standard.

149 The Board believes that the criteria for classifying an investment as expected to be held to maturity should be based on the intent and ability of the investing entity to hold the security to its maturity. Intent and ability differ from a mere absence of an intent to sell the security. An evaluation of whether an entity has the intent and ability to hold its investments should be based on the entity's current and projected financial condition and its recent pattern in buying, selling, and managing Treasury securities. A security should not be classified as expected to be held to maturity if for cash needs or other investment management reasons the investing entity is not able to hold the security to its maturity.

150 At each financial reporting date, the appropriateness of this classification should be reassessed. In rare instances, an entity's originally stated intent or ability to hold a security to maturity may change due to significant unforeseen changes in the entity's cash needs or in other circumstances. When this occurs, securities initially classified as expected to be held to maturity should be reclassified to securities available for sale or early redemption.

Accounts Payable

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151 Accounts payable are set up to record an entity's liability for goods and services received or work progress made by a contractor for which payment has not been made.

152 Some respondents questioned the timing of recognizing a liability in accounts payable. A federal entity, under budgetary accounting, records an obligation when the entity places a purchase order or signs a contract.<$FThe term obligations incurred is defined as amounts of orders placed, contracts awarded, services received, and similar transactions that will require payment in the same or future periods. Such amounts include outlays for which obligations have not been previously recorded. Such amounts also include adjustments for (a) differences between amounts recorded as obligations and actual outlays to liquidate those obligations, (b) cancellations of obligations, and (c) refunds arising during the reporting period for recovery of erroneous payments or due to accounting adjustments. However, adjustments to obligations incurred in prior years are reported separately as recoveries of prior year obligations. (For legal basis of obligations incurred, see 31 U.S.C. 200 and OMB Circular A-34.) See also JFMIP Report, Project on Standardization of Basic Financial Information Requirements of Central Agencies, (October, 1991) p. 24.> An obligation, once incurred, reduces an entity's resources available for obligation. Budgetary accounting entries are required to record the amounts obligated and to reduce the available budget authority. For financial reporting purposes, liabilities are recognized when goods and services are received or are recognized based on an estimate of work completed under a contract or agreement.

153 Some federal entities believe it is appropriate to recognize a liability in accounts payable when a purchase order is placed. The theory of this practice is that the purchase order represents a use of the entity's budgetary resources and that recognizing the liability would correctly reduce the entity's available budgetary resources.

154 Proponents for this practice also argue that, in many cases, goods produced under government contracts bear unique specifications for government needs and, as a result, cannot be sold to other customers. Thus, they argue that it is virtually certain that the government has incurred a liability toward the contractor.

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155 The Board recognizes that there is a need to reconcile budget execution results and financial effects. In budgetary accounting, when a purchase order is placed, an obligation is recorded to ensure budgetary control. However, recognition of the claim from a financial accounting standpoint does not occur until goods are delivered, work progress is actually made by a contractor, or services are performed since these events generally trigger a cash outlay that liquidates the obligation. The Board does not believe that recognizing a liability prior to a actual receipt or constructive receipt of goods or services should be adopted as a financial accounting standard. It also does not believe that it is appropriate to erase the distinction between recording obligations for budget purposes and recognizing a liability for financial accounting purposes.

156 Some respondents question whether a liability should be recognized for multi-year contracts that are to be financed through appropriations over a number of years. As has been discussed earlier, when a contract is entered, an obligation is recognized in budgetary accounting. However, until goods or services are received or work progress is made, the Board does not believe that an obligation should be recognized as a liability. When goods or services are received or work progress is made under either a short or long-term contract, a liability for unpaid amounts should be recognized.

Interest Payable

157 There were no substantial comments on the recommended accounting standard for interest payable. The recommended standard does not differ from the current accounting practice within federal government agencies.

Other Current Liabilities

158 The recommended standard covers the current liabilities that are not specifically defined in other standards. Current liabilities specifically defined in this Statement are accounts payable and interest payable. Accounts payable and interest payable represent liabilities arising from discrete transactions. The Board also plans to issue statements to define other specific liabilities such as liabilities incurred under a loan guarantee contract and

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borrowings from other entities.

159 Other current liabilities generally are related to on-going and continuous expenses, which are typically recognized throughout each accounting period rather than on an individual transaction basis. A typical example is the liability for employees salary that is accrued at the end of a fiscal year but is not paid.

160 The Exposure Draft indicated that a liability was considered funded if the related expense was incurred under budget authority. Some respondents suggested that the term budget authority be changed to budgetary resources . They argued that budgetary resources encompass not only new budget authority, but also other resources available to incur liabilities for specified purposes in a given year.

161 The Board agrees that a liability (or a portion of the liability) should be considered funded from the reporting entity's perspective if it is covered by available budgetary resources. However, the recommended standard takes the position that a liability should be recognized when it is incurred, regardless of whether it is covered by available budgetary resources. The recommended standard also requires that disclosure should be made for liabilities that are not covered by available budgetary resources.

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APPENDIX B: ILLUSTRATION OF THE INTEREST METHOD FOR INVESTMENT DISCOUNT AND PREMIUM

This Appendix provides an illustration of the interest method for amortizing a discount or premium of an investment in a marketable or a market-based Treasury security, such as a Treasury bond. The interest method is required in the recommended standard for investments. Before explaining the interest method itself, the concept of discount and premium will be explained.

Bond Discount and Premium

The price of a bond equals the present value of the bond's net future cash flows, including principal and interest payments, discounted to the time of its issuance. The discount rate is referred to as the effective interest

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rate. Since the effective interest rate usually equals the market interest rate, it may differ from the stated interest rate (the coupon rate) of the bond. The difference between the effective interest rate of a bond and its stated interest rate causes the bond price to be different from its face amount.

A Treasury bond may be purchased at a price higher or lower than the bond's face amount (par amount). The difference between the purchase price and the face amount is a discount if the price is lower than the face amount; or a premium if the price is higher than the face amount. The investor initially records the bond at its face amount and records the discount or the premium in a valuation allowance account. Thus, the carrying amount of the bond equals its face amount minus or plus the discount or the premium. The discount or the premium is amortized over the life of the bond, so that the bond would be redeemed at its face amount at its maturity.

The Interest Method [Footnote 10]

Under the interest method of amortization, an amount of interest equal to the carrying amount of the investment times the effective interest rate, is calculated for each accounting period. This calculated interest is the effective interest of the investment (referred to as effective yield in some literature). The amount of effective interest is compared with the stated interest of the investment. (The stated interest is the interest that is payable to the investor according to the stated interest rate.) The difference between the effective interest and the stated interest is the amount by which the discount or the premium should be amortized (i.e., reduced) for the accounting period.

[Footnote 10 :The interest method of amortization is described in several FASB statements and APB Opinions. For example, see paragraph 18, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, and paragraph 16 of APB Opinion No. 12, Omnibus Opinion.]

EXAMPLES [Footnote 11]

In the first example, which shows the amortization of a

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discount, Treasury bonds with the face amount of $100,000 were purchased by a federal entity on the bonds' issuance date, January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is $96,007, with a discount of $3,993, which reflects an effective interest rate of 8 percent.

[Footnote 11: The examples are adapted from Glenn A. Welsch and Charles T. Zlatkovich, Intermediate Accounting, 8th ed. (Boston: Richard D. Irwin, Inc., 1989), p. 656.]

In Table 1 below, the annual discount amortization is in column 4, which equals column 3 minus column 2.

TABLE 1: DISCOUNT AMORTIZATION

DATE	STATED INTEREST 7%	BONDS EFFECTIVE INTEREST 8%	DISCOUNT AMORTIZATION	UNAMORTIZED BALANCE	CARRYING AMOUNT
1/1/92				$3,993	$96,007
12/31/92	$7,000	$7,681	$681	3,312	96,688
12/31/93	7,000	7,735	735	5,577	97,423
12/31/94	7,000	7,794	794	1,783	98,217
12/31/95	7,000	7,857	857	926	99,074
12/31/96	7,000	7,926	926	0	100,000

In the second example, which is the amortization of a premium, Treasury bonds with the face amount of $100,000 were purchased by a federal entity on the bonds' issuance date, January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is $104,212, with a premium of $4,212, which reflects an effective interest rate of 6 percent.

In Table 2 below, the annual premium amortization is in column 4, which equals column 2 minus column 3.

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TABLE 2: PREMIUM AMORTIZATION

DATE	STATED INTEREST 7%	EFFECTIVE INTEREST 6%	PREMIUM AMORTIZATION	UNAMORTIZED BALANCE	BONDS CARRYING AMOUNT
1/1/92				$4,212	$104,212
12/31/92	$7,000	$6,253	$747	3,465	103,465
12/31/93	7,000	6,208	792	2,673	102,673
12/31/94	7,000	6,160	840	1,833	101,833
12/31/95	7,000	6,110	890	943	100,943
12/31/96	7,000	6,057	943	0	100,000

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APPENDIX C: GLOSSARY

This glossary provides definitions of many terms used in this Statement. The definitions may be modified or superseded when relevant terms are considered or defined by the FASAB in future projects.

ALLOCATIONS: The amount of obligational authority transferred from one agency, bureau, or account that is set aside in a transfer appropriation account to carry out the purpose of the parent appropriation or fund. (JFMIP, Project on Standardization of Basic Financial Information Requirements of Central Agencies, dated October 1991, hereafter cited as JFMIP Standardization Project)

AMORTIZATION: The gradual extinguishment of any amount over a period of time through a systematic allocation of the amount over a number of consecutive accounting periods such as the retirement of a debt by serial payments to a sinking fund. (Kohler's Dictionary).

APPROPRIATION: In most cases, appropriations are a form of budget authority provided by law that permits federal agencies to incur obligations and make payments out of the Treasury for specified purposes. An appropriation usually follows enactment of authorizing legislation. An appropriation act is the most common means of providing budget authority, but in some cases the authorizing legislation itself provides the budget authority.

ASSETS: Tangible or intangible items owned by the federal

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government which would have probable economic benefits that can be obtained or controlled by a federal government entity. (Adapted from FASB Concepts Statement No. 6 and Kohler's Dictionary.)

AUTHORITY TO BORROW: Authority to borrow is a subset of budget authority. (See budget authority.)

BUDGET AUTHORITY: The term budget authority means the authority provided by Federal law to incur financial obligations, as follows:

-- provisions of law that make funds available for obligation and expenditure (other than borrowing authority), including the authority to obligate and expend the proceeds of offsetting receipts and collections;

-- borrowing authority (authority to borrow), which means authority granted to a Federal entity to borrow and obligate and expend the borrowed funds, including through the issuance of promissory notes or other monetary credits;

-- contract authority, which means the making of funds available for obligation but not for expenditure [Statutory authority under which contracts or other obligations may be entered into prior to an appropriation for the payment of such obligations. The later appropriation provides cash to liquidate such obligations. See OMB Circular A-34.], and

-- offsetting receipts and collections as negative budget authority, and the reduction thereof as positive budget authority. (Omnibus Budget Reconciliation Act of 1990 (Pub. L. 101-508), Sec. 13211): Budget authority may be classified by period of availability (1-year, multiple-year, and no-year), by nature of authority (current or permanent), by the manner of determining amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections).

BUDGETARY RESOURCES: Those amounts available to enter into obligations for specified purposes in a given year. They include: (1) new budget authority, (2) offsetting

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collections credited to an appropriation or fund account, (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations, <R>and, (4) unobligated balances of such resources at the beginning of the year or transferred in during the year. (JFMIP Standardization Project)

COLLECTIONS: Amounts received by the federal government during the fiscal year. Collections are classified as follows:

-- Budget receipts or off-budget receipts are collections from the public based on the government's exercise of its sovereign powers, including collections from participants in compulsory social insurance programs.

-- Offsetting collections are collections from government accounts (intragovernmental transactions) or from the public that are offset against budget authority and outlays rather than reflected as receipts in computing the budget and off-budget totals. They are classified as (a) offsetting receipts (i.e., amounts deposited to receipt accounts), and (b) collections credited to appropriation or fund accounts. The distinction between these two major categories is that collections credited to appropriation or fund accounts are offset within the account that contains the associated disbursements (outlays), whereas offsetting receipts are in accounts separate from the associated disbursements. Offsetting collections are deducted from gross disbursements in calculating net outlays. (Based on A Glossary Of Terms Used in the Federal Budget Process; and Related Accounting, Economic, and Tax Terms, Third Edition, General Accounting Office, March 1981, hereafter referred to as the Budget Glossary.)

CONTRACT AUTHORITY: Contract authority is a subset of budget authority. (See budget authority.)

CURRENT LIABILITIES: Amounts owed by a federal entity for which the financial statements are prepared, and which need to be paid within the fiscal year following the reporting date.

DIRECT LOAN: A disbursement of funds by the government to a

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nonfederal borrower under a contract that requires the repayment of such funds within certain time, with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular No. A-11.)

ENTITY: A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with OMB annual guidance on Form and Content of Financial Statements.

EXPENSE: Outflows or other using up of assets or incurrence of liabilities (or a combination of both) during a period of providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period. (Adapted from Kohler's Dictionary and FASB Concepts Statement No. 6.)

EXPIRED APPROPRIATIONS (ACCOUNTS): Appropriation accounts in which the balances are no longer available for incurring new obligations because the time available for incurring such obligations has expired. (JFMIP Standardization Project)

FEDERAL ENTITIES (UNITS, COMPONENTS): See entity.

INTEREST METHOD: For purposes of this Statement, the method used to amortize a bond discount or premium using the effective interest rate (the discount rate) of the bond. The amortized amount equals the effective interest amount minus the stated interest amount. (See Appendix B.)

LIABILITY: A probable and measurable future outflow of resources arising from past transactions or events.

MARKET-BASED TREASURY SECURITIEs: Treasury securities issued to governmental accounts that are not traded on any securities exchange but mirror the prices of marketable securities with similar terms. (See Treasury Financial Manual 2-4100, Federal Agencies' Financial Reports, Exhibit No. 3.)

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MARKET VALUE: For investments in marketable securities, the term refers to the value of such securities determined by prices quoted on securities exchange markets multiplied by the number of bonds or shares held in an investment portfolio.

MARKETABLE TREASURY SECURITIES: Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

NET REALIZABLE VALUE (NRV): The estimated amount that can be recovered from disposing of an item.

OBLIGATED BALANCES: The net amount of obligations in a given account for which payment has not yet been made. (JFMIP Standardization Project) Obligations: Amounts of orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payments during the same or a future period. (JFMIP Standardization Project)

OFFSETTING RECEIPTS: Offsetting receipts are a subset of offsetting collections. (See collections.)

REAPPROPRIATION: Enacted legislation that continues the availability of unexpended funds that expired or would otherwise expire. (JFMIP Standardization Project)

RECOGNITION (OR RECOGNIZE): The term recognition, as used in this Statement, bears the same meaning as used by FASB in its conceptual statements. Recognition is the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item. (FASB Statement of Financial Accounting Concepts No. 5, para. 6)

REIMBURSEMENTS: Sums received as payment or advance payment for goods or services furnished either to the public or to

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another federal government account. If authorized by law, these sums are credited directly to specific appropriation and fund accounts. These amounts are deducted from the total obligations incurred (and outlays) in determining net obligations (and outlays) for such accounts. (Budget Glossary) Reimbursements are offsetting collections. (See offsetting collections.)

TRANSFERS BETWEEN APPROPRIATION/FUND ACCOUNTS: Occur when all or part of the budget authority in one account is transferred to another account when such transfers are specifically authorized by law. The nature of the transfer determines whether the transaction is treated as an expenditure transfer or a non-expenditure transfer. (JFMIP Standardization Project)

UNOBLIGATED BALANCES: Balances of budgetary resources that have not yet been obligated. (JFMIP Standardization Project)

Unobligated balances expire (cease to be available for obligation) for:

-- 1-year accounts at the end of the fiscal year;

-- multiple-year accounts at the end of the period specified;

-- no-year accounts only when they are 1) rescinded by law, 2) purpose is accomplished, or 3) when disbursements against the appropriation have not been made for 2 full consecutive years. (Budget Glossary).

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Executive Office of the President
Office of Management and Budget

ACCOUNTING FOR DIRECT LOANS AND LOAN GUARANTEES

STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NUMBER 2

July 15, 1993

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EXECUTIVE SUMMARY	Paragraph numbers 1-3
INTRODUCTION	Paragraphs 4-20
THE ACCOUNTING STANDARDS	Paragraphs 21-61
Post-1991 Direct Loans	Paragraph 22
Post-1991 Loan Guarantees	Paragraph 23
Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees	Paragraphs 24-29
Subsidy Amortization and Reestimation	Paragraphs 30-32
Criteria for Default Cost Estimates	Paragraphs 33-36
Revenues and Expenses	Paragraphs 37-38
Pre-1992 Direct Loans and Loan Guarantees	Paragraphs 39-40
Modification of Direct Loans and Loan Guarantees	Paragraphs 41-56
Foreclosure of Post-1991 Direct Loans and Guaranteed Loans	Paragraphs 57-60
Write-off of Direct Loans	Paragraph 61
APPENDIX A: BASIS OF THE BOARD'S CONCLUSIONS	Paragraphs 62-128
APPENDIX B: TECHNICAL EXPLANATIONS AND ILLUSTRATIONS	
APPENDIX C: GLOSSARY	

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EXECUTIVE SUMMARY

1 The Statement provides accounting standards for federal direct loans and loan guarantees. The standards require that direct loans obligated and loan guarantees committed after September 30, 1991, be accounted for on a present value basis. The use of the present value accounting method is consistent with the intent of the Federal Credit Reform Act of 1990.

2 The standards contain the following essential requirements:

-- Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

-- For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

-- For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.

-- The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).

-- When direct loans or loan guarantees are modified, the cost of modification is recognized at an

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amount equal to the decrease in the present value of the direct loans or the increase in the present value of the loan guarantee liabilities measured at the time of modification.

-- Upon foreclosure of direct or guaranteed loans, the acquired property is recognized as an asset at the present value of its estimated future net cash inflows.

3 The standards permit but do not require restating pre-credit reform direct loans and loan guarantees at present value.

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INTRODUCTION

BACKGROUND

4 The federal government, in discharging its reponsibility to promote the nation's general welfare, makes DIRECT LOANS [Footnote 1] and guarantees loans to segments of the population not adequately served by nonfederal financial institutions. Examples of federal CREDIT PROGRAMS include farmers' home loans, small business loans, veterans' mortgage loans, and student loans. For those unable to afford credit at the market rate, federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom nonfederal financial institutions would be reluctant to grant credit because of the high risk involved, federal credit programs guarantee the payment of these nonfederal loans, absorbing the costs of defaults.

[Footnote 1: Terms included in Appendix C: Glossary are printed in CAPITAL LETTERS when they appear for the fist time. (In the printed text, the terms appeared in bold face.)]

5 Because federal credit programs provide interest subsidies and sustain losses caused by defaults, the costs of these programs are significant. It is crucial, therefore, that the actual and expected costs of federal credit programs be fully recognized in both budget and financial reporting.

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THE FEDERAL CREDIT REFORM ACT OF 1990

6 The primary intent of the Federal Credit Reform Act of 1990 is to ensure that the SUBSIDY COSTS of direct loans and LOAN GUARANTEES are taken into account in making budgetary decisions. To achieve this general result, the Act has the following specific purposes: (a) ensure a timely and accurate measure and presentation in the President's budget of the costs of direct loan and loan guarantee programs, (b) place the cost of credit programs on a budgetary basis equivalent to other federal spending, (c) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries, and (d) improve the allocation of resources among credit programs and between credit and other spending programs.

7 The major provisions of the Act, which is effective for fiscal year 1992 and thereafter, are to:

-- Require that, for each fiscal year in which the direct loans or the loan guarantees are to be obligated, committed, or disbursed, the President's budget reflect the long-term cost to the government of the subsidies associated with the direct loans and loan guarantees. The subsidy cost estimate for the President's budget is to be based on the PRESENT VALUE of specified cash flows discounted at the average rate of marketable Treasury securities of similar maturity.

-- Require that, before direct loans are obligated or loan guarantees are committed, annual appropriations generally be enacted to cover these costs. (However, mandatory programs have permanent indefinite appropriations.)

-- Provide for borrowing authority from Treasury to cover the non-subsidy portion of direct loans.

-- Establish budgetary and financing control for each credit program through the use of three types of accounts: the PROGRAM ACCOUNT (budgetary), the FINANCING ACCOUNT (non-budgetary), and the LIQUIDATING ACCOUNT (budgetary).

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THE NEED FOR ACCOUNTING INFORMATION

8 Accounting information on credit programs provides the basis for evaluating program performance by comparing actual accounting data with estimated budget data. Budget analysts and decision-makers can use accounting information to compare actual cash flows with projected cash flows and actual costs of direct loans and loan guarantees with their estimated costs.

9 For credit program managers, information on estimated default losses and related liabilities, when recognized in a timely manner, can be an important tool in evaluating credit program performance. The information can help determine a credit program's overall financial condition and identify its financing needs.

10 Furthermore, cost and performance information on loans and loan guarantees maintained by COHORT and RISK CATEGORY can highlight those groups that are not expected to meet budget estimates because of increased risk. Based on such information, program managers can take timely action to reduce costs, control risks where possible, and improve credit program performance.

PRESENT VALUE ACCOUNTING

11 The Federal Credit Reform Act of 1990 requires that effective October 1, 1991, the cost of direct loans and loan guarantees be estimated at present value for the budget. The objectives of using the present value measurement in federal credit reform are to measure, recognize, and control subsidy costs of direct loans and loan guarantees. [Footnote 2]

[Footnote 2: Congressional Budget Office, "Credit Reform: Comparable Budget Costs for Cash and Credit" (Dec. 1989), p. 33.]

12 For direct loans, the effect of using the present value measurement is to estimate the extent of the disbursed amounts that would be recovered, and the extent of the disbursed amounts that is a subsidy cost. The portion that

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can be recovered is the present value of projected net cash inflows discounted at the Treasury rate of similar maturity. This portion is not considered a cost to the government because it is expected to be returned to the government in future amounts. The remaining portion of the cash disbursement represents a cost to the government, resulting either from lending at a rate lower than the Treasury interest rate, or from default losses, or both.

13 Under credit reform, the subsidy portion of direct loans is financed by appropriations, and the unsubsidized portion of the loans, which equals the present value of the government collections from the borrowers, is financed with funds borrowed from Treasury. The subsidy cost of loans must be REESTIMATED and updated annually.

14 The present value measurement basis is also applied to loan guarantees. Before credit reform, as in the case of direct loans, loan guarantees were measured for the budget on a cash basis. Thus, loan guarantees could appear to be virtually cost free, since cash payments by the government were not required unless and until the guaranteed loans defaulted at a future date. Under credit reform, the future cash outflows required by LOAN GUARANTEE COMMITMENTS must be projected and discounted at an appropriate Treasury interest rate. The present value of the cash outflows is the cost of the loan guarantees. Before loan guarantees are committed, annual appropriations generally must be enacted to cover the cost of the loan guarantees.

FINANCIAL REPORTING

15 The Board believes that present value measurement should be adopted for financial accounting and reporting on direct loans and loan guarantees that have been or will be obligated or committed after September 30, 1991. Since the Act requires that the costs of these POST-1991 DIRECT LOANS AND LOAN GUARANTEES be estimated at present value for budget purposes, financial reports on actual results measured at present value can be used as feedback to compare with budget estimates. Such comparisons can be used as a basis to improve future estimates and REESTIMATES.

16 The Board recognizes that effective use of the present value accounting method depends on accurate projections of future cash flows over the life of direct or

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guaranteed loans. The efforts to make accurate projections should begin with establishing and using reliable records of historical credit performance data, and should take into consideration current and forecasted economic conditions.

17 The Board recognizes the value of having financial accounting support the budget. It endorses the logic underlying credit reform, and it recommends that accounting standards for credit be consistent with budgeting under credit reform. The Board is aware that as more experience is gained, some modifications may be made in budgetary requirements. It is the intention of the Board that so long as the modifications are made on a credit reform basis and do not materially affect the basic recognition and measurement principles embodied in the accounting standards, accounting practices for direct loans and loan guarantees should change as needed in order to be consistent with the budget.

18 The Board considered the expected costs and efforts that would be required in restating PRE-1992 DIRECT LOANS AND LOAN GUARANTEES at present value. Based on this consideration, the standards permit but do not require restating those loans and loan guarantees on a present value basis.

19 The standards were proposed in an Exposure Draft issued in September 1992. Comments were received from 36 organizations and individuals. Oral comments were also presented at a meeting by representatives of federal agencies with major credit programs. The Board considered all the comments received and incorporated changes, as appropriate. Issues raised by those who responded to the Exposure Draft and the Board's conclusions are presented in Appendix A, Basis of the Board's Conclusions.

EFFECTIVE DATE

20 The FASAB recommends that the accounting standards recommended in this Statement become effective for fiscal years ending September 30, 1994, and thereafter. An earlier implementation is encouraged.

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THE ACCOUNTING STANDARDS

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EXPLANATION

21 These standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The standards apply to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category.

ACCOUNTING STANDARDS

Post-1991 Direct Loans

22 Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

Post-1991 Loan Guarantees

23 For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

24 For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term, applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

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25 For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

26 The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.

27 The default cost of direct loans or loan guarantees results from any anticipated deviation, other than prepayments, by the borrowers from the payments schedule in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. Projected net recoveries include the amounts that would be collected from the borrowers at a later date or the proceeds from the sale of acquired assets minus the costs of foreclosing, managing, and selling those assets.

28 The present value of fees and other collections is recognized as a deduction from subsidy costs.

29 Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

Subsidy Amortization and Reestimation

30 The subsidy cost allowance for direct loans is amortized by the INTEREST METHOD using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed. The amortized amount is recognized as an increase or decrease in interest income.

31 Interest is accrued and compounded on the liability

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of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed. The accrued interest is recognized as interest expense.

32 The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the reestimation takes into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required.

Criteria for Default Cost Estimates

33 The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent reestimates. Default costs are estimated and reestimated for each program on the basis of separate cohorts and risk categories. The reestimates take into account the differences in past cash flows between the projected and realized amounts and changes in other factors that can be used to predict the future cash flows of each risk category.

34 In estimating default costs, the following risk factors are considered: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; and (6) newly developed events that would affect the loans' performance. Improvements in methods to reestimate defaults are also considered.

35 Each credit program should use a systematic methodology, such as an econometric model, to project

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default costs of each risk category. If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category.

36 Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based. To document actual experience, a data base should be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Revenues and Expenses

37 Interest accrued on direct loans, including amortized interest, is recognized as interest income. Interest accrued on the liability of loan guarantees is recognized as interest expense. Interest due from Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

38 Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

Pre-1992 Direct Loans and Loan Guarantees

39 The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1992, are recognized when it is more likely than not that the direct loans will not be totally collected or that the loan guarantees will require a future cash outflow to pay default claims. The allowance of the uncollectible amounts and the liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors

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discussed in the previous section should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

40 Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required.

Modification of Direct Loans and Loan Guarantees

41 The term modification means a federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

42 Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Existing contracts may be altered through such means as forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered reestimates, or workouts as defined below, or are permitted under the terms of existing contracts.

43 Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection.

44 The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms. Workouts are actions taken to maximize repayments of existing direct loans or minimize claims under existing loan guarantees. The expected effects of work-outs on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

A. MODIFICATION OF DIRECT LOANS

45 With respect to a direct or indirect modification

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of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the PRE-MODIFICATION VALUE [Footnote 3] of the loans over their POST-MODIFICATION VALUE [Footnote 4] The amount of the modification cost is recognized as a modification expense when the loans are modified.

[Footnote 3: The term pre-modification value is the present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).]

[Footnote 4: The term post-modification value is the present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).]

46 When post-1991 direct loans are modified, their existing BOOK VALUE is changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the ORIGINAL DISCOUNT RATE (the rate that is originally used to calculate the present value of the direct loans, when the direct loans were disbursed).

47 When pre-1992 direct loans are directly modified, they are transferred to a financing account and their book value is changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans. When pre-1992 direct loans are indirectly modified, they are kept in a liquidating account. Their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification.

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48 The change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the MODIFICATION ADJUSTMENT TRANSFER [Footnote 5] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 5: OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of modification adjustment transfer equal to the excess; and that if the cost of modification exceeds the decrease in book value, the reporting entity pays to the Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)]

B. MODIFICATION OF LOAN GUARANTEES

49 With repsect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the POST-MODIFICATION LIABILITY [Footnote 6] of the loan guarantees over their PRE-MODIFICATION LIABILITY.[Footnote 7] The modification cost is recognized as modification expense when the loan guarantees are modified.

[Footnote 6: The term post-modification liability is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).]

[Footnote 7: The term "pre-modification liability" is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on

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marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate.)

50 The existing book value of the liability of modified post-1991 loan guarantees is changed to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (the rate that is originally used to calculate the present value of the liability when the guaranteed loans were disbursed).

51 When pre-1992 loan guarantees are directly modified, they are transferred to a financing account and the existing book value of the liability of the modified loan guarantees is changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. When pre-1992 direct loan guarantees are indirectly modified, they are kept in a liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification.

52 The change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer [Footnote 8] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 8: OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of modification adjustment transfer equal to the excess; and that if the cost of modification exceeds the increase in liability, the reporting entity pays to the Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)]

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C. SALE OF LOANS

53 The sale of post-1991 and pre-1992 direct loans is a direct modification. The cost of modification is determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.

54 For a loan sale with RECOURSE, potential losses under the recourse or guarantee obligations are estimated, and the present value of the estimated losses from the recourse is recognized as subsidy expense when the sale is made and as a loan guarantee liability.

55 The book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss. [Footnote 9] For sales of post-1991 direct loans, the modification adjustment transfer [Footnote 10] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 9: If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.]

[Footnote 10: See footnote No. 5 for an explanation of modification adjustment transfer.

D. DISCLOSURE

56 Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or lose related to the modification.

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Foreclosure of Post-1991 Direct Loans and Guaranteed Loans

57 When property is transferred from borrowers to a federal credit program, through FORECLOSURE or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

58 If a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the present value of the estimated claim is recognized as a special contra valuation allowance.

59 At a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted at the original discount rate.

60 When assets are acquired in full or partial settlement of post-1991 direct loans or guaranteed loans, the present value of the government's claim against the borrowers is reduced by the amount settled as a result of the foreclosure.

Write-off of Direct Loans

61 When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the WRITE-OFF, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

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APPENDIX A: BASIS OF THE BOARD'S CONCLUSIONS

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PRESENT VALUE ACCOUNTING

62 Several respondents were opposed to using present value accounting for direct loans and loan guarantees. They pointed out that although the Federal Credit Reform Act of 1990 requires the use of present value to measure the subsidy costs of direct loans and loan guarantees for the budget, the law does not require using present value for financial reporting. They believed that since there are no legal requirements, the adoption of present value accounting should be based on cost-benefit considerations.

63 These respondents emphasized the complexity and cost of implementing and maintaining present value accounting. Because of the need to separately account for the direct loans or loan guarantees obligated or committed by each credit program in a fiscal year by cohort, as years go by, the number of cohorts would multiply. An agency with a number of loan and loan guarantee programs estimated that within 5 years, there would be more than 200 cohorts, one for each year and each program. Since most of its loans are long-term, maturing in 30 or more years, the number of cohorts would be staggering.

64 The respondents who were opposed to present value accounting doubted whether there would be any significant improvement in financial information on loans and loan guarantees reported on a present value basis compared with information traditionally reported on a nominal value basis. They contended that both present value accounting and nominal value accounting rely on historical experience and management judgment to evaluate risk as the primary variable in determining a default allowance. They further argued that since present value calculations involve cash flow estimates over future years, information based on the estimates is not necessarily more reliable than information reported under the nominal value accounting method.

65 A number of respondents expressed support of the Board's proposal to use present value accounting for direct loans and loan guarantees. They believed that it is a positive step to bring budgeting and financial reporting together. They also believed that implementation of the proposed standards would present useful information for monitoring programs with direct loans and loan guarantees.

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66 In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 and to make financial reporting compatible with the budget. (See Exposure Draft, Vol. 1, par. 15.) The Board believes that one of the objectives of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget. [Footnote 11]

[Footnote 11: FASAB Exposure Draft, Objectives of Federal Financial Reporting, Vol. 1, par. 13.]

67 The Federal Credit Reform Act of 1990 requires using present value for the budget. The Board does not believe that this requirement should be ignored for financial reporting. Since budgetary resources for direct loan and loan guarantee subsidies are provided on a present value basis, financial reporting on the acquisition, use, and status of the resources should be on the same basis. Only by using the same basis can financial information be used to compare the actual results with the budget.

68 Indeed, distortion in information would result if present value were not used to report direct loans or loan guarantees that are budgeted on a present value basis. This can be illustrated by the following example.

69 Suppose a group of 5-year term loans in the aggregate amount of $100,000 were disbursed by a federal credit program at the end of fiscal year 1992. The loans require paying an annual interest of 5 percent and repaying the principal in fiscal year 1997. It was estimated that the interest would be collected each year, but only $80,000 of the principal would be repaid when the loans mature. During the year the loans were disbursed, the average interest rate of Treasury securities of the same maturity was 9 percent.

70 Based on the cash flow projection shown in Table 1 below, at the end of the 1992 fiscal year, the present value of the direct loans was $71,440 and the loans' subsidy cost was $28,560. It is assumed in this example, that as required by credit reform, the subsidy cost ($28,560) was funded with appropriations, and the remaining amount ($71,440) was financed with borrowing from Treasury at 9 percent.

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TABLE 1: THE PRESENT VALUE OF DIRECT LOANS

FISCAL YEARS	EXPECTED PAYMENTS
1993	$ 5,000
1994	5,000
1995	5,000
1996	5,000
1997	$85,000
Present value at 9%	$71,440

71 If the nominal value accounting method were used in financial reporting, the $20,000 of the principal that was estimated to be uncollectible would have been reported as a bad debt expense. The estimated uncollectible amount of $20,000 would have been recognized as the cost of the loans in financial statements. In reality, however, the agency spent $28,560 of budgetary resources to fund the cost of the loans.

72 Also, if the nominal value accounting method were used, the loans as assets would have been reported at $80,000 at the end of the 1992 fiscal year, which equals the $100,000 principal of the loans minus an allowance of $20,000 for the uncollectible amount. On the other hand, debt to Treasury would have been reported at $71,440, which was the amount actually borrowed to finance the loans. The financial information would have shown an excess of the assets over the liability by $8,560. In reality, however, even if the default estimate was correct, the entire collection of interest and principal would be used to pay interest and principal to Treasury. The credit program in fact would have no excess in assets. The following is a comparison of the loans reported on a present value basis and on a nominal value basis. [Footnote 12]

[Footnote 12: Tables are provided only for illustration. They do not represent a reporting format.]

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TABLE 2: REPORTING ON THE DIRECT LOANS AT PRESENT VALUE ON SEPTEMBER 30, 1992

ASSETS:		LIABILITIES:	
Loans receivable	$100,000	Debt to Treasury	$71,440
Subsidy cost allowance	(28,560)		
Loans receivable, Net	$ 71,440		
		Net Position:	$0

TABLE 3: REPORTING ON THE DIRECT LOANS AT NOMINAL VALUE ON SEPTEMBER 30, 1992

ASSETS:		LIABILITIES:	
Loans receivable	$100,000	Debt to Treasury	$71,440
Allowance for bad debts	(20,000)		
Loans receivable, Net	$ 80,000		
		Net Position:	$ 8,560

73 A similar distortion would result in reporting loan guarantees. The distortion would be caused by reporting loan guarantee liabilities on a nominal value basis, whereas the budgetary resources received to finance the liabilities are measured at a present value basis.

74 In evaluating efforts and costs of implementing present value accounting for post-1991 direct loans and loan guarantees, one should keep in mind that the federal direct loan and loan guarantee programs have modified or will have to modify their accounting systems in order to implement the budgeting requirements of the Federal Credit Reform Act of 1990. They will have to maintain data by cohort and risk category, compute interest on borrowing from Treasury and on uninvested funds, and make subsidy estimates and reestimates. The accounting standards provided in this statement do not require more than the budget process requires in these respects, and thus they would not result in a substantial amount of additional effort or cost.

75 Some respondents indicated that it would be

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burdensome if present value accounting were to be implemented on a loan-by-loan (or transaction) basis. The Board does not propose that the accounting standards be implemented on a loan-by-loan basis. The standards should apply to a cohort (or risk category) of direct loans or loan guarantees in the aggregate.

76 In addition to making financial reporting consonant with the budget, the Board also believes that the standards proposed in the Exposure Draft will produce better financial information for the following reasons:

77 First, the proposed standards would require measuring and recognizing the subsidy costs of direct loans and loan guarantees at their inception rather than at a later date. The current accounting practice does not require this. In the absence of this requirement, the cost of direct loans is not recognized when the loans are disbursed, and the liability to pay claims under loan guarantees is not usually recognized when guaranteed loans are disbursed.

78 Second, the proposed standards would require a comprehensive evaluation of future cash flows over the life of direct loans and guaranteed loans, including payments of interest, principal, fees, prepayments, defaults, delinquencies, and recoveries. The current accounting practice typically provides an allowance for the portion of the principal that would not be collected. It does not take into account the impact of other cash flow elements.

79 Third, the proposed standards would require discounting the net cash flows at the government's borrowing rate on marketable Treasury securities. Discounting is a basic feature of present value accounting that measures and recognizes the interest subsidy cost of direct loans and loan guarantees, and the time value of all cash flows. The time value of such cash flows is not accounted for under the nominal value accounting method, and the interest subsidy cost is not accounted for when the loans are disbursed.

80 Finally, the proposed standards would require an annual systematic review of the projected cash flows. The projections would be revised and updated to reflect newly developed events, changes in economic conditions, and better understanding of the factors that cause defaults. The subsidy costs would be reestimated accordingly. The

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reestimation requirement assures that credit programs maintain an up-to-date data base by cohort and risk category of actual collections, defaults, and amounts written off on federal loans and loan guarantees. Such a complete data base was not available prior to credit reform.

81 In summary, the recognition of cost at inception, the comprehensive evaluation of all future cash flows, and the discounting of future cash flows to present value are complementary elements at the core of present value accounting. When taken together, they place an economic value on the cost the federal government incurs in making direct loans and loan guarantees. Likewise, they place an economic value rather than a nominal value on loan assets and loan guarantee liabilities.

82 Based on the view that financial accounting should be compatible with the budget, and based on the other advantages of using the present value accounting, the Board has concluded that the present value accounting method should be used in the accounting standards for post-1991 direct loans and loan guarantees.

SUBSIDY COST COMPONENT

83 The Exposure Draft proposed that when direct or guaranteed loans are disbursed, their subsidy expense be recognized separately among interest subsidy costs, default costs, fees (as a deduction from the costs), and other subsidy costs.

84 The Exposure Draft also proposed the following requirement: The interest subsidy allowance shall be amortized using the interest method. Compound interest shall be accumulated on the allowances for default losses, fees, and other cost components.

85 The Exposure Draft posed a question: Should the subsidy cost components, if material, be recognized separately in financial reporting? Some respondents agreed that the subsidy cost components should be separately recognized. They believed that separate recognition would provide the level of detail needed to understand the program better and improve their component estimates for budget formulation.

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86 Some respondents were opposed to reporting subsidy costs by component on the grounds that (1) only the aggregate amount of subsidy costs is needed for budget execution purposes, (2) information on cost components may not be used by management, and (3) the cost of complex record-keeping and calculations outweigh the benefit.

87 After considering the benefits and efforts required in accounting for subsidy cost components, the Board has concluded that when direct or guaranteed loans are disbursed, the subsidy expense of the direct loans or loan guarantees should be recognized in separate components. The Board believes that by reporting the subsidy expense components of direct or guaranteed loans disbursed during the reporting year, the cost components of newly disbursed direct loans and loan guarantees can be compared with those of prior years. The cost component information would be valuable for making credit policy decisions, monitoring portfolio quality, and improving credit performance. Information on interest subsidies and fees would help in making decisions on setting interest rates and fee levels. Information on default costs would help in evaluating credit performance.

88 In calculating the present value of the subsidy costs for the budget, agencies must first develop data on cash flow components. OMB requires agencies to use the OMB credit subsidy model, which takes these cash flows as inputs and automatically calculates the components of the subsidy cost. Since the information on subsidy cost components of new direct loans and loan guarantees is available, reporting the information would not require significant additional efforts.

89 However, the Board realizes that it would require considerable efforts to maintain records for the present value of cost components for each existing cohort of loans and loan guarantees, amortize or accumulate interest on each component each year, adjust each component each year for reestimates, and, if applicable, adjust each component for modifications when they occur. After considering the efforts that would be required and the benefits that could be derived, the Board decided not to recommend the requirement to amortize or accumulate interest on each subsidy cost component. Without this requirement, credit programs may

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amortize the subsidy allowance of each cohort in aggregate, using the interest method. They would not have to maintain records for the present value of each cost component and adjust them annually. This would greatly ease the record-keeping and calculation burden.

90 By eliminating the requirement to amortize and accumulate interest on each component of the subsidy cost allowance, the Board realizes that information would not be available to track changes in the present values of the components. However, data would still be available to track changes in the total amount of a cohort's subsidy allowance affected by annual reestimates. The primary factor that causes changes in the subsidy allowance would be default reestimates. Furthermore, the Board believes that it is of a critical importance that each credit program maintain a data base for actual collections, defaults, delinquencies, and recoveries. For purposes of monitoring program performance and estimating future losses, the actual default and collection data base is more important than tracking changes in the allowance for the present value of subsidy costs by component. The actual default and collection data base is also necessary for estimating and reestimating subsidy costs.

ACCOUNTING FOR FEES

91 In the Exposure Draft, the Board proposed that the present value of estimated fee receipts be recognized as a deduction from the subsidy expense. The Board posed a question: How should fees be recognized on an entity's financial reports? Should they be recognized as a deduction of subsidy expense, or as a revenue?

92 Many respondents agreed with the proposal that the present value of estimated fee collections be recognized as a deduction of subsidy expense. Some respondents contended that fees should be recognized as a revenue rather than as an expense component. They stated that offsetting revenues against expenses would not provide clear revenue/expense information concerning the operating results of a credit program. Some of the respondents also said that to the extent some of the fees are used to defray administrative costs, they should not offset subsidy expenses because the Federal Credit Reform Act of 1990 excludes administrative

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costs from subsidy expenses.

93 The Board is not persuaded by the arguments that fees should be reported as a revenue. The subsidy expense of direct loans and loan guarantees is the focal point of credit reform, and it is measured as the present value of the net cash flows of the direct loans and loan guarantees. Since the estimated fees are a component of the cash flows, the Board believes that the present value of fees should be reported as a component of the subsidy expense. Since the Board has concluded that all of the subsidy expense components, including the present value of fees, are to be reported separately, reporting the present value of fees as an expense component would not reduce information on the collection of fees. Furthermore, the administrative expenses that are excluded from subsidy costs are often covered by appropriations, rather than paid by fee collections. Thus, it is not necessary to allocate a portion of the fee collections to pay the administrative costs that are not a part of the subsidy costs.

PRE-1992 DIRECT LOANS AND LOAN GUARANTEES

94 The phrase pre-1992 direct loans and loan guarantees refers to direct loans obligated and loan guarantees committed before October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. In the Exposure Draft, the Board did not recommend restating pre-1992 direct loans and loan guarantees at present value. The Board's position was that the costs of restating those direct loans and loan guarantees would outweigh the benefits.

95 Most respondents who commented on this issue agreed with the Board's position. They emphasized that the restatement of pre-1992 direct loans and loan guarantees would be a complex process and would require substantial resources. They pointed out that a major difficulty is caused by the lack of complete and accurate historical data that a restatement needs to be based upon. Because of the lack of accurate data, even if the agencies incurred a great deal of cost, the restated loans and loan guarantees could not be accurately compared with post-1991 loans and loan guarantees on the same basis. The respondents pointed out that since the pre-1992 direct loans and loan guarantees

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were obligated or committed in the past, restated information would be of limited usefulness to current budget decisions. They also pointed out that the amount of pre-1992 direct loans and loan guarantees outstanding would diminish over time as loans matured, defaulted, or were modified.

96 In addition to considering the comments on the Exposure Draft, the Board also considered the findings of a GAO report presented to the Board. [Footnote 13] The GAO report suggested that by not requiring a restatement of pre-1992 direct loans and loan guarantees at present value, poor information would be perpetuated, which could affect the ability to (1) forecast the future budgetary impact of pre-credit reform credit activity, (2) minimize losses, and (3) judge the reasonable accuracy of subsidy estimates for post-1991 credit. The GAO report recommended using simplified methods, such as sampling techniques, to restate pre-1992 direct loans and loan guarantees at present value.

[Footnote 13: GAO Report to the Chairman, Senate Budget Committee, Federal Credit Programs: Agencies Had Serious Problems Meeting Credit Reform Accounting Requirements (GAO/AFMD-93-17, Jan. 1993).]

97 However, there was a strong indication in the comments the Board received and in the findings of the GAO report that agencies have been experiencing serious difficulties in implementing the credit reform requirements related to post-1991 direct loans and loan guarantees. A restatement of pre-1992 direct loans and loan guarantees, even on a sampling basis, would require additional use of the agencies' limited accounting resources. The Board also agrees with the view that as the pre-1992 direct and guaranteed loans are approaching their maturity and are paid off, liquidated, or written off, the difference between their present value and nominal value becomes less significant. Thus, the Board concludes that it is appropriate not to require restating pre-1992 direct loans and loan guarantees at present value.

98 The Department of Veterans Affairs stated in its comments that it had accounted for pre-1992 loan guarantees on a present value basis. The Department of Education indicated in its comments that it planned to report pre-1992 loans on a present value basis. Their efforts to account for pre-1992 loans and loan guarantees at present value,

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although not at the same level of detail as required by credit reform, could very well result in improved information for credit management. Other agencies may follow their examples. The Board believes that reporting those pre-1992 direct loans and loan guarantees on a present value basis should be permitted.

99 Although a restatement of pre-1992 direct loans and loan guarantees at present value is not required, the Board continues to believe that it is of fundamental importance to estimate and recognize losses and liabilities for those direct loans and loan guarantees. Loss estimation and recognition are necessary to support federal government financial planning and management. The information on both current and potential liabilities related to federal credit programs alerts Congress and federal officials to the long-term costs and future financing needs.

100 The recommended standards would require that losses of pre-1992 direct loans and liabilities related to pre-1992 loan guarantees be recognized when it is more likely than not that the loans will not be totally collected or the loan guarantees will require a future cash outflow to pay default claims. This is the same standard that the Board recommended for the recognition of losses on receivables in FASAB Statement of Recommended Accounting Standards No. 1, Accounting for Selected Assets and Liabilities.

101 The Board believes that each loan guarantee program should disclose the aggregate amount of outstanding guaranteed loans. In addition, it should also disclose its risk exposure, which is the guaranteed portion of the total outstanding guaranteed loans.

MODIFICATIONS

102 A modification is a government action that alters the estimated subsidy cost of outstanding direct loans or loan guarantees. Both a government action and an alteration in subsidy cost are necessary conditions for a modification. A subsidy reestimate is not a modification.

103 Direct modifications change the subsidy cost by legislation or administrative actions that alter the terms of existing contracts or by selling loan assets. Existing

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contracts may be altered by such means as forgiveness, forbearance, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered workouts as explained below or are permitted by the existing contract terms.

104 Indirect modifications change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection. Such new legislation would produce a one-time effect on the subsidy cost of outstanding direct loans and loan guarantees only. After the enactment of the legislation, the effects of the legislation are included in the original subsidy cost estimates of newly obligated direct loans and newly committed loan guarantees. Thus, the legislation is not a modification with respect to direct loans obligated and loan guarantees committed subsequent to its enactment.

105 The term modification does not include the routine administrative work-outs of troubled loans or loans in imminent default. Work-outs are actions undertaken to maximize the repayments to the government under existing direct loans or to minimize claim payments that the government would make under loan guarantees. The expected effects of work-outs on cash flows are included in the original estimate and the reestimates of the subsidy cost. Therefore, a workout effort is not a government action that alters the estimated subsidy cost of direct loans or loan guarantees.

106 The term modification also does not include actions that are permitted within the existing contract terms, such as prepayments without penalty permitted by existing loan contracts. The expected effects of such actions on cash flows are included in the original estimate and the reestimates of the subsidy cost.

107 Neither the term modification nor the term workout includes additional disbursements to borrowers that increase the amount of direct loans outstanding. These disbursements are considered to be new loans in the amount of the increment.

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108 When direct loans and loan guarantees are modified, the subsidy cost of the modification must be calculated. The book value of the modified loans and the liabilities of the modified loan guarantees must be restated. The Exposure Draft used two types of discount rates to calculate the present values of post-1991 direct loans and loan guarantees that are modified: CURRENT DISCOUNT RATES and original discount rates.

109 The term current discount rate refers to the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct or guaranteed loans, under either pre-modification terms, or post-modification terms, whichever is appropriate. The cost of modification is measured as the excess of the present value of pre-modification net cash flows over the present value of post-modification cash flows, both discounted at a current discount rate. This is consistent with the measurement method described in OMB instructions.

110 The term original discount rate refers to the discount rate that is originally used to calculate the present value of the direct loans or the present value of loan guarantee liabilities, when the direct or guaranteed loans were disbursed. The value of modified loans or the liability of modified loan guarantees equals the present value of modified cash flows discounted at the original discount rate. The original discount rate is used to determine the value of modified loans because this is the interest rate that the Treasury charges on funds that it lends to the credit program to finance the loans. The original discount rate is also used to determine the liability of modified loan guarantees because this is the interest rate that the Treasury pays on funds that it holds for the credit program to pay future claims.

111 Because of using the two different rates, a difference will normally occur between the change in the book value of modified direct loans and the cost of the modification. In the case of loan guarantees, there will normally also be a difference between the change in the liability of modified loan guarantees and the cost of modification.

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112 The Exposure Draft used an example to illustrate the difference. [Footnote 14] The example used the original discount rate of 6 percent to calculate the book value of a modified loan, and it used the current discount rate of 8 percent to calculate the cost of modification. The calculations resulted in a difference between the change in book value and the cost of modification.

[Footnote 14: See Exposure Draft, Vol. 2, pars. 221 through 231, and Appendix 2, pages 139 through 143.]

113 OMB instructions require that an amount equal to the difference between the change in book value and the cost of modification either be returned to, or received from, the Treasury to offset the difference. The amount transferred to offset the difference is referred to in OMB instructions as the modification adjustment transfer. This transfer does not constitute a part of the cost of modification and is not a budget outlay or collection.

114 Several respondents objected to use of the current rate for measuring the modification cost. They believed that both the modification cost and the value of the modified loans (or the liability of modified loan guarantees) should be measured on the same basis, using the original discount rate. They said that by using the original discount rate for measuring both the cost and the book value or the liability, there would be no difference between the modification cost and change in book value (or change in loan guarantee liability). They argued that the additional computations at current discount rate do not result in any additional meaningful information for use by management. They contended that the complexity of the computation, the effect of changing discount rates, and the resulting difference between the change in book value and the cost of modification would only detract from management's ability to analyze the results of modification.

115 The Board realizes that it is undesirable to calculate the cost of modification and change in book value on different bases. Because the cost of modification and the book value are calculated on different bases, the modification expense recognized would not equal the decrease in the book value of direct loans (or the increase in the liability of loan guarantees) resulting from the modification.

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116 However, it is also undesirable to recognize a modification expense at a measurement basis that differs from the budget and appropriation basis. The OMB instructions concerning the definition and the cost of modification have carried a great weight on the Board's consideration of the subject. The OMB instructions require that the cost of modification be measured at the current rate, and appropriations approved for a modification will equal the cost of modification. The Board believes that financial reporting should reflect the modification cost recognized in the budget and the modification appropriations received.

117 The Board also appreciates the rationale in OMB instructions. The Federal Credit Reform Act of 1990 requires that the calculation of modification cost be based on the estimated present value of the direct loans or loan guarantees at the time of modification. This requirement has been interpreted as calculating the present value of modification cost at the discount rate applicable at the time of modification. The Board also agrees with the substantive rationale for using the current rate. By using the current rate, the calculation of the modification cost will reflect the economic cost of the modification at the time when the modification decision is made.

118 The Board found that some of the opposition to the use of the current rate for modifications arose because of a misunderstanding about the difference between modifications and work-outs. Once the distinction was clarified between work-outs (which are included in the initial subsidy estimates and are quantified using the original rates) and modifications (which require separate action as described, but are less frequent in occurrence), much of the opposition to using current rates for modifications disappeared.

119 In considering a solution for the measurement difference between the modification cost and the book value of the loan (or the loan guarantee liability), the Board has considered as an alternative whether the current rate could also be used to calculate the value of modified direct loans (or the liability of modified loan guarantees) so that the change in direct loan book value or loan guarantee liability could equal the cost of modification. The Board has decided against this for the two reasons explained below.

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120 First, under credit reform, the un-subsidized portion of direct loans is financed by funds borrowed from Treasury, while the subsidy cost of the direct loans is financed by appropriations. Thus, the carrying amount of direct loans at any point should equal the balance of debt to Treasury. Proceeds from collecting direct loan principal and interest will be used to repay debt to Treasury. This exact match between loan assets and liabilities (debt to Treasury) is a unique feature that makes credit reform loans and loan guarantees different from private sector lending.

121 When a modification occurs, the book value of the direct loans is affected. An amount of modification appropriation, plus or minus the modification adjustment transfer, would be used to reduce the debt to Treasury. By doing so, the book value of the modified loans and the balance of the debt to Treasury would continue to be equal. It is important to note that the interest rate on the debt to Treasury does not change as a result of the modification; it remains the original rate. Thus, the debt balance to Treasury in fact equals the present value of future payments to Treasury discounted at the original rate. Since the debt to Treasury is based on the original rate, that rate should also be used to calculate the book value of modified loans, so that the book value of the loans and the balance of debt to Treasury would be kept equal.

121 A parallel situation exists with loan guarantees. The financing account of each loan guarantee program maintains a fund balance with the Treasury equal to the liability of the loan guarantees. The fund balance and the liability grow at the same compound interest rate. The fund balance will accrue interest at the original rate applicable at the time the guaranteed loans were disbursed. The interest rate will not change because of a modification of the loan guarantees. Thus, only by measuring the liability of the modified loan guarantees at the original rate could the liability be kept equal to the fund balance.

122 Second, even if the current rate were used to calculate the book value of modified loans, the difference between the change in book value (or the change in liability balance) and the modification cost would not disappear. In measuring the change in book value (or the change in liability balance), the starting point is the

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pre-modification book value (or the pre-modification liability balance), which is based on the original discount rate. If the current rate is used to calculate the post-modification book value of modified direct loans, the change in book value would equal the difference between the pre-modification book value (based on the original rate) and the post-modification book value (based on the current rate). Similarly, if the current rate is used to calculate the post-modification balance of modified loan guarantee liabilities, the change in liability balance would equal the difference between the pre-modification balance (based on the original rate) and the post-modification balance (based on the current rate).

124 The cost of modification, on the other hand, is calculated differently. The starting point of the calculation is not the existing pre-modification book value of the modified loans (or the existing pre-modification book value of the liability of the modified loan guarantees). For both direct loans and loan guarantees, the calculation uses the present value of pre-modification net cash flows discounted at the current discount rate as the starting point. This pre-modification value differs from the existing pre-modification book value because the latter is based on the original discount rate. The cost of modification equals the difference between the present value of pre-modification net cash flows (discounted at the current rate) and the present value of post-modification net cash flows (also discounted at the current rate). Since the calculations take a different starting point, the cost of modification would not equal the change in book value.

125 Because of the two reasons above, the Board believes that the best solution available is to measure the cost of modification at the current discount rate, and to calculate the carrying amount of modified loans and loan guarantee liabilities at the original discount rate.

126 However, while it makes sense to determine the cost of modification based on the current discount rate, financial reporting cannot discard the pre-modification balance of direct loans or loan guarantee liabilities that are carried in the accounting records. Because of the use of different discount rates, the change in book value will be different from the cost of modification. The Board believes that the effect of a modification on assets or liabilities

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should be reflected in the operating statement. The Board believes that in addition to recognizing the cost of modification as a modification expense, any difference between the change in book value and the modification expense should be recognized as a gain or loss. Thus, the net effect of the modification on the operating statement equals the decrease in loan assets or the increase in the liability of loan guarantees resulting from the modification.

127 Based on this view, the Board has concluded that, with respect to a modification of direct loans, any difference between the change in the book value of the direct loans resulting from the modification and the cost of modification should be recognized as a gain or loss in the operating statement. Similarly, any difference between the change in the amount of liability of loan guarantees resulting from the modification and the cost of modification should be recognized as a gain or loss in the operating statement. The gain or loss is to be recognized in a category distinguished from the modification expense. The modification adjustment transfer paid or received to offset the gain or loss is to be reported as a financing source or a reduction in financing source.

128 The Board further believes that agency financial statements should include a footnote to explain the calculation of the cost of modifications and nature of gain or loss on modifications.

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APPENDIX B: TECHNICAL EXPLANATIONS AND ILLUSTRATIONS

This Appendix explains and illustrates the accounting standards for direct loans and loan guarantees. The explanations and illustrations are presented to show how the standards may be applied but are not standards themselves. They also take into account OMB and Treasury regulations on credit reform.

This Appendix has 4 parts:

-- Part I: Post-1991 Direct Loans

-- Part II: Pre-1992 Direct Loans

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-- Part III: Post-1991 Loan Guarantees

-- Part IV: Pre-1992 Loan Guarantees

Topics covered include:

-- the measurement and recognition of direct loans, subsidy costs, and the liability of loan guarantees;

-- the reestimation and the amortization of the subsidy cost allowance;

-- the reestimation of loan guarantee liabilities and the accumulation of interest on the liabilities;

-- the recognition of revenues and expenses;

-- modifications of direct loans and loan guarantees (including the sale of direct loans);

-- the write-off of direct loans; and

-- the foreclosure of assets upon default.

The Appendix does not illustrate financial statements, journal entries, or accounting procedures. Readers should consult OMB, GAO, and Treasury for guidance.

PART I POST-1991 DIRECT LOANS

Post-1991 direct loans are direct loans obligated after September 30, 1991. The accounting for post-1991 direct loans is explained and illustrated in this part of the Appendix through an example described below:

At the end of fiscal year 1994, a federal credit program disburses a number of direct loans with a total principal of $10 million. Those loans constitute a cohort for that year. The maturity term of that cohort is 5 years and the stated annual interest rate is 4 percent.

All of the amounts used in the text below are in thousands of dollars.

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The loan contracts require an annual payment of $2,246 per year for 5 years, paid at the end of each year. In Table 1 below, the required annual payments are shown in column (a). [Footnote 15] The amounts in column (b) equal the beginning loan balance of each period multiplied by the stated interest rate of 4 percent. The amounts in column (c) are principal repayments, which equal the amounts in column (a) minus the amounts in column (b). The amounts in column (d) are the ending principal balance of each period, which equal the beginning balance minus the principal repayment of that period, shown in column (c).

[Footnote 15: The annual payment is derived by dividing the present value factor of 4.45182 into the principal of $10,000. The present value factor can be found in any ordinary annuity table, and it equals the present value of $1 paid over 5 periods discounted at 4 percent. Alternatively, knowing the loan principal, the number of pay back periods, and the interest rate, one can use computer software or a financial calculator to find the required payment per period.]

TABLE 1: PAYMENT SCHEDULE (IN THOUSANDS OF DOLLARS)

	PAYMENT (a)	INTEREST (b)	PRINCIPAL (c)	YEAR-END LOAN BALANCE (d)
FY 1994				$10,000
1995	$2,246	$400	$1,846	8,154
1996	2,246	326	1,920	6,234
1997	2,246	249	1,997	4,237
1998	2,246	169	2,077	2,160
1999	2,246	86	2,160	0

It is also assumed that:

-- The average interest rate of Treasury marketable securities of a similar maturity for the period during which the loans are disbursed is 6 percent.

-- Fees totaling $500 are received when the loans are disbursed. The fees are used to reduce the need to borrow from Treasury.

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A. REPORTING POST-1991 DIRECT LOANS AND THEIR SUBSIDY COSTS

The accounting standard for post-1991 direct loans requires that direct loans disbursed and outstanding be recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance. [Footnote 16]

[Footnote 16: In this Appendix, the requirements of the accounting standards are summarized to address specific situations. However, the standards are not quoted verbatim. Readers should refer to the text of the standards for their exact wording.]

To implement the standard in the example, a cash flow projection and present value calculations are prepared. Based upon the risk factors and other criteria for default cost estimates that are enumerated in the accounting standards, it is estimated that losses in cash flows due to the defaults would equal 30 percent of the scheduled payments for fiscal year 1997 and each year thereafter. [Footnote 17] Table 2 below displays the cash flow projections and present value calculations.

[Footnote 17: The standard defines losses in cash flows due to default as being due to defaults net of recoveries. However, to simplify computations, recoveries are assumed to be zero throughout Parts I and II of this Appendix. References to defaults throughout Parts I and II should be understood to mean defaults net of recoveries for all cases where recoveries are expected. The accounting standard for recoveries is illustrated in Part III of this Appendix.]

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TABLE 2:PROJECTED CASH FLOWS DISCOUNTED TO THE END OF FY 1994 (IN THOUSANDS OF DOLLARS)

	FEE COLLECTIONS	P & I PAYMENTS*	DEFAULT LOSSES	NET CASH INFLOWS
FY 1994	$500			$ 500
1995		$2,246		2,246
1996		2,246		2,246
1997		2,246	$ (674)	1,572
1998		2,246	(674)	1,572
1999		2,246	(674)	1,572
PV at 6%	$500	$9,461	$(1,603)	$8,358

*The term P & I Payments used in this table as well as other tables throughout this Appendix denotes scheduled principal and interest payments required in loan contracts.

The present value of the loans' estimated net cash inflows is $8,358. The direct loans are recognized as assets at that amount. Since the loans' outstanding principal is $10,000, the difference between the loans' outstanding principal and their present value is $1,642, which is recognized as the subsidy cost allowance.

The accounting standard for post-1991 direct loans requires that for direct loans disbursed during a fiscal year, a subsidy expense be recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term, applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

In the example, the present value of the loans' cash outflows is the disbursed amount of $10,000. The present value of the loans' estimated net cash inflows is $8,358. The difference between those two amounts is $1,642, which is recognized as subsidy expense.

The accounting standard for post-1991 direct loans requires that for the fiscal year during which new direct loans are disbursed, the components of the subsidy expense of those new direct loans be recognized separately among

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interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury interest rate (6 percent in this example). In this example, the amount of the loans disbursed is $10,000. The present value of the scheduled interest and principal payments is $9,461. The difference between those two amounts is $539, which is recognized as the interest subsidy cost.

The default cost of direct loans results from any anticipated deviation, other than prepayments, by the borrowers from the payment schedules in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. (See footnote 3.) In this example, the present value of the projected payment omissions minus net recoveries is $1,603, which is recognized as the default cost.

The present value of fee collections is $500, which is recognized as a deduction from subsidy costs.

There are no other subsidy costs [Footnote 18] in this example.

[Footnote 18: The term other subsidy costs is explained in the standard for subsidy costs of post-1991 direct loans and loan guarantees.]

The subsidy expense of the loans is the sum of the above cost components, which is $1,642, calculated as follows:

Interest subsidy cost	$ 539
Fee collections	(500)
Loan default cost	1,603
Total subsidy cost	$1,642

The loan disbursements are financed by three sources: subsidy payments, borrowing from Treasury, and fee

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collections. The subsidy cost of $1,642 is provided by appropriated funds; and the present value of loans, equal to $8,358, is provided by fee collections and funds borrowed from Treasury at the Treasury interest rate of 6 percent.

The fees are collected when the loans are disbursed. Because all cash flows, including fee collections, are used to calculate the subsidy cost allowance, the amount of the fee collections is credited to the subsidy cost allowance. The collected amount reduces the amount that has to be borrowed from the Treasury. As a result, the subsidy cost allowance is $2,142, which is the sum of the interest subsidy cost of $539 and the default subsidy cost of $1,603. This is $500 more than the total subsidy cost of $1,642. The debt to Treasury is $7,858, which is $500 less than the present value of the loans of $8,358.

Table 3 displays the asset and liability balances at the end of fiscal year 1994.

TABLE 3: ASSETS AND LIABILITIES AS OF THE END OF FY 1994
(IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$10,000	Debt to Treasury	$7,858
Less:			
Allowance for subsidy costs	(2,142)		
Loans receivable - net	$ 7,858		

B. SUBSIDY REESTIMATION AND AMORTIZATION

(1) SUBSIDY REESTIMATION

The accounting standard for post-1991 direct loans requires that the subsidy cost allowance for direct loans be reestimated each year as of the date of the financial statements. Since the allowance represents the present value of the net cash outflows of the underlying direct loans, the reestimation takes into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost

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allowance resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).

The standard further states that reporting the subsidy cost allowance of direct loans and reestimates by component is not required.

In Appendix A, the Basis of the Board's Conclusions, it is pointed out that the primary factor that causes changes in the subsidy cost allowance would be default reestimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and reestimates.

In this illustration, it is originally estimated that 30 percent of the loan payments would be lost due to defaults for fiscal year 1997 and thereafter. The first reestimate is made early in fiscal year 1995. Because so little time has passed since the subsidy was initially estimated, the estimated cash flows are unchanged and the reestimate is zero. (This illustration assumes that the interest rates at the time of loan obligation and disbursement are the same, so no reestimate is needed for the difference in interest rates.)

The second reestimation is performed early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It reestimates the subsidy cost allowance as of the end of fiscal year 1994. After evaluating all of the risk factors, it is concluded that defaults would occur in fiscal year 1996, instead of 1997, and that 60 percent, instead of 30 percent, of the cash flows would be lost due to the defaults in fiscal year 1996 and thereafter. Table 4 below displays the present values of the reestimated cash flows discounted to the end of fiscal year 1994.

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TABLE 4: SUBSIDY COST REESTIMATION: PROJECTED CASH FLOWS DISCOUNTED TO THE END OF FY 1994 (IN THOUSANDS OF DOLLARS)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1995	$2,246	$ 0	$2,246
1996	2,246	(1,348)	898
1997	2,246	(1,348)	898
1998	2,246	(1,348)	898
1999	2,246	(1,348)	898
PV at 6%	$9,461	$(4,405)	$5,056

The present value of the reestimated net cash inflows discounted to the end of fiscal year 1994 is $5,056, compared to the loans' book value of $7,858, a decrease of $2,802. Thus, the subsidy cost allowance is increased by $2,802, from $2,142 to $4,944. The amount of the increase in the subsidy cost allowance (which is the decrease in the present value of the loans), resulting from the reestimate, is recognized as subsidy expense reestimates .

A subsidy payment of $2,802, equal to the subsidy expense resulting from the reestimate, is received under permanent indefinite authority. The amount is used to repay borrowing from Treasury. Thus, the outstanding balance of the debt to Treasury is reduced by $2,802 to $5,056.

Furthermore, the direct loan program also receives a payment under permanent indefinite authority to cover the interest accrued on the reestimate subsidy payment of $2,802 for the period from the end of fiscal year 1994 to the end of fiscal year 1995. The payment is $168, which equals $2,802 times the applicable Treasury interest rate of 6 percent. This amount is recognized as interest income reestimates, and the money is used to pay the interest on the $2,802 borrowed from Treasury but repaid with the reestimate subsidy.

Table 5 displays the asset and liability balances as of the end of fiscal year 1994, adjusted for the reestimate that was calculated early in fiscal year 1996.

TABLE 5: ASSETS AND LIABILITIES AS OF THE END OF FY 1994:

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AMOUNTS ADJUSTED FOR REESTIMATE CALCULATED IN EARLY FY 1996
(IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$10,000	Debt to Treasury	$5,056
Less:			
Allowance for subsidy costs	(4,944)		
Loans receivable - net	$ 5,056		

(2) SUBSIDY AMORTIZATION

The accounting standard for post-1991 direct loans requires that the subsidy cost allowance for direct loans be amortized by the interest method using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed. The amortized amount is recognized as an increase or decrease in interest income.

The subsidy cost allowance is amortized as a whole, not by components. Under the interest method of amortization, the amortization of each period equals the effective interest of the outstanding direct loans minus the nominal interest. For any period for which interest is to be paid (a fiscal year in this example), the effective interest equals the book value (which is also the present value) of the direct loans at the beginning of the period times the applicable Treasury rate. The nominal interest equals the outstanding nominal balance of the loans at the beginning of the period times the interest rate stated in the loan contracts.

In the example, the book value of the direct loans, as reestimated, is $5,056. The effective interest for fiscal year 1995 is $303, which equals the book value of $5,056 times the applicable Treasury rate of 6 percent. The nominal interest for that year is $400, which equals the nominal principal of the direct loans $(10,000) times the stated rate of 4 percent. The amortized amount is a negative amount of $97 for fiscal year 1995, which equals the effective interest minus the nominal interest. The subsidy cost allowance is increased by $97, from $4,944 to

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$5,041. The amortized amount is recognized as a reduction in interest income. (Interest income for fiscal year 1995 is calculated in section C: Revenues and Expenses.) [Footnote 19]

[Footnote 19: Amortization can alternatively be computed as interest expense other than reestimates $(471) minus the sum of interest income from borrowers $(400), interest income from reestimates $(168), and interest income on fund balance with Treasury $(0). These figures are derived in section C below.]

The same procedure of amortization is applied for each of the subsequent years so long as the direct loans are outstanding. The collection of interest and principal payments must be properly accounted for together with the amortization, so that the asset and liability balances can be updated.

At the end of fiscal year 1995, payments of $2,246 are received from the borrowers as scheduled. Of this amount, $400 is interest payments, and the remaining amount of $1,846 is principal repayments. Thus, the outstanding nominal balance of the loans is reduced by $1,846 to $8,154.

The $2,246 received from the borrowers was paid to Treasury. Although the debt to Treasury outstanding at the end of fiscal year 1994 was $7,858, the amount of $2,802 has been paid off by the subsidy payment for the reestimate. This left $5,056 of debt to Treasury. The interest that accrued on this remaining debt to Treasury is $303; the interest that accrued on the amount of debt paid off by the subsidy reestimate is $168, but it is covered by the interest on the reestimate. Therefore, of the $2,246 collected from the borrowers, $303 is interest paid to Treasury. The remaining $1,943 is principal repayment to Treasury. After the principal repayment, the outstanding debt to Treasury becomes $3,113.

Table 6 below displays the asset and liability balances after the amortization and the collection of interest and principal payments at the end of fiscal year 1995.

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TABLE 6: ASSETS AND LIABILITIES AFTER AMORTIZATION AT THE END OF FY 1995 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$8,154	Debt to Treasury	$3,113
Less:			
Allowance for subsidy costs	(5,041)		
Loans receivable - net	$ 3,113		

C. REVENUES AND EXPENSES

The accounting standard for post-1991 direct loans requires that interest accrued on direct loans, including amortized interest, be recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

In this example, interest income for fiscal year 1995 is $471, which consists of the following items:

Nominal interest	$ 400
Amortized interest	(97)
Interest reestimates	168
Total interest income	$ 471

Interest expense on the debt to Treasury for the fiscal year is also $471, which equals the debt to Treasury of $7,859 at the beginning of the year times 6 percent. It is financed with the following sources:

Collections from borrowers	$303
Interest on reestimated subsidy payments	168
Total interest expense	$471

Costs of administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized separately as administrative expenses. Administrative expenses are not included in calculating the

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subsidy costs of direct loans.

D. MODIFICATION OF POST-1991 DIRECT LOANS

The accounting standard on modifications states that the term modification means a federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans.

Readers should refer to the text of the standard and to Appendix A, Basis of the Board's Conclusions, for a more detailed definition of modifications.

Assume that in October 1995, shortly after the close of fiscal year 1995, Congress passed legislation to aid the borrowers. The legislation forgave some of the outstanding loans, and extended the maturity of the remaining loans for one additional year (to the end of fiscal year 2000). It is estimated that 70 percent of the outstanding amounts, or $5,708, is forgiven.

The legislative action is within the definition of direct modification because it is a federal government action that directly changes the estimated subsidy cost and the present value of outstanding direct loans by altering the terms of existing contracts.

The accounting standard on modifications states that with respect to a direct or indirect modification of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the pre-modification value of the loans over their post-modification value. The amount of the modification cost is recognized as a modification expense when the loans are modified.

The accounting is implemented in the steps described below.

(1) CALCULATE THE PRE-MODIFICATION VALUE

The pre-modification value is the present value of the net cash inflows of the direct loans estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

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As used in this part and Part II of this Appendix, the current discount rate is the interest rate applicable at the time of modification on marketable Treasury securities with a similar maturity to the remaining maturity of the direct loans under pre-modification terms or post-modification terms, whichever is appropriate. [Footnote 20]

[Footnote 20: The definition of the current discount rate is provided in Appendix C, Glossary.]

The cash flows of the loans under pre-modification terms during 1996-99 are assumed to be the same as the cash flows that were reestimated early in fiscal year 1996 for these years and that are shown in Table 4. Those cash flows are used to calculate the loans' pre-modification value. It is assumed that the Treasury rate for a comparable maturity (4 years) and applicable to the time of modification is 4.5 percent. As Table 7 below shows, the present value of the pre-modification cash flows discounted at 4.5 percent is $3,223.

TABLE 7: PRE-MODIFICATION VALUE (IN THOUSANDS OF DOLLARS, CALCULATED AT THE CURRENT DISCOUNT RATE)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1996	$2,246	$(1,348)	$ 898
1997	2,246	(1,348)	898
1998	2,246	(1,348)	898
1999	2,246	(1,348)	898
PV at 4.5%	$8,058	$(4,835)	$3,223

(2) CALCULATE THE POST-MODIFICATION VALUE

The loans' post-modification value is the present value of the loans' net cash inflows estimated at the time of modification under post-modification terms and discounted at the current discount rate (for a 5-year maturity).

The modification forgives 70 percent of the outstanding principal amounts, and requires the remaining 30 percent, or

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$2,446, be paid back in 5 years (instead of 4 years) starting with year 1996. The stated interest rate remains at 4 percent. As shown in Table 8 below, under the modified terms, the required annual principal and interest payment is $549.

TABLE 8: PAYMENT SCHEDULE OF THE MODIFIED LOANS (IN THOUSANDS OF DOLLARS)

	PAYMENT	YEAR-END INTEREST	PRINCIPAL	LOAN BALANCE
FY 1995				$ 2,446
1996	$549	$97	$452	1,994
1997	549	79	470	1,524
1998	549	61	488	1,036
1999	549	41	508	528
2000	549	21	528	0

It is estimated that 20 percent of the scheduled cash inflows of the modified loans would be lost due to defaults. The current discount rate for a maturity of 5 years is 5 percent. As Table 9 shows, the present value of the post-modification cash inflows discounted at 5 percent is $1,902.

TABLE 9: POST-MODIFICATION VALUE (IN THOUSANDS OF DOLLARS, CALCULATED AT THE CURRENT DISCOUNT RATE)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1996	$549	$(110)	$ 439
1997	549	(110)	439
1998	549	(110)	439
1999	549	(110)	439
2000	549	(110)	439
PV at 5%	$2,377	$(475)	$1,902

(3) CALCULATE AND RECOGNIZE THE COST OF MODIFICATION

The cost of modification is the excess of the pre-modification value over the post-modification value.

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Since the pre-modification value is $3,223, and the post-modification value is $1,902, the cost of modification is $1,321, which is recognized as a subsidy expense for modifications.

(4) CALCULATE THE CHANGE IN THE LOANS' BOOK VALUE

The accounting standard on direct loan modifications requires that when post-1991 direct loans are modified, their existing book value be changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the original discount rate (the rate that is originally used to calculated the present value of the direct loans, when the direct loans were disbursed).

In this example, the original discount rate is 6 percent. As Table 10 below shows, the present value of the net cash inflows estimated under the modified terms and discounted at 6 percent is $1,849.

TABLE 10: POST-MODIFICATION BOOK VALUE (IN THOUSANDS OF DOLLARS, CALCULATED AT THE ORIGINAL DISCOUNT RATE)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1996	$549	$(110)	$ 439
1997	549	(110)	439
1998	549	(110)	439
1999	549	(110)	439
2000	549	(110)	439
PV at 6%	$2,312	$(463)	$1,849

At the time the modification action is taken, the existing book value of the loans is $3,113. The book value is changed to $1,849. This represents a decrease in book value by $1,264.

Table 11 displays the effect of the modification on the book amounts. The table shows that, due to the forgiveness, (1) the outstanding balance of the loans receivable is reduced from $8,154 to $2,446, (2) the book value is reduced

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from $3,113 to $1,849, and (3) the subsidy cost allowance, which is the difference between the gross amount and the book value, is changed from $5,041 to $597.

TABLE 11: CHANGE IN THE VALUE OF MODIFIED LOANS (IN THOUSANDS OF DOLLARS)

	GROSS AMOUNT	ALLOWANCE	BOOK VALUE
Before Modification	$8,154	$(5,041)	$3,113
After Modification	$2,446	$(597)	$1,849

(5) CALCULATE THE GAIN OR LOSS AND THE DEBT TO TREASURY

The accounting standard on direct loan modifications states that the change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the modification adjustment transfer [Footnote 21] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 21: OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of modification adjustment transfer equal to the excess; and if the cost of modification exceeds the decrease in book value, the reporting entity pays to Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)]

The change in book value in this case is $1,264, compared to the cost of modification of $1,321. The amount of the modification cost exceeds the change in book value by $57. This excess is recognized as a gain.

The credit program receives a subsidy appropriation

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equal to the cost of modification. Since the cost of modification exceeds the decrease in book value by $57, the credit program pays to the Treasury a modification adjustment transfer of $57 to offset the excess. This is reported as a reduction in financing source.

The $1,321 subsidy appropriation received minus the $57 modification adjustment transfer paid is used to repay debt to Treasury. As a result, the debt to Treasury is reduced by $1,264 from $3,113 to $1,849.

Table 12 displays the asset and liability balances after the modification in October 1995.

TABLE 12: ASSETS AND LIABILITIES AFTER MODIFICATION IN OCTOBER 1995 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$2,446	Debt to Treasury	$1,849
Less:			
Allowance for subsidy costs	(597)		
Loans receivable - net	$ 1,849		

(6) PROVIDE DISCLOSURES

The accounting standard requires that disclosure be made in notes to financial statements to explain the nature of the modification of direct loans, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification.

With respect to the modification described above, a footnote disclosure should be made in the financial statements for fiscal year 1996. The disclosure would explain the following: [Footnote 22]

[Footnote 22: The disclosure will not be illustrated for other modifications explained in this Appendix.]

(a) The direct loans in the cohort of fiscal year 1994 were modified in October 1995. The modification was to forgive 70 percent of the outstanding loans and to extend

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the maturity of the remaining loans to the end of fiscal year 2000.

(b) The modification expense is $1,321, which is the decrease in the present value of the cash flows from that estimated under pre-modification terms to that estimated under post-modification terms, discounted at the current interest rate of marketable Treasury securities of similar maturity. The pre-modification cash flows were discounted at the current discount rate of 4.5 percent, which was applicable to a maturity of 4 years, and the post-modification cash flows were discounted at the current discount rate of 5 percent, which was applicable to a maturity of 5 years.

(c) As a result of the modification, the book value of the loans receivable decreased by $1,264, from $3,113, as reported at the end of fiscal year 1995, to $1,849. The difference between this decrease in book value and the modification expense, which amounts to $57, is recognized as a gain in the operating statement.

E. Write-off of Direct Loans

The accounting standard on write-off of direct loans requires that when post-1991 direct loans are written off, the unpaid principal of the loans be removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

Direct loans in this example that are determined to be uncollectible are written off as of the end of fiscal year 1996. However, before the write-off, accounting is performed for the year-end reestimation, the amortization of the allowance for subsidy costs, and the recording of collections and payments. This takes the following steps:

(1) THE REESTIMATION OF THE SUBSIDY COST ALLOWANCE

In early fiscal year 1997, before the write-off, the credit program makes a year-end reestimation for the subsidy cost allowance. This reestimation is for the balances

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calculated as of the end of fiscal year 1995 adjusted for the modification in October 1995 (Table 12). The result of the reestimation indicates that 20 percent of the outstanding loan payments due after the modification were lost because of defaults for fiscal year 1996, and the expected loss would be 30 percent in fiscal year 1997 and thereafter. The reestimated loss of 30 percent for fiscal year 1997 and the subsequent years is 10 percentage points more than the previous estimate made in October 1995, when the loans were modified. As Table 13 below shows, the net present value of the reestimated net cash inflows, discounted at the original rate of 6 percent to the end of fiscal year 1995, is $1,670.

TABLE 13: SUBSIDY COST REESTIMATION: PROJECTED CASH FLOWS DISCOUNTED TO THE END OF FY 1995 (IN THOUSANDS OF DOLLARS)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1996	$549	$(110)	$ 439
1997	549	(165)	384
1998	549	(165)	384
1999	549	(165)	384
2000	549	(165)	384
PV at 6%	$2,313	$(643)	$1,670

Based on the reestimate, the direct loans' book value is reduced by $179, from $1,849 to the reestimated present value of $1,670. This is accomplished by adjusting the subsidy cost allowance upward by $179, from $597 to $776. The increase of $179 in the subsidy cost allowance is recognized as subsidy expense reestimates.

A subsidy payment of $179 equal to the subsidy cost increase resulting from the reestimate is received under permanent indefinite authority and is used to reduce debt to Treasury. As a result, the debt to Treasury is reduced from $1,849 to $1,670.

Furthermore, the direct loan program also receives a payment under permanent indefinite authority to cover the interest accrued on the increased subsidy expense of $179. The payment is $11, which equals $179 times the applicable Treasury interest rate of 6 percent. This amount is

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recognized as interest income reestimates, and the money is used to pay interest accrued for fiscal year 1996 on the $179 borrowed from Treasury, that is repaid by the subsidy reestimate.

The following table displays the asset and liability balances as of the end of fiscal year 1995, adjusted for the modification in October 1995 and the results of the reestimate that is calculated in early fiscal year 1997.

TABLE 14: ASSETS AND LIABILITIES AS OF THE END OF FY 1995: AMOUNTS ADJUSTED FOR MODIFICATION IN OCTOBER 1995 AND REESTIMATES CALCULATED IN EARLY FY 1997 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$2,446	Debt to Treasury	$1,670
Less:			
Allowance for subsidy costs	(776)		
Loans receivable - net	$ 1,670		

(2) THE AMORTIZATION OF THE SUBSIDY COST ALLOWANCE

The subsidy cost allowance is amortized as of the end of fiscal year 1996. The amortized amount equals the loans' effective interest minus their nominal interest. The loans' effective interest for fiscal year 1996 is $100, which is the loan's book value of $1,670, as reestimated, times the original discount rate of 6 percent. The loans' nominal interest is $98, which is the loans' nominal outstanding balance of $2,446 times the stated interest rate of 4 percent. Thus, the amortized amount is $2, which is the effective interest minus the nominal interest. The amortized amount is recognized as interest income, and the allowance for subsidy costs is reduced by $2, and becomes $774.

(3) COLLECTIONS AND PAYMENTS

Of the scheduled annual payment of $549 for fiscal year 1996, payments of $439 are received from the borrowers, which equal 80 percent of the scheduled payments. Of the

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amount received, $78 is interest payment (which equals 80 percent of the loans' balance of $2,446 times the stated interest rate of 4 percent), and the remaining $361 is principal repayment. The outstanding nominal principal of the loans is reduced by $361 to $2,085. There is unpaid accrued interest of $20 (which equals 20 percent of the loans' nominal balance as of the end of fiscal year 1995 times the stated interest rate of 4 percent). At this point of time, the loans' book value is $1,331, which equals the outstanding principal of $2,085, plus interest receivable of $20, minus the subsidy cost allowance of $774.

The debt to Treasury was $1,849 after the modification in October 1995. Of that amount, $179 has been paid off with the subsidy payment received as a result of the reestimate, which reduces the debt to $1,670; and the $11 of accrued interest on the $179 has been paid off with the interest on the reestimate. The interest accrued on the remaining debt is $100, which equals the debt balance of $1,670 times the Treasury interest rate of 6 percent. Of the $439 in payments received from the borrowers, $100 is used to pay interest due Treasury, and the remaining $339 is used to reduce debt to Treasury. As a result, the balance of debt to Treasury becomes $1,331.

Table 15 displays the asset and liability balances after the amortization and the recording of collections and payments at the end of fiscal year 1996.

TABLE 15: ASSETS AND LIABILITIES AFTER AMORTIZATION AT THE END OF FY 1996 (IN THOUSANDS OF DOLLARS

ASSETS		LIABILITIES	
Loans receivable	$2,085	Debt to Treasury	$1,331
Interest receivable	20		
Less:			
Allowance for subsidy costs	(774)		
Loans and interest receivable - net	$1,331		

(4) WRITE-OFF OF UNCOLLECTIBLE DIRECT LOANS

It is confirmed that non-performing loans with an

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outstanding balance of $489 (20 percent of the direct loan balance after modification in October 1995) are in default and will not be collected. The credit program is authorized to write off those loans, and the unpaid accrued interest of $20. The total amount of the write-off is $509. Thus, the principal is reduced by $489 to $1,596, and the interest receivable of $20 is written off. The subsidy cost allowance is reduced by $509, from $774 to $265.

The loans' book value is not changed by the write-off; it remains $1,331, which equals the remaining principal of $1,596, minus the subsidy allowance of $265. Table 16 below shows the asset and liability balances after the write-off.

TABLE 16: ASSETS AND LIABILITIES AFTER THE WRITE-OFF AS OF THE END OF FY 1996 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Loans receivable	$1,596	Debt to Treasury	$1,331
Less:			
Allowance for subsidy costs	(265		
Loans receivable - net	$ 1,331		

The book value of $1,331, as indicated in the above table, equals the present value of estimated net cash inflows of the remaining outstanding loans. The estimated cash flows and the present value calculations are shown in Table 17.

In Table 17 the amounts in column (a) are the scheduled annual principal and interest payments. Since the principal of the outstanding loans is $1,596 and the remaining life of the loans is 4 years, the required annual payment is $439. The amounts in column (b) equal the default amounts reestimated at the end of fiscal year 1996 minus the scheduled payments of the loans that have been written off (recoveries on those loans are assumed to be zero). The amounts in column (c) are the projected net cash inflows of the outstanding loans.

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TABLE 17: PROJECTED CASH FLOWS AFTER LOAN WRITE-OFF: DISCOUNTED TO THE END OF FY 1996 (IN THOUSANDS OF DOLLARS)

	P & I Payments (a)	Default Losses (b)	Net Cash Flows (c)
FY 1997	$439	$(55)	$384
1998	439	(55)	384
1999	439	(55)	384
2000	439	(55)	384
PV at 6%	$1,521	$(190)	$1,331

It should be noted that to calculate the amortization correctly in subsequent periods, the unpaid principal and interest should be written out of the nominal principal balance. The amortization would be distorted if the unpaid amounts were kept in the nominal principal balance and continued to accrue interest. However, direct loan programs may need to keep the non-paying loans in their accounting records until collection efforts are exhausted and the loans are authorized to be written off. The non-paying loans and interest accrued on them should be accounted for separately, so that the amortization of the subsidy cost allowance of the performing loans can be calculated correctly. Readers should consult Treasury, OMB, or GAO, for guidance on accounting for non-paying loans.

F. SALE OF DIRECT LOANS

The accounting standard on sale of loans states that the sale of post-1991 and pre-1992 direct loans is a direct modification. [Footnote 23]

[Footnote 23: This assumes that the sales proceeds were not included in the cash flow estimates for the initial subsidy calculation.]

It is assumed that after the close of fiscal year 1996, the credit program is authorized to sell the loans. In October 1996, all of the loans are sold with recourse. The net proceeds from the sale amount to $1,100. Accounting for the sales takes the steps explained in the paragraphs that follow.

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(1) RECOGNIZE THE COST OF MODIFICATION

The accounting standard on sale of loans requires that the cost of modification be determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.

The pre-modification value of the loans sold is the present value of the loans' net cash inflows estimated under pre-modification terms and discounted at the current discount rate.

The net cash inflows of the direct loans estimated prior to the sale are assumed to be the same as those estimated after the loan write-off at the end of fiscal year 1996 (shown in Table 17). It is assumed that the current discount rate for a similar maturity (4 years) is 5 percent. To calculate the pre-modification value, the net cash flows are now discounted at the current discount rate of 5 percent. As Table 18 shows, the pre-modification value of the loans sold is $1,362.

TABLE 18: PRE-MODIFICATION VALUE OF THE LOANS SOLD, AS OF OCTOBER 1996 (IN THOUSANDS OF DOLLARS, CALCULATED AT THE CURRENT DISCOUNT RATE)

	P&I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1997	$ 439	$ (55)	$ 384
1998	439	(55)	384
1999	439	(55)	384
2000	439	(55)	384
PV at 5%	$1,557	$(195)	$1,362

The pre-modification value of the loans sold exceeds the net proceeds of $1,100 from the sale by $262, which is recognized as a modification expense. The credit program receives an appropriation equal to that amount to cover the modification cost. (The credit program must have an appropriation equal to the modification cost before it can sell the loans.)

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(2) RECOGNIZE BOOK VALUE GAIN OR LOSS

The accounting standard on sale of direct loans states that the book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss. [Footnote 24] For sales of post-1991 direct loans, the modification adjustment transfer paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 24: If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.]

The existing book value of the loans sold is $1,331. Upon the sale, this amount is removed from the books. At the same time, the net proceeds of $1,100 from the sale are recorded. The book value loss is $231. The accounting standard requires that any difference between the book value loss and the cost of modification be recognized as a gain or loss. In this case, the cost of modification is $262 and the book value loss is $231. The difference of $31 is recognized as a gain. Under the OMB instructions, this amount will be paid to Treasury as a modification adjustment transfer, and is recorded as a reduction in financing sources.

(3) RECOGNIZE THE SUBSIDY EXPENSE ON RECOURSE

The accounting standard on sale of loans requires that for a loan sale with recourse, potential losses under the recourse or guarantee obligations be estimated, and that the present value of the estimated losses from the recourse be recognized as subsidy expense when the sale is made and as a loan guarantee liability.

It is estimated that 10 percent of the loans sold with a principal of $160 would default at the end of fiscal year 1997. Upon their default, the federal credit program will

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pay the loan purchaser an amount equal to the defaulted principal plus accrued interest. The estimated future default payment is $166, which equals the principal of the loans that are expected to default plus the 4 percent nominal interest of $6 accrued on those loans for one year.

At the time the loans are sold, the interest rate of Treasury securities of a similar maturity is 5 percent. The present value of the estimated default payment discounted at 5 percent is $158. This amount is recognized as a subsidy expense and a loan guarantee liability. The credit program receives an appropriation of $158 to cover the guarantee expense, which is paid to the loan guarantee financing account and becomes part of the fund balance of that account. (An appropriation must be available to cover the subsidy expense before the loans can be sold, since the payment to the loan guarantee financing account must be made in order for the guarantee to take effect.)

At this point, the credit program has $1,489 in cash, which was derived from the following events:

Net proceeds from the loan sale	$1,100
Appropriation to cover the modification cost	262
Appropriation to cover estimated recourse liability	158
Less: modification adjustment transfer	(31)
Total in fund balance	$1,489

The credit program uses $1,331 to pay off the debt to Treasury, which was borrowed to finance the direct loans. The remaining balance of $158 has been paid to the loan guarantee financing account (as stated above). That amount, together with interest for one year at 5 percent, is to cover the recourse liability of the loan guarantee financing account.

PART II PRE-1992 DIRECT LOANS

Pre-1992 direct loans are direct loans obligated prior to October 1, 1991, and are recorded in liquidating accounts. The accounting standard requires that the losses of pre-1992 direct loans be recognized when it is more likely than not that the direct loans will not be totally

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collected. The allowance of the uncollectible amounts should be reestimated each year as of the date of the financial statements. In estimating losses, the risk factors discussed in the standard for post-1991 direct loans should be considered.

The standard further states that restatement of pre-1992 direct loans on a present value basis is permitted but not required.

All of the amounts used in the text that follows are in thousands of dollars.

A. PROVISION FOR UNCOLLECTIBLE AMOUNTS

Assume that at the end of fiscal year 1994 a credit program has pre-1992 direct loans with outstanding principal of $5,000 at 7 percent interest rate, maturing in three years (at the end of fiscal year 1997). The program management evaluates the risk factors enumerated in the accounting standard, and estimates that the net loss of principal due to defaults would be $2,000. Thus, the program management provides an allowance of $2,000 for uncollectible amounts, and charges that amount to bad debt expense. [Footnote 25] Thus, the book value of the loans is $3,000, as shown below:

[Footnote 25: This assumes that no allowance for uncollectible amounts was provided prior to fiscal year 1994. If there is an allowance for uncollectible amounts, that allowance should be adjusted to the current estimate and the difference between the current estimate and the existing allowance should be charged to bad debt expense.]

Loans receivable	$5,000
Less uncollectible amounts	(2,000)
Loan receivable, net	$3,000

B. MODIFICATION OF PRE-1992 DIRECT LOANS

Assume that in October 1994, shortly after the close of fiscal year 1994, a decision is made to take the following actions: (1) forgive 50 percent of the amounts due, (2) lower the interest rate to 4 percent, and (3) extend the due date to the end of fiscal year 2000.

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These actions are within the definition of direct modification because they are federal government actions that would directly change estimated subsidy costs and the present value of outstanding direct loans by altering the terms of existing contracts.

The accounting standard on direct loan modifications states that with respect to a direct or indirect modification of pre-1992 direct loans, the cost of modification is the excess of the pre-modification value of the loans over their post-modification value. The amount of the modification cost is recognized as a modification expense when the loans are modified.

Accounting for the cost of modification takes the following steps:

(1) CALCULATE THE PRE-MODIFICATION VALUE

The pre-modification value is the present value of the net cash inflows of the direct loans estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

It is estimated that under the pre-modification terms, 40 percent of the cash flows would be lost due to defaults in fiscal year 1995 and each year thereafter. The current discount rate for a maturity of 3 years is 4 percent. As Table 19 below shows, the present value of the estimated net cash inflows discounted at 4 percent is $3,172. This is the pre-modification value of the loans.

TABLE 19: PRE-MODIFICATION VALUE (IN THOUSANDS OF DOLLARS, CALCULATED AT THE CURRENT DISCOUNT RATE)

	P & I PAYMENTS	DEFAUL LOSSES	NET CASH FLOWS
FY 1995	$1,905	$(762)	$1,143
1996	1,905	(762)	1,143
1997	1,905	(762)	1,143
PV at 4%	$5,287	$(2,115)	$3,172

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(2) CALCULATE THE POST-MODIFICATION VALUE

The loans' post-modification value is the present value of the loans' net cash inflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification reduces the outstanding principal by 50 percent to $2,500, lowers the nominal interest rate to 4 percent, and extends the maturity by 3 years to the end of fiscal year 2000. As shown in Table 20 below, under the post-modification terms, the required payments will be $477 per year for six years.

TABLE 20: PAYMENT SCHEDULE OF THE MODIFIED LOANS (IN THOUSANDS OF DOLLARS)

	PAYMENT	INTEREST	PRINCIPAL	YEAR-END LOAN BALANCE
FY 1994				$2,500
1995	$477	$100	$377	2,123
1996	477	85	392	1,731
1997	477	69	408	1,323
1998	477	53	424	899
1999	477	36	441	458
2000	477	19	458	0

Taking into consideration that the loans owed by borrowers with poor conditions have been forgiven, it is estimated that only 10 percent of the cash flows would be lost due to defaults. The current discount rate for a maturity of 6 years is 5 percent. As shown in Table 21, the present value of the estimated net cash inflows discounted at 5 percent is $2,179. This is the loans' post-modification value.

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TABLE 21: POST-MODIFICATION VALUE (IN THOUSANDS OF DOLLARS, CALCULATED AT THE CURRENT DISCOUNT RATE)

	P & I PAYMENTS	DEFAULT LOSSES	NET CASH FLOWS
FY 1995	$477	$(48)	$ 429
1996	477	(48)	429
1997	477	(48)	429
1998	477	(48)	429
1999	477	(48)	429
2000	477	(48)	429
PV at 5%	$2,421	$(242)	$2,179

(3) CALCULATE AND RECOGNIZE THE COST OF MODIFICATION

The cost of modification is the excess of the loans' pre-modification value over the loans' post-modification value. Since the loans' pre-modification value is $3,172, and their post-modification value is $2,179, the cost of modification is $993, which is recognized as a subsidy expense for modifications.

The credit program receives an appropriation of $993 to cover the modification expense, which is paid to the financing account. The financing account, in turn, pays this amount to the liquidating account as part of its payment to acquire the loans. (A subsidy appropriation equal to the cost of modification must be available before the modification can take place.)

(4) CALCULATE THE CHANGE IN BOOK VALUE AND THE GAIN OR LOSS

With respect to modifications of pre-1992 direct loans, the standard requires that when pre-1992 direct loans are directly modified, they be transferred to a financing account and their book value be changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans.[Footnote 26]

[Footnote 26: The accounting standard provides that when pre-1992 direct loans are indirectly modified, they are kept in a liquidating account; and that their bad debt allowance is reassessed and adjusted to

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reflect amounts that would not be collected due to the modification. Indirect modifications of pre-1992 direct loans are not illustrated.]

The change in book value of pre-1992 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the cost of modification and the change in the loans' book value due to modification is recognized as a gain or loss.

Prior to the modification, the book value of the loans was recorded in the liquidating account at $3,000. Upon modification, the loans are transferred from the liquidating account to the financing account and recorded at their post-modification value of $2,179. The change in book value is a decrease of $821. Since the cost of modification is $993, and the change in book value is $821, the difference of $172 is recognized as a gain.

The financing account pays the liquidating account an amount equal to the loans' pre-modification value of $3,172. This comes from two sources. First, the financing account receives the $993 that is appropriated for the cost of modification. Second, the financing account borrows from Treasury the remainder, which is $2,179, the post-modification value of the loans. In exchange, the liquidating account transfers to the financing account the loan assets that had a book value of $3,000 before the modification was made. The gain to the liquidating account is $172, which, as shown above, equals the difference between the cost of modification and the change in book value of the loans.

Post-1991 loan guarantees are loan guarantees committed after September 30, 1991. The accounting standards for post-1991 loan guarantees are explained and illustrated through the use of an example described below:

A cohort of 5-year term loans that amounts to $10 million in face value is guaranteed by a federal loan guarantee program. The guarantee covers 60 percent of the principal and interest payments. The borrowers are required to pay interest annually at 7 percent, and to repay the principal when the loans mature at the end of the 5th year.

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The government agrees to pay a 1 percent interest supplement to the lenders at the end of each year over the loans' life. The loans are disbursed on September 30, 1994. The federal loan guarantee program collects a fee of 5 percent, when the loans are disbursed. The average interest rate of marketable Treasury securities of a similar maturity for the period in which the guaranteed loans are disbursed is 6 percent.

All of the amounts used in the text that follows are in thousands of dollars.

A. REPORTING THE LIABILITY OF POST-1991 LOAN GUARANTEES AND THEIR SUBSIDY COSTS

The accounting standard for post-1991 loan guarantees requires that for guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees be recognized as a liability. Disclosure is made of the face value of the guaranteed loans outstanding and the amount of the outstanding balance that is guaranteed.

To implement the standard in the example, cash flow estimates and present value calculations are prepared. It is projected that the borrowers would pay interest when due, but would default on 60 percent, or $6,000, of the principal repayments. Upon default, the federal credit program will pay 60 percent of the defaulted principal, equal to $3,600, to the lenders. It is projected that a net recovery of $2,000 will be realized a year later through the foreclosure and sale of pledged assets. The fees of $500 are received when the guaranteed loans are disbursed.

Table 22 below shows the estimated cash flows and the present values of the cash flows.

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TABLE 22: PROJECTED CASH FLOWS DISCOUNTED TO THE TIME OF DISBURSEMENT (IN THOUSANDS OF DOLLARS)

	FEE RECEIPTS	INTEREST SUPPLE-MENTS	DEFAULT PAYMENTS	NET RECOV-ERIES	NET CASH FLOWS
FY1994	$(500)				$(500)
1995		$100			100
1996		100			100
1997		100			100
1998		100			100
1999		100	$3,600		3,700
2000				$(2,000)	(2,000)
PV at 6%	$(500)	$421	$2,690	$(1,410)	$1,201

The present value of the estimated net cash outflows of the loan guarantees is $1,201. This amount is recognized as a liability.

Disclosure is made in a footnote to the financial statements for fiscal year 1994 that guaranteed loans have an outstanding principal of $10,000, and the guaranteed amount is $6,000. (A similar disclosure is made in each year so long as the guaranteed loans are outstanding.)

The accounting standard for post-1991 loan guarantees requires that for guaranteed loans disbursed during a fiscal year, a subsidy expense be recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the guaranteed loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term, applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

In the example, the present value of the cash outflows minus the present value of the cash inflows is $1,201, which is recognized as a subsidy expense.

The accounting standard for post-1991 loan guarantees requires that for the fiscal year during which new guaranteed loans are disbursed, the components of the

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subsidy expense of those new loan guarantees be recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

The interest subsidy cost of the loan guarantees is the present value of the interest supplement payments to the lenders, which, in this example, is $421.

The default cost is the present value of the projected default payments minus the present value of net recoveries. The present value of the default payments is $2,690, and the present value of the net recoveries is $1,410. Thus, the default cost is $1,280.

The present value of fee collections, which is $500, is recognized as a deduction from subsidy costs.

There are no other subsidy costs in this example.

The subsidy expense of the loan guarantees is the sum of the above cost components, which is $1,201, calculated as follows:

Interest subsidy cost	$ 421
Fee collections	(500)
Loan default cost	1,280
Total subsidy cost	$1,201

The loan guarantee program receives an appropriation equal to the subsidy cost of $1,201. When the guaranteed loans are disbursed, the appropriated amount is paid to the loan guarantee financing account and is recorded in fund balance with Treasury. The $500 of fees are collected at the same time. The amount of the fees is debited to fund balance with Treasury and credited to the liability of the loan guarantees. Thus, the fund balance is raised to $1,701, on which Treasury pays 6 percent interest. The loan guarantee liability is also raised from $1,201 to $1,701.

Table 23 shows the projected cash flows and their present values after the receipt of fees.

TABLE 23: PROJECTED CASH FLOWS DISCOUNTED TO THE END OF FY 1994, AFTER THE RECEIPT OF FEES
(IN THOUSANDS OF DOLLARS)

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	INTEREST SUPPLEMENTS	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH FLOWS
FY 1994				
1995	$100			$ 100
1996	100			100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(2,000)	(2,000)
PV at 6%	$421	$2,69	$(1,410)	$1,701

Table 24 displays the asset and liability balances at the end of the 1994 fiscal year.

TABLE 24: ASSETS AND LIABILITIES AT THE END OF FY 1994 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Fund balance with Treasury	$1,701	Loan guarantee liability	$1,701

B. LIABILITY REESTIMATION AND INTEREST COMPOUNDING

(1) THE REESTIMATION OF THE LIABILITY OF LOAN GUARANTEES

The accounting standard for post-1991 loan guarantees requires that the liability for loan guarantees be reestimated each year as of the date of the financial statements. Since the liability represents the present value of the net cash outflows of the underlying loan guarantees, the reestimation takes into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the loan guarantee liability resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the liability of loan guarantees and reestimates by component is not required.

In Appendix A, the Basis of the Board's Conclusions, it is pointed out that the primary factor that causes changes

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in the subsidies would be default reestimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and reestimates.

In the example, it is initially estimated that 60 percent of the loans will default on the principal repayments when the loans mature at the end of fiscal year 1999, and that $2,000 will be recovered from the sale of foreclosed assets. The first reestimate is made early in fiscal year 1995. Because so little time has passed since the subsidy was initially estimated, the estimated cash flows are unchanged and the reestimate is zero. (This illustration assumes that the interest rates at the time of commitment and disbursement are the same, so no reestimate is needed for the difference in interest rates.)

The second reestimation of the subsidy cost is made early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It reestimates the loan guarantee liability as of the end of fiscal year 1994. It indicates that the initial default estimate is correct. However, it also indicates that the net recovery realized at the end of fiscal year 2000 would be $1,000, rather than $2,000. As shown in Table 25, because of the decrease in the amount of recovery, the present value of the net cash outflows discounted to the end of fiscal year 1994, is $2,406, rather than $1,701, as previously estimated for the end of fiscal year 1994 and shown in Table 23.

TABLE 25: SUBSIDY COST REESTIMATION: PROJECTED CASH FLOWS DISCOUNTED TO THE END OF FY 1994 (IN THOUSANDS OF DOLLARS)

	INTEREST SUPPLEMENTS	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH FLOWS
FY 1995	$100			$ 100
1996	100			100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(1,000)	(1,000)
PV at 6	$421	$2,690	$(705)	$2,406

The reestimated liability is $2,406, compared to the existing liability of $1,701, an increase of $705. The

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increase of $705 is added to the loan guarantee liability and is recognized as a subsidy expense reestimates.

The credit program receives a subsidy payment under permanent indefinite authority equal to $705 to cover the cost increase resulting from the reestimate. In addition, a payment of $42 is also received under permanent indefinite authority to cover the interest accrued on the $705 reestimate payment for the period from the end of fiscal year 1994 to the end of fiscal year 1995, and is reported as interest income. The total amount of $747 received is added to the fund balance.

(2) INTEREST COMPOUNDING

The accounting standard for post-1991 loan guarantees requires that interest be accrued and compounded on the liability of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed. The accrued interest is recognized as interest expense.

With the passage of time, the present value of the liability of the loan guarantees increases at a rate equal to the rate of interest used to discount the liability. The increase for fiscal year 1995 is $144, which equals the balance of the liability of $2,406, as reestimated, multiplied by the interest rate of 6 percent. The amount of the increase in the present value of the liability is added to the liability balance, and concurrently it is recognized as interest expense. As a result, the liability becomes $2,550.

Interest is also accrued on the credit program's fund balance of $1,701 at 6 percent. The amount of interest accrued is $102, which is added to the fund balance, and is recognized as interest income. As mentioned previously, the payments of $747 to cover the reestimated subsidy cost and the accrued interest are also added to the fund balance.

The interest supplement of $100 is paid for fiscal year 1995. Both the fund balance and the liability are reduced by $100.

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As a result of the above transactions, the fund balance becomes $2,450, calculated as follows:

Fund balance at the end of FY 1994	$1,701
Interest on the fund balance	102
Subsidy payment reestimates	705
Interest on subsidy payment reestimates	42
Interest supplement paid	(100)
Fund balance at the end of FY 1995	$2,450

The loan guarantee liability is also $2,450 at the end of fiscal year 1995, calculated as follows:

Liability balance at the end of FY 1994, as reestimated	$2,406
Increase due to passage of time	144
Interest supplement paid	(100)
Liability balance at the end of FY 1995	$2,450

Table 26 displays the asset and liability balances at the end of the 1995 fiscal year.

TABLE 26: ASSETS AND LIABILITIES AFTER INTEREST ACCUMULATIONS AT THE END OF FY 1995 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Fund balance with Treasury	$2,450	Loan guarantee liability	$2,450

C. REVENUES AND EXPENSES

The accounting standard for post-1991 loan guarantees requires that interest accrued on the liability of loan guarantees be recognized as interest expense, and that interest due from Treasury on uninvested funds be recognized as interest income. Interest accrued on debt to Treasury, if any, is recognized as interest expense.

In the example, interest accrued on the liability of loan guarantees is $144, which equals the reestimated liability of $2,406 times 6 percent. The amount is recognized as interest expense, and the same amount is added

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to the liability, as explained above.

Interest income recognized for fiscal year 1995 is also $144, consisting of (a) interest income of $102 on the fund balance, which equals the fund balance of $1,701 times 6 percent, and (b) interest income of $42 on the subsidy payment reestimates.

Costs of administering loan guarantee activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized separately as administrative expenses. Administrative expenses are not included in calculating the subsidy costs of loan guarantees.

D. MODIFICATION OF POST-1991 LOAN GUARANTEES

Assume that in October 1995, shortly after the close of fiscal year 1995, the loan guarantee program takes action to expand its guarantee from 60 percent of the outstanding loan principal to 80 percent. This action is within the definition of direct modification because it is a government action that directly changes the estimated subsidy cost and the present value of the loan guarantee liability by altering the terms of the loan guarantee agreement.

The accounting standard on modifications of loan guarantees states that with respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification liability of the loan guarantees over their pre-modification liability. The modification cost is recognized as modification expense when the loan guarantees are modified.

The accounting is implemented in the steps described below.

(1) CALCULATE THE PRE-MODIFICATION LIABILITY

The pre-modification liability is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the current discount rate.

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As used in this part and Part IV of this Appendix, the current discount rate is the interest rate applicable at the time of modification on marketable Treasury securities with a similar maturity to the remaining maturity of the guaranteed loans under pre-modification terms or post-modification terms, whichever is appropriate. [Footnote 27]

[Footnote 27: The definition of the current discount rate is provided in Appendix C, Glossary.]

The cash flows for the loan guarantees under pre-modification terms during 1996-2000 are assumed to be the same as the cash flows that were reestimated early in fiscal year 1996 for these years and that are shown in Table 25. Assume that the current discount rate for a comparable maturity (4 remaining years) is 4 percent. As Table 27 shows, the present value of the pre-modification net cash outflows discounted at 4 percent is $2,618.

TABLE 27: PRE-MODIFICATION LIABILITY (IN THOUSANDS OF DOLLARS; CALCULATED AT THE CURRENT DISCOUNT RATE)

	INTEREST SUPPLEMENTS	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH FLOWS
FY 1996	$100			$ 100
1997	100			100
1998	100			100
1999	100	$3,600		3,700
2000			$(1,000)	(1,000)
PV at 4%	$363	$3,077	$(822)	$2,618

(2) CALCULATE POST-MODIFICATION LIABILITY

The loan guarantees' post-modification liability is the present value of the loan guarantees' net cash outflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification increases the guarantee percentage from 60 percent to 80 percent. It is estimated that 60 percent or $6,000 in principal repayments will default.

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This estimate is not affected by the modification. However, with the expansion of the guarantee percentage, the credit program will pay 80 percent of the defaulted amounts, equal to $4,800, to the lenders. The net cash outflows estimated under the post-modification terms are discounted at the current rate of 4 percent. As shown in Table 28 below, the present value of the estimated net cash outflows is $3,644. This is the post-modification liability of the loan guarantees.

TABLE 28: POST-MODIFICATION LIABILITY (IN THOUSANDS OF DOLLARS; CALCULATED AT THE CURRENT DISCOUNT RATE)

	INTEREST SUPPLEMENTS	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH FLOWS
FY 1996	$100			$ 100
1997	100			100
1998	100			100
1999	100	$4,800		4,900
2000			$(1,000)	(1,000)
PV at 4%	$363	$4,103	$(822)	$3,644

(3) CALCULATE AND RECOGNIZE THE COST OF MODIFICATION

The cost of modification is the excess of the loan guarantee's post-modification liability over their pre-modification liability. Since the loan guarantees' post-modification liability is $3,644, and their pre-modification liability is $2,618, the cost of modification is $1,026, which is recognized as a subsidy expense for modifications.

(4) CALCULATE THE CHANGE IN THE BOOK VALUE OF THE LIABILITY

The accounting standard on loan guarantee modifications requires that the existing book value of the liability of modified post-1991 loan guarantees be changed to an amount equal to the present value of the net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (the rate that is originally used to calculate the present value of the liability, when the

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guaranteed loans were disbursed).

In this example, the original discount rate is 6 percent. The present value of the loan guarantees' net cash outflows estimated under the modified terms and discounted at 6 percent is $3,401. (See Table 29.)

TABLE 29: POST-MODIFICATION BOOK VALUE LIABILITY (IN THOUSANDS OF DOLLARS; CALCULATED AT THE ORIGINAL DISCOUNT RATE)

	INTEREST SUPPLEMENTS	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH FLOWS
FY 1996	$100			$ 100
1997	100			100
1998	100			100
1999	100	$4,800		4,900
2000			$(1,000)	(1,000)
PV at 6	$346	$3,802	$(747)	$3,40

At the time the modification action was taken, the existing book value of the loan guarantee liability was $2,450 (See Table 26). The book value is changed to $3,401. This is an increase of $951 in the book value of the loan guarantee liability.

(5) RECOGNIZE A GAIN OR LOSS

The accounting standard on loan guarantee modifications states that the change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer [Footnote 28] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[Footnote 28: OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of modification adjustment transfer equal to the excess; and

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if the cost of modification exceeds the increase in liability, the reporting entity pays to Treasury an amount of modification adjustment transfer to offset the excess. (See OMB Circular A-11.)]

The change in book value in this case is $951, compared to the cost of modification of $1,026. The difference between those two amounts is $75, which is recognized as a gain.

The credit program receives a subsidy appropriation equal to the cost of modification. Since the cost of modification exceeds the increase in book value by $75, the credit program pays to Treasury a modification adjustment transfer of $75 to offset the gain. This is reported as a reduction in financing source. The net effect of the modification is to increase the fund balance of the credit program by $951 to $3,401.

Table 30 displays the asset and liability balances after the modification in October 1995.

TABLE 30: ASSETS AND LIABILITIES AFTER THE MODIFICATION IN OCTOBER 1995 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Fund balance with Treasury	$3,401	Loan guarantee liability	$3,401

E. DEFAULT AND FORECLOSURE

Assume that for fiscal year 1996 and thereafter, annual reestimations do not result in any changes in cash flow estimates. [Footnote 29] After accumulating interest at 6 percent and paying the $100 interest supplement annually, the credit program has $3,856 in its fund balance with Treasury at the end of fiscal year 1999, prior to paying any default claims. Table 31 shows annual changes in the fund balance.

[Footnote 29: This assumption is made only to avoid repetitious illustrations.]

TABLE 31: FUND BALANCE (IN THOUSANDS OF DOLLARS)

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AT THE END OF	INTEREST ACCRUED	INTEREST SUPPLEMENT PAID	FUND BALANCE
FY 1995			$3,401
1996	$204	$(100)	3,505
1997	210	(100)	3,615
1998	217	(100)	3,732
1999	22	(100)	3,856

At the same time, the program's loan guarantee liability at the end of fiscal year 1999 is also $3,856, which equals the estimated default claim payment of $4,800 minus $943, the present value of the estimated net recovery from foreclosing assets. It has been estimated that the net recovery would be $1,000 and would be realized at the end of fiscal year 2000. The present value of the net recovery discounted to the end of fiscal year 1999 at the original discount rate of 6 percent is $943.

As expected, when the guaranteed loans mature at the end of 1999, $6,000 of the principal is in default. To meet its guarantee obligation, the loan guarantee program must pay 80 percent of the default amount, or $4,800, to the lenders. When the defaults occur, the loan guarantee program in this example has the options to foreclose property pledged by the borrowers who defaulted, and/or to acquire the loans involved, as a compensation for the default payment.

The accounting standard on foreclosure requires that when property is transferred from borrowers to a federal credit program, through foreclosure or other means, as a compensation for losses that the government sustained under post-1991 loan guarantees,[Footnote 30] the foreclosed property be recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

[Footnote 30: The accounting standard is the same for property transferred in partial or full settlement of post-1991 direct loans, and the application of the standard to direct loans is illustrated by the present example of loan guarantees.]

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The accounting standard states that at a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted at the original discount rate.

In this example, the default occurs at the loans' maturity and virtually no cash inflows can be realized either from selling the loans or collecting payments from the borrowers. The loan guarantee program therefore forecloses the assets. It continues to estimate that the net cash inflow from possessing and selling the foreclosed property will be $1,000 and will be received at the end of fiscal year 2000. The present value of the estimated net cash inflow discounted at the original rate of 6 percent to the end of fiscal year 1999 is $943.

The accounting standard requires that if a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the present value of the estimated claim be recognized as a special contra valuation allowance.

In this example, no such claim is assumed. Thus, the present value of the foreclosed property is recorded as an asset at $943. Concurrently, the amount of $943 is credited to the loan guarantee liability, so that the loan guarantee liability is increased from $3,856 to $4,800.

The default payment of $4,800 is more than the fund balance of $3,856, and the loan guarantee program does not receive cash from selling the foreclosed assets until one year later. The loan guarantee program borrows the difference of $943 from Treasury. [Footnote 31] Thus, the fund balance is increased by $943 to $4,800, allowing the default payment to be made.

[Footnote 31: Borrowing from Treasury is necessary in this example because all default payments occur at the same time. If they occurred in different years, the default payments in most cases might be covered by the fund balance and the proceeds from selling foreclosed assets. Borrowing would only be needed for defaults near the maturity date of the guaranteed loans.]

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When the default payment is made, both the fund balance and the loan guarantee liability are reduced to zero. The credit program takes collection action against the borrowers. However, further recovery is not anticipated. At this time, the loan guarantee program has the following asset and liability balances as shown in Table 32.

TABLE 32: ASSETS AND LIABILITIES AT THE END OF FY 1999 (IN THOUSANDS OF DOLLARS)

ASSETS		LIABILITIES	
Foreclosed property	$943	Debt to Treasury	$943

F. DISPOSITION OF THE FORECLOSED PROPERTY

The foreclosed property is initially recorded at the present value of the estimated net cash inflows. Until the property is sold, the present value of the property must be updated to recognize changes in value due to the passage of time. The recognition is made through an accrual of interest at the original discount rate. The amount of interest accrued for fiscal year 2000 is $57, which equals the book value of the foreclosed property at the beginning of the fiscal year, which is $943, times the original discount rate of 6 percent. This amount of interest is recognized as interest income, and is added to the book value of the foreclosed property. As a result, the book value of the foreclosed property becomes $1,000 at the end of fiscal year 2000.

Interest is also accrued on the debt to Treasury of $943 at the rate of 6 percent. The amount of interest for fiscal year 2000 is $57, and is recognized as interest expense. The amount is added to the debt to Treasury. As a result the debt to Treasury becomes $1,000 at the end of fiscal year 2000.

It is assumed that the property is sold at the end of fiscal year 2000 and the amount of net proceeds from the sale is $1,000. The amount of the net proceeds is used to pay off the debt to Treasury. As a result, the asset and liability balances for this cohort of loan guarantees are reduced to zero.

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A reestimation should be performed for the net cash flow of the property after the end of fiscal year 2000. If the reestimation resulted in a reduction of the present value of the property, the amount of the reduction would be recognized as subsidy expense reestimates. As illustrated in preceding sections on reestimates, a payment from permanent indefinite authority would be available to cover the subsidy reestimate expense. In this case, because the property was sold at the estimated time for the estimated amount, there is no reestimate subsidy expense.

PART IV PRE-1992 LOAN GUARANTEES

Pre-1992 loan guarantees are loan guarantees committed prior to October 1, 1991, and the liabilities under pre-1992 loan guarantees are recorded in liquidating accounts. The accounting standard requires that the liabilities of pre-1992 loan guarantees be recognized when it is more likely than not that the loan guarantees will require a future cash outflow to pay default claims. The liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating liabilities, the risk factors discussed in the standard for post-1991 loan guarantees should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

The standard states that restatement of pre-1992 loan guarantees on a present value basis is permitted but not required.

All of the amounts used in the text that follows are in thousands of dollars.

A. RECOGNITION OF LIABILITIES

Assume that a federal credit program guarantees a group of loans and the guarantee was committed prior to October 1, 1991. At the end of fiscal year 1994, the loans have outstanding principal of $5,000 at 7 percent interest rate, maturing in three years. The borrowers are required to pay interest annually and to repay the principal at the end of 1997. The guarantee covers 60 percent of the principal.

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[Footnote 32]

[Footnote 32: A loan guarantee may guarantee both principal and interest payments. In that case, the estimate and recognition of loan guarantee liabilities should be based on defaults on both principal and interest payments.]

Disclosure is made in a footnote to the financial statements for fiscal year 1994 that guaranteed loans have an outstanding principal of $5,000, and the guaranteed amount is $3,000. (A similar disclosure is made in each year so long as the guaranteed loans are outstanding.)

The program management evaluates the risk factors enumerated in the accounting standard, and estimates that $2,500 of the loans' principal repayments would be defaulted when the loans mature. The program will pay 60 percent of the defaulted amount, equal to $1,500. It is also estimated that the credit program would realize a net recovery of $500 through acquiring and selling pledged assets. Thus, the program management recognizes a liability of $1,000, which equals the estimated default payment minus the net recovery. The $1,000 is charged to default expense. [Footnote 33]

[Footnote 33: This assumes that no liability was previously recognized. If a liability has been recognized for the loan guarantees, the liability should be adjusted to the current estimate, and any increase in liability should be charged to default expense.]

B. MODIFICATION OF PRE-1992 LOAN GUARANTEES

Assume that in October 1994, shortly after the close of fiscal year 1994, a decision is made to increase the guarantee from 60 percent of the loan payments to 80 percent. This action is within the definition of direct modification because it is a federal government action that directly changes the estimated subsidy cost and the present value of outstanding loan guarantees by altering the terms of existing contracts.

The accounting standard on modifications of loan guarantees states that with respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification

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liability of the loan guarantees over their pre-modification liability. The modification cost is recognized as modification expense when the loan guarantees are modified.

Accounting for the cost of modification takes the following steps:

(1) CALCULATE THE PRE-MODIFICATION LIABILITY

The pre-modification liability is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under pre-modification terms and discounted at the current discount rate.

It is estimated that under the pre-modification terms, a default payment of $1,500 would be made at the end of fiscal year 1997, and a net recovery of $500 from the sale of foreclosed assets would be received at the end of fiscal year 1998. The current discount rate for a maturity of 3 years is 4 percent. As shown in Table 33, the present value of the estimated net cash outflows discounted at 4 percent is $906. This is the pre-modification liability of the loan guarantees.

TABLE 33: PRE-MODIFICATION LIABILITY (IN THOUSANDS OF DOLLARS,CALCULATED AT THE CURRENT DISCOUNT RATE)

	DEFAULT PAYMENTS	NET RECOVERIES	NET CASH OUTFLOW
FY 1995			
1996			
1997	$1,500		$1,500
1998		$(500)	(500)
PV at 4%	$1,333	$(427)	$906

(2) CALCULATE THE POST-MODIFICATION LIABILITY

The loan guarantees' post-modification liability is the present value of the loan guarantees' net cash outflows estimated at the time of modification under post-modification terms and discounted at the current discount rate.

The modification expands the guarantee from 60 percent

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to 80 percent. It is estimated that $2,500 of the principal repayments will default when the loans mature. With the expansion of the guarantee percentage, the credit program will pay 80 percent of the defaulted amounts, equal to $2,000, to lenders at the end of fiscal year 1997. A net recovery of $500 would be received from selling foreclosed assets at the end of fiscal year 1998. The cash outflows estimated under the post-modification terms are discounted at the current discount rate of 4 percent. As shown in Table 34 below, The present value of the estimated net cash outflow is $1,351. This is the post-modification liability of the loan guarantees.

TABLE 34: POST-MODIFICATION LIABILITY (IN THOUSANDS OF DOLLARS,CALCULATED AT THE CURRENT DISCOUNT RATE)

	Default Payments	Net Recoveries	Net Cash Outflow
FY 1995			
1996			
1997	$2,000		$2,000
1998	$(500)		(500)
PV at 4%	$1,778	$(427)	$1,351

(3) CALCULATE AND RECOGNIZE THE COST OF MODIFICATION

The cost of modification is the excess of the loan guarantees' post-modification liability over their pre-modification liability. Since the loan guarantees' post-modification liability is $1,351, and their pre-modification liability is $906, the cost of modification is $445, which is recognized as a subsidy expense for modifications. A subsidy appropriation of that amount is required before the modification can take place. The appropriated amount is paid to the financing account.

(4) CALCULATE THE CHANGE IN THE BOOK VALUE OF THE LIABILITY

With respect to modifications of pre-1992 loan guarantees, the standard requires that when pre-1992 loan guarantees are directly modified, they be transferred to a financing account and the existing book value of the liability of the modified loan guarantees be changed to an

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amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. [Footnote 34]

[Footnote 34: The accounting standard states that when pre-1992 loan guarantees are indirectly modified, they are kept in a liquidating account, and that the liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification. Indirect modifications of pre-1992 loan guarantees are not illustrated in the Appendix.]

Prior to the modification, the liability of the loan guarantees was recorded in a liquidating account at $1,000. Upon modification, the loan guarantees are transferred from the liquidating account to a financing account, since this is a direct modification. The liability is recorded in the financing account at the post-modification liability of $1,351. The change in book value of the liability is an increase of $351.

(5) RECOGNIZE A GAIN OR LOSS

The accounting standard on loan guarantee modifications states that the change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in liability and the cost of modification is recognized as a gain or loss.

In this case, the cost of modification is $445, and the change in book value is $351. The difference of $94 is recognized as a gain.

When the loan guarantees are transferred from the liquidating account to the financing account, the liquidating account pays the financing account an amount equal to the loan guarantees' pre-modification liability of $906. The transfer of the loan guarantees has the following effects on the liquidating account: (1) the existing liability of the transferred loan guarantees equal to $1,000 is removed, (2) the fund balance is reduced by $906, which is the amount paid to the financing account, and (3) a gain of $94 is recognized.

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The financing account records the liability of the loan guarantees at $1,351, which is their post-modification liability. It also records a fund balance of $1,351, which consists of the $906 received from the liquidating account, and the $445 appropriated to cover the cost of modification.

****

APPENDIX C: GLOSSARY

The glossary defines many terms used in this Statement. The definitions may be modified or superseded when relevant terms are considered or defined by the FASAB in future projects.

Book value: The net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

Cohort: Those direct loans obligated or loan guarantees committed by a program in the same year even if disbursements occur in subsequent years. Post-1991 direct loans or loan guarantees will remain with their original cohort throughout the life of the loan, even if the loan is modified. Pre-1992 loans and loan guarantees that are modified shall each, respectively, constitute a single cohort. (OMB Circular No. A-11, Preparation and Submission of Budget Estimates, Executive Office of the President, Office of Management and Budget, July 1992, hereafter cited as OMB Circular No. A-11.)

Credit program: For the purpose of this Statement, a federal program that makes loans and/or loan guarantees to nonfederal borrowers.

Direct loan: A disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time, with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular No. A-11)

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Econometric model: An equation or a set of related equations used to analyze economic data through mathematical and statistical techniques. Such models may be devised in order to depict the essential quantitative impact of alternative assumptions or government policies. (Dictionary of Banking and Finance, Jerry M. Rosenberg, Ph.D., Wiley & Sons, New York, 1982, hereafter cited as Rosenberg's Dictionary.)

Financing account: A non-budget account associated with each credit program account. The financing account holds fund balances, receives the subsidy cost payment from the credit program account, and includes all other cash flows to and from the government resulting from post-1991 direct loans or loan guarantees. (OMB Circular No. A-11, and OMB Circular No. A-34, Instructions on Budget Execution, Part VI, Credit Apportionment and Budget Execution, September, 1991, hereafter cited as OMB Circular No. A-34.)

Foreclosure: A method of enforcing payment of a debt secured by a mortgage by seizing the mortgaged property. Foreclosure terminates all rights that the mortgagor has in the mortgaged property upon completion of due process through the courts. (Treasury Financial Manual Supplement)

Interest method: A method used to amortize the premium or discount of an investment in bonds, or, as used in this Statement, to amortize the subsidy cost allowance of direct loans. Under this method, the amortization amount of the subsidy cost allowance equals the effective interest minus the nominal interest of the direct loans. The effective interest equals the present value of the direct loans times the effective interest rate (the discount rate). The nominal interest equals the nominal amount (face amount) of the direct loans times the stated interest rate (the rate stated in the loan agreements).

Liquidating account: The budget account that includes all cash flows to and from the government resulting from pre-1992 direct loans or loan guarantees (those originally obligated or committed before Oct. 1, 1991), except those pre-1992 direct loans and loan guarantees that have been directly modified and transferred to a financing account. (See OMB Circular No. A-11)

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Loan guarantee: Any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender, but does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (OMB Circular No. A-11)

Loan guarantee commitment: A binding agreement by a federal agency to make a loan guarantee when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement. (OMB Circular No. A-11)

Modification: A federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans (or direct loan obligations), or the liability of loan guarantees (or loan guarantee commitments). Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms.

Modification adjustment transfer: A non-expenditure transfer from a financing account to the Treasury, or vice versa, to offset the difference between the cost of modification of direct loans (or loan guarantees) and the change in the book value of direct loans (or loan guarantee liabilities). (See also OMB Circular A-11)

Nominal (or face or par)value or amount: The amount of a bond, note, mortgage, or other security as stated in the instrument itself, exclusive of interest or dividend accumulations. The nominal amount may or may not coincide with the price at which the instrument was first sold, its present market value, or its redemption price. Often referred to as the stated value. (Adapted from Kohler's Dictionary for Accountants, 6th ed., hereafter cited as

Kohler's Dictionary.)

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Present value (PV): The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest. (Adapted from Kieso and Weygandt, Intermediate Accounting, 7th ed., p. 264.)

Program account: The budget account into which an appropriation to cover the subsidy cost of a direct loan or loan guarantee program is made and from which such cost is disbursed to the financing account. Usually, a separate amount for administrative expenses is also appropriated to the program account. (OMB Circular No. A-11)

Recourse: The rights of a holder in due course of a financial instrument (such as a loan) to force the endorser on the instrument to meet his or her legal obligations for making good the payment of the instrument if dishonored by the maker or acceptor. The holder in due course must have met the legal requirements of presentation and delivery of the instrument to the maker of a note or acceptor of a draft and must have found that this legal entity has refused to pay for or defaulted in payment of the instrument. (Rosenberg's Dictionary)

Reestimate: Refers to estimates of the subsidy costs performed subsequent to their initial estimates made at the time of a loan's disbursement.

Restatement (of direct loans or loan guarantees): Refers to establishing a new book value of a direct loan or the liability of a loan guarantee.

Risk category: Subdivisions of a cohort of direct loans or loan guarantees into groups of loans that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all loans obligated or committed for a program during the fiscal year that share characteristics predictive of defaults and other costs. (OMB Circular No. A-11)

Subsidy cost: The cost of a grant of financial aid, usually by a governmental body, to some person or institution for particular purposes. (Kohler's Dictionary)

Credit subsidy cost is the estimated long-term cost to the government of direct loans or loan guarantees

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calculated on a net present value basis, excluding administrative costs. (Adapted from OMB Circular No. A-11)

Direct loan subsidy cost is the estimated long-term cost to the government of direct loans calculated on a present value basis, excluding administrative costs. The cost is the present value of estimated net cash outflows at the time the direct loans are disbursed. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the loan, applicable to the time when the loans are disbursed. (Adapted from OMB Circular No. A-11)

Loan guarantee subsidy cost is the estimated long-term cost to the government of loan guarantees calculated on a present value basis, excluding administrative costs. The cost is the present value of estimated net cash outflows at the time the guaranteed loans are disbursed by the lender. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the loan guarantees, applicable to the time when the guaranteed loans are disbursed. (Adapted from OMB Circular No. A-11)

Write-off: An action to remove an amount from an entity's assets. A write-off of a loan occurs when an agency official determines, after all appropriate collection tools have been used, that a debt is uncollectible. Active collection on an account ceases, and the account is removed from an entity's receivables. (Treasury Financial Manual Supplement)

The following additional terms have been defined specifically for the standard for modifications provided in this Statement. These terms are not intended for general application to other federal financial transactions.

Current discount rate: With respect to the modification of direct loans or loan guarantees, it is the discount rate used to measure the cost of a modification. It is the interest rate applicable at the time of modification on marketable Treasury securities with a similar maturity to the remaining maturity of the direct or guaranteed loans, under either pre-modification terms, or post-modification

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terms, whichever is appropriate.

Original discount rate: The discount rate originally used to calculate the present value of direct loans or loan guarantee liabilities, when the direct or guaranteed loans were disbursed.

Pre-modification liability: The present value of net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms, discounted at the current discount rate.

Pre-modification value: The present value of net cash inflows of direct loans estimated at the time of modification under pre-modification terms, discounted at the current discount rate.

Pre-1992 direct loans: Direct loans obligated before October 1, 1992.

Pre-1992 loan guarantees: Loan guarantees committed before October 1, 1992.

Post-modification liability: The present value of net cash outflows of loan guarantees estimated at the time of modification under the post-modification terms, discounted at the current discount rate.

Post-modification value: The present value of net cash inflows of direct loans estimated at the time of modification under the post-modification terms, discounted at the current discount rate.

Post-1991 direct loans: Direct loans obligated after September 30, 1992.

Post-1991 loan guarantees: Loan guarantees committed after September 30, 1992.

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Executive Office of the President
Office of Management and Budget

ACCOUNTING FOR INVENTORY AND RELATED PROPERTY

STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS

NUMBER 3

October 27, 1993

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TABLE OF CONTENTS

ABBREVIATIONS

EXECUTIVE SUMMARY Paragraphs number 1-3

INTRODUCTION

Objective Paragraph 4
Approach Paragraph 5-6
Materiality Paragraphs 7-15
Effective Date Paragraph 16

THE ACCOUNTING STANDARDS
Inventory Paragraphs 17-35
Operating Materials and Supplies Paragraphs 36-50
Stockpile Materials Paragraphs 51-56
Seized and Forfeited Property Paragraphs 57-78
Foreclosed Property Paragraphs 79-91
Goods Held Under Price Support and Stabilization Programs Paragraphs 92-109

APPENDIX A:
BASIS OF THE BOARD'S CONCLUSIONS Paragraphs 110-162

GLOSSARY

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ABBREVIATIONS

ARB	Accounting Research Bulletin
CCC	Commodity Credit Corporation
CFO	Chief Financial Officers
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FIFO	first-in, first-out
GAO	General Accounting Office
IRS	Internal Revenue Service
LAC	latest acquisition cost
LIFO	last-in, first-out
OMB	Office of Management and Budget
SPR	Strategic Petroleum Reserves

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EXECUTIVE SUMMARY

1 This is the third statement of recommended accounting standards issued by the Federal Accounting Standards Advisory Board (referred to as FASAB or the Board). The standards presented in this document apply to several types of tangible property, other than long term fixed assets, held by federal government agencies.

2 These accounting standards cover the following assets:

-- inventory (i.e., items held for sale);

-- operating materials and supplies;

-- stockpile materials;

-- seized and forfeited property;

-- foreclosed property; and

-- goods held under price support and stabilization programs (including nonrecourse loans and purchase agreements).[Footnote 1.]

[Footnote 1: As well as addressing the commodities acquired through price support and stabilization programs, this

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standard addresses nonrecourse loans and purchase agreements.]

The following tables summarize the provisions in the recommended accounting standards. The tables highlight the major provisions; they should not be substituted for close review of the standards themselves.

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TABLE 1: SUMMARY OF ACCOUNTING STANDARDS

Standard	Description	Valuation Method	Recognition Requirements and comments
Inventory	Tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be used in the provision of services for a fee	(1) Historical cost or any other valuation methods which approximate historical cost (2) Latest acquistion cost	As an asset upon receipt of title or goods. As cost of goods sold upon delivery to buyer. For latest acquisition cost, an allowance account will be established equal to the cumulative unrealized holding gains/ losses associated with ending inventory. Categories will be established for inventory held for sale; excess, obsolete, and unserviceable inventory; and inventory held for repair.
Operating materials and	Tangible personal property to be consumed in normal	Historical cost or any other valu-	The consumption method shall be applied. However,

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supplies	operations	ation methods which approximate historical cost	if operating materials and supplies are (1) not significant amounts, (2) in the hands of the end-user, or (3) if it is not cost beneficial to apply the consumption method, the purchases method may be applied. Categories will be established for operating materials and supplies; operating materials and supplies held in reserve for future use; and excess, obsolete, and unserviceable operating materials and supplies.
Stockpile materials	Strategic and critical held due to statutory requirements For use in national defense, conservation, or national emergencies	Historical cost or any other valuation methods which approximate historical cost	As an asset upon receipt of title or goods. As an expense upon disposal, use, or sale.

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TABLE 2: SUMMARY OF ACCOUNTING STANDARDS

Standard	Description	Valuation	Recognition Requirements
Seized	Monetary in-	Market value	As an asset upon

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and forfeited property	struments and property acquired as a result of orfeiture proceedings		forfeiture with a deferred revenue established. [Footnote 1] As revenue upon sale or disposition of nonmonetary forfeited property. As revenue upon forfeiture for monetary instruments.
Foreclosed property	Assets received in satisfaction of a loan receivable or as a result of a claim under a guaranteed or insured loan	Post-1991: [Footnote 2] net present value Pre-1992: [Footnote 3] lower of cost or net realizable value	As an asset upon foreclosure. .
Commoditites	Items acquired, held, sold, or otherwise disposed of to stabilize or support market prices.	Lower of cost or net realzable value	As an asset upon receipt. As a loss on farm price support if the net realizable value is less than the cost at acquisition. As an expense upon disposal or use.
Commodity nonrecourse loans	Short-term loans with commodities pledged as collateral	The principal amount of the loan less any allowance for for expected losses	As an asset upon issuance. As a loss on farm price support at reporting date if they are more likely than not and measurable.
Commodity purchase agreements	Agreements to purchase commodities at a given price at the option of the seller	Estimated amount of the contingent loss	As a contingent liability if the loss is more likely than not and measurable.

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[Footnote 1: Seized property other than monetary instruments would not be recognized as the entity's asset since it is not owned by the federal government. However, the market value of seized property should be disclosed in notes to the financial statements. This recognizes that the entity has a fiduciary responsibility for the property.

Seized monetary instruments are recognized as assets with an offsetting liability to recognize the potential for remission to the owners. This treatment was provided in order to maintain a higher level of financial control over seized monetary instruments.]

[Footnote 2: "Post-1991" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees committed after September 30, 1991.]

[Footnote 3: "Pre-1992" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees commmitted before October 1, 1991. In addition, any programs or agencies that are specifically exempt from the provisions of the Federal Credit Reform Act should follow accounting provisions for "pre-1992" property.]

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INTRODUCTION

OBJECTIVE

4 In this Statement, the Board recommends accounting standards for six assets of the federal government and its entities. The first group of assets addressed, those formerly referred to as "inventory," includes inventory held for sale, operating materials and supplies, stockpile materials, and commodities. The decision to include other assets held for sale resulted in adding two items: (1) seized and forfeited property and (2) foreclosed property.

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APPROACH

5 Following publication of the Exposure Draft in January 1993, the Board received comments from 44 organizations and individuals. A public hearing, at which eight people presented oral comments on the Exposure Draft, was held on April 21 and 22, 1993.

6 In preparing this Statement of recommended standards, the Board considered all the comments received and incorporated changes, as appropriate. The issues raised and the specific changes made are discussed in Appendix A, "Basis of the Board's Conclusions."

MATERIALITY

7 In preparing the standards, the Board intended that their application be limited to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The Board proposes relying on the Financial Accounting Standards Board's (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board's position on the issue of materiality at this time.

8 The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

9 FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the

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judgment of the financial statement user.

10 The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.

11 In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.

12 This is expressed well in the "Government Auditing Standards" (the "Yellow Book"):

> "In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private-sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions." (Ch. 3, par. 33.)

13 While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.

14 Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgments of the entity's efficiency and the effectiveness and its compliance with laws and regulations in a material manner.

15 In order to emphasize that materiality should be

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considered in applying all accounting standards, the Board has decided to place a notice at the end of each recommended accounting standard. The notice will read as follows:

> The provisions of this statement need not be applied to immaterial items.

EFFECTIVE DATE

16 The Board recommends that the accounting standards presented in this Statement become effective for fiscal years ending September 30, 1994, and thereafter. Earlier implementation is encouraged.

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The Accounting Standards -- INVENTORY

INVENTORY

DEFINITION. 17 "Inventory" is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. The term "held for sale" shall be interpreted to include items for sale or transfer to (1) entities outside the federal government, or (2) other federal entities. The principal objective of the sale or transfer of inventory is to provide a product or service for a fee that generally recovers full cost or an identified portion of the cost. "Other federal entities" may include entities within the same organization/agency. Sales transactions may be executed through transfer of funds between federal entities; it is not essential that the transaction be an exchange of goods for cash or cash equivalents. In addition, inventory may be acquired through donation or barter. Inventory excludes some other assets held for sale, such as (1) stockpile materials, (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; however, the purpose of acquiring them is not to provide a product or a service for a fee.

18 Inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future

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sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. These categories are defined in paragraphs 17, 27, 29, and 32 respectively.

RECOGNITION. 19 Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or the goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

VALUATION. 20 Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost.

(1) 21 Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

22 The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost system).

(2) 23 The latest acquisition cost method provides that the last invoice price[Footnote 2.], (i.e., the specific item's actual cost used in setting the current year stabilized standard [sales] price) be applied to all like units held including those units acquired through donation or nonmonetary exchange. The inventory shall be revalued periodically but at least at the end of each fiscal year. Revaluation results in recognition of unrealized holding

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gains/losses in the ending inventory value. Upon adjustment for unrealized holding gains/losses, the latest acquisition cost method then results in an approximation of historical cost.

24 An allowance for unrealized holding gains/losses in inventory shall be established to capture these gains/losses. The ending balance of this allowance shall be the cumulative difference between the historical cost, based on estimated or actual valuation, and the latest acquisition cost of ending inventory. The balance shall be adjusted each time the inventory balance is adjusted. The adjustment necessary to bring the allowance to the appropriate balance shall be a component of cost of goods sold for the period as described below.

25 The cost of goods sold for the period shall be computed as follows:

	Beginning inventory at beginning-of-the-period latest acquisition cost
LESS	allowance for unrealized holding gains/losses at the beginning-of-the-period
PLUS	actual purchases
EQUALS	Cost of Goods Available for Sale
LESS	ending inventory at end-of-the-period latest acquisition cost
PLUS	allowance for unrealized holding gains/losses at the end-of-period
EQUALS	Cost of Goods Sold

EXCEPTION TO VALUATION. 26 Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine approximate costs, (2) immediate marketability at quoted prices, and (3) unit interchangeability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.

Other Categories of Inventory

INVENTORY HELD IN RESERVE FOR FUTURE SALE. 27 Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed

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(although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

28 The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage, and (5) the likelihood that a supply of the items will be available in the future.

EXCESS, OBSOLETE, AND UNSERVICEABLE INVENTORY. 29 "Excess inventory" is inventory stock that exceeds the demand expected in the normal course of operations because the amount on hand is more than can be sold in the foreseeable future and that does not meet management's criteria to be held in reserve for future sale. "Obsolete inventory" is inventory that is no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable inventory" is damaged inventory that is more economical to dispose of than to repair. The category "excess, obsolete and unserviceable inventory" shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

30 Such inventory shall be valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. Any subsequent adjustments to its net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).

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31 Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.

INVENTORY HELD FOR REPAIR. 21 Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.

(1) Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established. The annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.

(2) 33 Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

34 Transition to either of these two methods may result in recognizing an accumulated amount of needed repairs that were not previously accounted for. To avoid overstating repair expense for the first period that repair expense is accrued, prior period amounts are to be separately identified or estimated. The estimated amount to repair inventory that is attributable to prior periods shall be credited to the repair allowance under the repair allowance method or to the inventory account under the direct method and reported as an adjustment to equity.

Disclosure Requirements 35

-- General composition of inventory.

-- Basis for determining inventory values; including the valuation method and any cost flow assumptions.

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-- Changes from prior year's accounting methods; if any.

-- Balances for each of the following categories of inventory; inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements.

-- Restrictions on the sale of material.

-- The decision criteria for identifying the category to which inventory is assigned.

-- Changes in the criteria for identifying the category to which inventory is assigned.

The provisions of this statement need not be applied to immaterial items.

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The Accounting Standards -- OPERATING MATERIALS AND SUPPLIES

OPERATING MATERIALS AND SUPPLIES

DEFINITION. 36 "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

37 Operating materials and supplies shall be categorized as (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies. These categories are defined in paragraphs 36, 45, and 47 respectively.

RECOGNITION. 38 The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and

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supplies shall be recognized and reported as assets when produced or purchased. "Purchased" is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

39 The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.

40 If (1) operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

41 An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall not be considered an end user.

VALUATION UNDER THE CONSUMPTION METHOD. 42 Operating materials and supplies shall be valued on the basis of historical cost.

43 Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

44 The first-in, first-out (FIFO); weighted average;

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or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).

Other Categories of Operating Materials and Supplies

OPERATING MATERIALS AND SUPPLIES HELD IN RESERVE FOR FUTURE USE.

45 Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.

46 The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

EXCESS, OBSOLETE, AND UNSERVICEABLE OPERATING MATERIALS AND SUPPLIES. 47 "Excess operating materials and supplies" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable

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future and that do not meet management's criteria to be held in reserve for future use. "Obsolete operating materials and supplies" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable operating materials and supplies" are operating materials and supplies that are physically damaged and cannot be consumed in operations. The category "excess, obsolete and unserviceable operating materials and supplies" shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

48 Such operating materials and supplies shall be valued at their estimated net realizable value. The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete or unserviceable and their estimated net realizable value shall be recognized as a loss (or gain) and either reported separately or disclosed. Any subsequent adjustments to their estimated net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).

49 Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies.

Disclosure Requirements. 50

-- General composition of operating materials and supplies.

-- Basis for determining operating materials and supplies values; including valuation method and any cost flow assumptions.

-- Changes from prior year's accounting methods, if any.

-- Balances for each of the categories of operating materials and supplies described above.

-- Restrictions on the use of material.

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-- Decision criteria for identifying the category to which operating materials and supplies are assigned.

-- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

The provisions of this statement need not be applied to immaterial items.

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The Accounting Standards -- STOCKPILE MATERIALS

STOCKPILE MATERIALS

DEFINITION. 51 "Stockpile materials" are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business. The following items are specifically excluded from stockpile materials: (1) items that are held by an agency for sale or use in normal operations (see proposed standards for inventory and operating materials and supplies), (2) items that are held for use in the event of an agency's operating emergency or contingency (see proposed standard for operating materials and supplies), and (3) materials acquired to support market prices (see proposed standard for goods held under price support and stabilization programs).

RECOGNITION. 52 The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. "Purchase" is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.

VALUATION. 53 Stockpile materials shall be valued on the basis of historical cost. Historical cost shall include

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all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of stockpile materials. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).

EXCEPTION TO VALUATION. 54 The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss or an expense in the period in which it occurs.

HELD FOR SALE. 55 When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time.

Disclosure Requirements. 56

-- General composition of stockpile materials.
-- Basis for valuing stockpile materials; including valuation method and any cost flow assumption.

-- Changes from prior year's accounting methods, if any.

-- Restrictions on the use of materials.

-- Balances of stockpile materials in each category described above (i.e, stockpile materials and

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stockpile materials held for sale).

-- Decision criteria for categorizing stockpile materials as held for sale.

-- Changes in criteria for categorizing stockpile materials as held for sale.

The provisions of this statement need not be applied to immaterial items.

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The Accounting Standards -- SEIZED AND FORFEITED PROPERTY

SEIZED AND FORFEITED PROPERTY

57 As a consequence of various laws, certain property is seized by authorized law enforcement agencies. In some instances, there may be as many as three government entities involved with seized property. The first is the seizing agency. Second, the seizing agency may turn the property over to a custodial agency. Third, financial records may be maintained by a "central fund" created to support the seizure activities of multiple agencies. Alternatively, the seizing agency may carry out one or both of the custodial agency or central fund roles.

58 The seized assets may be subsequently forfeited to the government through abandonment or administrative or judicial procedures. The forfeited property is then sold, converted for use by the government, or transferred to other governmental entities. Because this property is first seized, then all or a portion of it is forfeited, this standard separately addresses the accounting and reporting for seized property and the accounting and reporting for forfeited property.

SEIZED PROPERTY

DEFINITION. 59 "Seized property" includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.

RECOGNITION. 60 Seized property shall be accounted

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for in the financial records of the entity that is operating as the central fund.[Footnote 3.]

[Footnote 3: If the central fund is other than the seizing or custodial agency, the latter should maintain sufficient internal records to carry out its stewardship responsibility.]

61 Seized monetary instruments shall be recognized as seized assets when seized. In addition, a liability shall be established in an amount equal to the seized asset value. Seized monetary instruments are recognized upon seizure due to (1) the fungible nature of monetary instruments and (2) the high level of control over the assets that is necessary.

62 Seized property other than monetary instruments shall be disclosed in the footnotes. The value of the seized property shall be accounted for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated.

VALUATION. 63 Seized property shall be valued at its market value when seized or, if market value cannot be readily determined, as soon thereafter as reasonably possible. Market value shall be based on the value of the property assuming an active market exists for the property. If no active market exists for the property in the general area in which it was seized, a value in the principal market nearest the place of seizure shall be used.

EXCEPTIONS TO VALUATION. 64 Valuation of property seized under the Internal Revenue Code shall be based on the taxpayer's equity, that is, market value less any third-party liens.

65 Seized monetary instruments shall be valued at their market value.

Disclosure Requirements. 66

-- Explanation of what constitutes a seizure and a general description of the composition of seized property.

-- Method(s) of valuing seizures.

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-- Changes from prior year's accounting methods; if any.

-- Analysis of change in seizures, including the dollar value and number of seized property that are (1) on hand at the beginning of the year, (2) made during the year, (3) disposed of during the year, and (4) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seizure and method of disposition where material.

FORFEITED PROPERTY

67 This subsection defines "forfeited property" and presents the accounting and reporting standards for them. Presented below are examples of forfeited property.

-- monetary instruments,

-- intangible property,

-- real property and tangible personal property,

-- property acquired by the government in satisfaction of a tax liability, and

-- unclaimed and abandoned merchandise.

DEFINITION. 68 "Forfeited property" consists of (1) monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.

RECOGNITION AND VALUATION. 69 Monetary instruments shall be reclassified from seized monetary instruments to forfeited monetary instruments when forfeited. Monetary instruments shall be valued at their market value when a forfeiture judgment is obtained. When the asset is recorded, revenue shall be recognized in an amount equal to the value

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of the monetary instrument and the associated liability for possible remittance shall be removed.

70 Intangible property, real property and tangible personal property shall be recorded with an offsetting deferred revenue when forfeiture judgment is obtained. When a determination is made that property will not be sold, the property shall be reclassified as forfeited property held for donation or use. The property shall be valued at its fair value at the time of forfeiture. A valuation allowance shall be established for liens or claims from a third-party. This allowance shall be credited for the amount of any expected payments to third-party claimants.

71 Forfeited property that cannot be sold due to legal restrictions but which may be either donated or destroyed shall be subject to the disclosure requirements described below. However, no financial value shall be recognized for these items.

72 Revenue from the sale of property shall be recognized when the property is sold.

73 Property not held for sale may be

-- placed into official use,

-- transferred to another federal government agency,

-- distributed to a state or local law enforcement agency, or

-- distributed to a foreign government.

74 When a determination is made that property will be distributed in one of the ways described above and not held for sale, the property shall be reclassified as forfeited property held for donation or use. Revenue associated with property not disposed of through sale shall be recognized upon approval of distribution and the previously established deferred revenue shall be reversed.

75 Revenue shall be classified as it arises from sale or from disposition, and this distinction shall be maintained in the entity's accounting reports.

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76 Property acquired by the government in satisfaction of a taxpayer's liability shall be recorded when title to the property passes to the federal government. At that time, a credit shall be made to the related account receivable. The property shall be valued at its market value less any third-party liens. Upon sale of the property, revenue shall be recognized in the amount of the sale proceeds and the property and the third-party liens are removed from the accounts.

77 Unclaimed and abandoned merchandise shall be recorded with an offsetting deferred revenue when statutory and/or regulatory requirements for forfeiture have been met. The merchandise shall be valued at its market value. Upon sale of the merchandise, revenue shall be recognized in the amount of the sale proceeds and the merchandise and the deferred revenue are removed from the accounts.

Disclosure Requirements. 78

-- Composition of forfeited property.

-- Method(s) of valuing forfeited property.

-- Restrictions on the use or disposition of forfeited property.

-- Changes from prior year's accounting methods, if any.

-- Analysis of change in forfeited property providing the dollar value and number of forfeitures that (1) are on hand at the beginning of the year, (2) are made during the year, (3) are disposed of during the year and the method of disposition, and (4) are on hand at the end of the year. This information would be presented by type of property forfeited where material.

-- If available, an estimate of the value of property or funds to be distributed to federal, state and local agencies in future reporting periods.

The provisions of this statement need not be applied to immaterial items.

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TABLE 1:SUMMARY OF ACCOUNTING STANDARDS

CATEGORY OF PROPERTY	METHOD OF DISPOSITION	VALUATION METHOD	RECOGNIZED AS ASSETS	RECOGNIZED AS REVENUE
Monetary instru-	Sale; proceeds credited to entity's fund	Market Value	Upon seizure	Upon obtaining forfeiture judgment
Intangible property, real property, and tangible personal property acquired by forfeiture proceedings	Sale	Market Value	Upon obtaining forfeiture judgment	Upon sale
	Transferred, distributed, or held for internal use	Market Value	Upon obtaining forfeiture judgment	Upon obtaining approval to transfer,distribute or use internally
Property acquired to satisfy tax liability	Sale; proceeds credited to Treasury General	Market value less amount of liens	Upon obtaining title to property	Upon sale of property
Unclaimed or abanoned merchandise	Sale; proceeds used to reimburse other funds; excess credited to Treasury General Fund	Market value	Upon meeting statutory and/ or regulatory requirements	Upon sale

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The Accounting Standards -- FORECLOSED PROPERTY

FORECLOSED PROPERTY

DEFINITION. 79 The term "foreclosed property" means any asset received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan (excluding commodities acquired under price support programs). All properties included in foreclosed property are assumed to be held for sale.

80 In accordance with the Federal Credit Reform Act of 1990, the remainder of this standard will refer to specific provisions for pre-1992 foreclosed property and post-1991 foreclosed property. "Pre-1992 foreclosed property" refers to property associated with direct loans obligated or loan guarantees committed before October 1, 1991. "Post-1991 foreclosed property" refers to property associated with direct loans obligated or loan guarantees committed after September 30, 1991. The distinction is necessary because for budget purposes, the cash flows associated with post-1991 direct loans and loan guarantees, including the cash flows associated with post-1991 foreclosed property, must be measured on a present value basis. However, pre-1992 foreclosed property need not be valued on this basis. Additionally, any programs that are specifically exempt from the use of present value techniques for determining the costs of direct loans and loan guarantees shall rely on the accounting principles provided for pre-1992 foreclosed property.

VALUATION OF FORECLOSED PROPERTY. 81 Post-1991 foreclosed property is valued at the net present value of the projected future cash flows associated with the property. Pre-1992 foreclosed property is recorded at cost and adjusted to the lower of cost or its net realizable value; any difference is carried in a valuation allowance. Both of these methods are described further below. For either post-1991 or pre-1992 foreclosed property, other valuation methods may be used as an approximation for the above methods if no material differences in valuation will result.

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NET PRESENT VALUE. 82 The first step in determining net present value is projecting the future cash flows associated with the property. The projected future cash flows shall include estimates of (1) the sales proceeds, (2) rent, management expense, and repair costs during the holding period, and (3) selling expenses (e.g., advertising and commissions). In estimating the sales proceeds, the entity's historical experience in selling property and the nature of the sale shall be considered. For instance, market value based on sales between willing buyers and sellers may not be appropriate for properties to be disposed of in a forced or liquidation sale. If the entity has historically been unable to realize the fair value of property, this shall be considered in estimating sales proceeds.

83 The second step is to discount these cash flows to their present value. In order to place the projected cash flows on a present value basis, a discount (interest) rate must be selected. The discount rates used shall be the same rates that were used to discount the cash flows of the related loans or guarantees.

84 Following foreclosure, the net present value (measured in a manner consistent with the measurement at the time of foreclosure) shall be adjusted periodically to recognize both changes in the expected future cash flows and for accrual of interest due to the passage of time. Any adjustments to the carrying amounts shall be included in the presentation of "interest income" and the reestimate of "subsidy expense."

NET REALIZABLE VALUE. 85 Pre-1992 foreclosed property held for sale should be reported in the entity's financial statements at expected net realizable value. The expected net realizable value shall be based on an estimate of the market value of the property adjusted for any expected losses and any other costs of the sale. The estimate of market value shall be based on (1) the market value of the property if an active market exists; (2) the market value of similar properties if no active market exists; or (3) a reasonable forecast of expected cash flows adjusted for estimates of all holding costs, including any cost of capital. In addition to considering market value, the expected net realizable value shall consider the entity's historical experience in disposing of foreclosed properties;

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i.e., if the entity is typically unable to obtain market value for properties, the expected net realizable value shall be adjusted to be consistent with historically experienced losses. Additionally, if the entity will not be able to sell the property under normal market conditions or is forced to sell the property within a given time, this factor shall be considered in arriving at net realizable value.

86 If the expected net realizable value is less than the cost, a loss has occurred. This loss shall be charged to operations, and a valuation allowance shall be established. If the asset's net realizable value subsequently increases or decreases, this amount shall be credited or charged to results of operations and the valuation allowance adjusted. However, the asset value shall not be adjusted above cost.

ASSETS SUBJECT TO CLAIMS OF OTHER PARTIES. 87 If the property is taken subject to claims of the lender, debtor, or other party, these claims shall be accounted for in a valuation allowance. These claims can be in the form of a lien or a residual interest of the debtor or lender, etc. For post-1991 foreclosed property, these claims shall be recorded at their net present value at the time of foreclosure. The discount rate applied shall be the same rate that applies to the related foreclosed property. For post-1991 foreclosed property, any periodic changes in the net present value of the claim shall be offset by a charge or a credit to "interest income" and the reestimate of "subsidy expense," as appropriate under the standards for direct loans and loan guarantees. For pre-1992 foreclosed property, these claims shall be recorded at the expected amount of the cash required to settle the claims.

RECEIPTS AND DISBURSEMENTS DURING THE HOLDING PERIOD FOR POST-1991 FORECLOSED PROPERTY. 88 Any receipts or disbursements associated with acquiring and holding post-1991 foreclosed property shall be charged or credited to foreclosed property. This shall include rental receipts, maintenance and repair expense, advertising costs, and any other elements of the projected cash flows considered in arriving at the net present value.

SALE OF FORECLOSED PROPERTY. 89 Upon sale, any difference between the net carrying amount of foreclosed

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property and the net proceeds of the sale shall be recognized as a component of operating results. For post-1991 foreclosed property, interest income shall be accrued from the previous periodic adjustment in the carrying amount up to the sale date. The difference between the adjusted carrying amount and the net sales proceeds shall be recognized as a reestimate of "subsidy expense." For pre-1992 foreclosed property, this difference shall be recognized as a gain or a loss on the sale of foreclosed property.

ASSETS CONVERTED FROM HELD-FOR-SALE ASSETS TO OPERATING ASSETS. 90 Assets not sold but placed into operation shall be removed from foreclosed property when such action is taken. If reimbursement for the transfer of assets from one program to another is made, the proceeds from the transfer shall be treated in the same manner as a sale to a third-party.

Disclosure Requirements. 91

-- Valuation basis used for foreclosed property.

-- Changes from prior year's accounting methods, if any.

-- Restrictions on the use/disposal of the property.

-- Balances in the categories described above.

-- Number of properties held and average holding period by type or category.

-- Number of properties for which foreclosure proceedings are in process at the end of the period.

The provisions of this statement need not be applied to immaterial items.

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The Accounting Standards -- GOODS HELD UNDER PRICE SUPPORT AND STABILIZATION PROGRAMS

GOODS HELD UNDER PRICE SUPPORT AND STABILIZATION PROGRAMS

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DEFINITION. 92 Goods acquired under price support and stabilization programs are referred to as commodities. "Commodities" are items of commerce or trade having an exchange value. They are acquired, held, sold, or otherwise disposed of to satisfy or help satisfy economic goals.

93 In conducting price support operations, the money is frequently disbursed in the form of "nonrecourse loans." Recipients of such loans pledge specific farm commodities as collateral for the loans and have the alternatives of redeeming the loans (repaying them with interest) or surrendering the commodities in exchange for the outstanding loan balance.

94 Besides acquiring commodities through surrender of collateral for nonrecourse loans, an entity may acquire commodities by a purchase settlement. A purchase settlement is exercised on the basis of a purchase agreement between a producer and the Commodity Credit Corporation (CCC). On the basis of the agreement, a producer has the option to sell commodities to CCC and receive full payment for the commodity at the price support rate. The amount of the purchase settlement is calculated by multiplying the price support rate by the number of units purchased by the CCC. Support price rates are set by law.

95 Because nonrecourse loans and purchase agreements are closely associated with the acquisition of the actual commodities, the three components of the price support program are addressed in this accounting standard.

RECOGNITION. 96 Nonrecourse loans shall be recognized as assets when the loan principal is disbursed. These loans shall be recorded at the amount of the loan principal. Interest income shall be recognized as it is earned and an interest receivable established.

97 Purchase agreement settlements are executed at the option of the producer (seller). This creates an uncertainty regarding losses to be incurred by the purchaser. At financial statement dates a loss shall be recognized if information indicates that it is probable that a loss has been incurred on purchase agreements outstanding and the amount of the loss can be reasonably measured or estimated. The amount of the loss shall be estimated and may be based

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on the contract price and the expected net realizable value of the commodities to be acquired.

98 If the contingent loss is not recognized because it is less than probable or it is not reasonably measurable, disclosure of the contingency shall be made if it is at least reasonably probable that a loss may occur.

99 Commodities shall be recognized as assets and reported on the face of the financial statements upon the producer's surrender of title to satisfy a nonrecourse loan or upon purchase by the agency.

100 Revenue shall be recognized upon the sale of commodities. At the time of sale, the carrying amount of the commodities sold shall be removed from commodities and reported as cost of goods sold.

101 The carrying amount of commodities held for other purposes shall be removed from the commodities asset account and reported as an expense upon transfer of the commodity.

VALUATION. 102 All nonrecourse loans shall be valued at the loan amount. Losses on nonrecourse loans shall be recognized when it is more likely than not that the loans will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence. The loan amount shall be preserved in the asset account as the gross value of the loan. When the loss is recognized, a valuation allowance, "allowance for losses", (a contra-asset) shall be established to reduce the gross value to its expected net realizable value. The allowance shall be reestimated on each financial reporting date.

103 The liability for losses on purchase agreements shall be valued at the net of the contract price and the net realizable value of the commodities described in the purchase agreement.

104 At the time of acquisition and for financial statement purposes, all commodities shall be valued at the lower of cost or net realizable value.

105 The cost for commodities acquired via a nonrecourse loan settlement is the amount of the loan principal (excluding interest), processing and packaging

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costs incurred after acquisition, plus other costs (e.g., transportation) incurred in taking title to the commodity.

106 The cost for commodities acquired via a purchase settlement is the unit price agreed upon in the purchase agreement multiplied by the number of units purchased by CCC plus other costs (e.g., transportation) incurred in taking title to the commodity.

107 For financial statement purposes, any adjustments necessary to reduce the carrying amount of commodities to the lower of cost or net realizable value shall be recognized as a loss on farm price support and reported in the current period. The adjustment to the carrying amount shall be recorded in a commodity valuation allowance. Recoveries of losses may be recognized up to the point of any previously recognized losses on the commodities, and the commodity valuation allowance reduced accordingly in the current period.

108 For cost determination, any of the following cost flow assumptions may be applied in arriving at inventory balances and cost of goods sold or transferred: first-in, first-out (FIFO); weighted average; moving average; and specific identification.

Disclosure Requirements. 109

-- Basis for valuing commodities;including the valuation method and any cost flow assumptions.

-- Changes from prior year's accounting methods, if any.

-- Restrictions on the use, disposal, or sale of commodities.

-- An analysis of change in the dollar value and volume of commodities, including those (1) on hand at the beginning of the year, (2) acquired during the year, (3) disposed of during the year by method of disposition, (4) on hand at the end of the year, (5) on hand at year's end and estimated to be donated or transferred during the coming period, and (6) that may be received as a result of surrender of collateral related to nonrecourse

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loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments.

The provisions of this statement need not be applied to immaterial items.

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APPENDIX A: Basis of the Board's Conclusions

110 This Appendix discusses the substantive comments that the Board received from respondents to the Exposure Draft, Accounting for Inventory and Related Property, issued in January 1993. The Appendix explains the Board's conclusions on issues raised by the respondents. A separate section is identified for each of the six recommended standards.

INVENTORY

111 Several respondents questioned the need for the various inventory categories proposed; inventory held in reserve for future sale; and excess, obsolete and unserviceable inventory. Respondents and speakers stated that (1) the requirement to segregate inventory and inventory held in reserve for future sale could result in arbitrary and subjective balance sheet allocations, (2) the category for excess, obsolete and unserviceable is unnecessary and (3) it is not cost-effective to modify systems to capture this data. However, other respondents supported the categories and indicated that they would result in more meaningful information.

112 Based on the comment letters received and the presentations at the public hearing, the objections seemed to be based on the belief that the Board intended to develop rigid guidelines for the categorization of inventory. However, it is apparent that these or similar categories are used internally by organizations. The Board is merely attempting to improve disclosure related to these categories. The Board concluded that the four categories should be maintained. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.

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113 Several respondents opposed identifying the holding costs associated with inventory held in reserve for future sale. They indicated that the information has no apparent utility value, that it was virtually impossible to compute and maintain incremental holding costs for the reserve, and that disclosure would not provide managers with useful information to make relevant decisions. They also indicated that this requirement would be too subjective and difficult to audit. The Board discussed this issue and concluded that the identification of holding cost was a broad issue and deserving of more detailed treatment than could be afforded in the inventory standard. The Board agreed to drop the disclosure requirement and to defer this issue until a later project on cost issues. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.

114 In the exposure draft, the Board requested opinions on two presentation formats for cost of goods sold and the change in the allowance for holding gains and losses under latest acquisition cost (LAC) (Par. 87). The following two cost of goods sold computations under the latest acquisition cost method where presented:

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Proposed presentation: (Appendix A)	Alternative presentation: (Appendix B)
Cost of Goods Sold:	Cost of Goods Sold:
Beginning Inventory at LAC	Beginning Inventory at LAC
	LESS: Allowance
ADD: Purchases	ADD: Purchases
EQUALS: Cost of Goods Available for Sale	EQUALS: Cost of Goods Available for Sale
LESS: Ending Inventory at LAC	LESS: Ending Inventory at LAC less Allowance
EQUALS: Cost of Goods Sold	EQUALS: Cost of Goods Sold
Nonoperating Change (Change in the Allowance for Unrealized Holding Gain/Loss on Inventory)	

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115 Most respondents to the question regarding the two alternative cost of goods sold computations indicated a preference for the alternative presentation from Appendix B. These respondents stated that changes in cost were "operating" in nature and should be included in the operating results. It was also noted that comparability would be improved under the alternative treatment since cost of goods sold would approximate historical cost. Two respondents provided examples of the "distortion of cost of goods sold" that may result under the proposed presentation. The examples showed that cost of goods sold as calculated under the first proposed treatment (Appendix A of the ED) might actually be less than it would have been under historical cost.

116 In reviewing the responses, it was noted that the "nonoperating change" seems to have been confused by some respondents with the "unrealized holding gain/loss" for the period. The full title, "Nonoperating Change - Change in the Balance of the Allowance for Unrealized Holding Gains/Losses" is, although cumbersome, more descriptive. The change in the balance is made up of decreases, due to liquidation of inventory or cost decreases, and increases, due to holding more inventory or cost increases. The net change should not be confused with the "unrealized holding gain/loss" for the period.

117 The Board, after much discussion, decided to adopt the alternative presentation (Appendix B of the ED). This would avoid (1) confusion as to the significance of the "nonoperating change" and (2) distortion of the cost of goods sold. In addition, for those wish to know the change in the allowance account, the Board decided that line items should be included in the calculation of the cost of goods sold to show the beginning and ending balances.

118 Some respondents believed that the Board should adopt the lower of cost or market (LCM) rule (traditional under Accounting Research Bulletin (ARB) 43) for valuing inventory. Respondents supporting the LCM rule stated that:

-- it provides a basis for measuring the utility of inventory, and

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-- the operating performance financial reporting objective seems to require that matching or assigning revenues and expenses to the appropriate period be a primary concern.

119 In evaluating the LCM rule the Board considered some of the unique facets of the Federal environment:

-- pricing is often based on full cost recovery regardless of changes in market pricing, and

-- managers are often required to stock inventory based on legislative or mission concerns that are not driven by profit maximization (therefore, cost fluctuations are not as relevant to performance measurement).

120 The Board concluded that there was no need to include the LCM rule in the inventory standards.

121 The Board requested comments on the impact of historical cost accounting on performance measurement, and the costs and benefits of market value accounting. The majority of respondents that addressed these questions expressed a preference for historical cost accounting due to its verifiability and understandability. They also believed that market value methods were too costly to implement and subjective. Another said that for most government operations, the goal is cost recovery and market value has little relevance.

122 One Board member believes that market value information is more relevant to decision makers than historical cost information. This opinion is shared by many in the academic community. However, the Board devoted considerable resources to the issue of measuring and reporting on holding gains and losses, an essential component of market value accounting, and was unable to resolve the issues that arose in a manner that would have been cost-effective. The Board has decided to rely primarily on historical cost accounting for inventory.

123 The Board also requested comments on the standard cost using replacement cost method. The method was described in detail in Appendix C to the exposure draft. "Standard

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costs" are defined as predetermined or budgeted per-unit costs. Standard costs are commonly used in manufacturing concerns and are being adopted in service industries as well.

124 In a standard cost system, variances between the actual per-unit cost and the standard per-unit rate are identified. Variances are typically calculated for the individual cost components, such as materials or labor, included in the overall per-unit rate.

125 Standard costs also provide managers useful information for managing inventory costs. As an agency purchases inventory during the year and incurs operating costs, the actual costs are compared with the standard costs to identify why the cost variances occurred. Since inventory and operating managers are evaluated against the standard, the managers have an incentive to meet the standard, which, in turn, provides for effective inventory cost control.

126 The distinction between the traditional standard cost system and that outlined in the exposure draft relates to replacement cost information. The method on which comments were requested would require standard costs based on the next period's expected replacement costs and overhead rates. Further, no adjustment to historical cost amounts would have been required for external reporting purposes.

127 The majority of the respondents cited substantially the same problems for this method as they cited for market value accounting in general. The calculations were viewed as complex, costly and subjective.

128 One Board member is concerned that this method would be excluded under the recommended standard. The Board does not believe that this is true. Standard cost systems, including replacement cost, are used internally in private industry to generate valuable management information. Standard cost information is then revised to approximate costs under historical cost bases because it is generally accepted accounting practices for financial reporting purposes. Therefore, a managerial costing system employing standards or replacement cost information that improves management's decision making could be entirely consistent with the standard so long as externally reported information approximates historical cost. Further, the Board expects to

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take up the issue of costing systems in a future project on cost measurement.

129 With regard to inventory held in reserve for future sale, one respondent indicated that the phrase "either reported or disclosed" (par. 39) implies off-balance sheet reporting. The respondent believes that this category should be reported on the balance sheet rather than disclosed. The Board concluded that the decision as to the level of detail shown on the balance sheet should be left to preparers and/or auditors. While the Board did not revise the standard to require reporting on the face of the financials, the language describing the reporting and disclosure options was clarified.

130 One respondent suggested that the standard be revised so that excess, obsolete and unserviceable inventory would be valued at the lower of cost or net realizable value rather than at net realizable value. The respondent indicated that any gains on excess, obsolete or unserviceable inventory due to valuation at net realizable value should be recognized only upon disposal of such inventory and not when identified as such or upon periodic revaluations. Private sector GAAP, per ARB 43, requires that losses be recognized prior to disposal of inventory but that gains not be recognized until realized. This one-sided treatment has been criticized over the years but has survived based on the principle of conservatism that has prevailed.

131 Since the Federal government does not operate in a "for-profit" environment and does not seek financing from investors who rely on audited financial statements to make decisions, the conservative position taken in the past is not as relevant. However, the Board concluded that no change to the standard was required.

132 Some respondents commented on the absence of the last-in, first-out cost flow (LIFO) method under acceptable cost flow assumptions; stating that LIFO should be included as an acceptable option under historical cost since it tends to match current costs with current revenues. The Board did not include LIFO as an acceptable cost flow assumption due to the stale inventory values reported on the balance sheet as a result. However, the Board did permit use of any method that reasonably approximates historical cost under one of

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the acceptable cost flow assumptions. Therefore, LIFO could be acceptable for an entity whose inventory turns over rapidly since there may be little difference between LIFO and any other cost flow assumption.

133 One respondent requested that the standard specifically address goods: a) held on consignment, b) acquired through barter, c) donated, d) that must be maintained by statute but have no market value, or e) that will not be sold or consumed but which must be held (e.g., weights and measures). The Board concluded that goods held on consignment were not within the scope of this standard. Goods maintained by statute but having no market value, and goods that will not be sold or consumed but must be held would presumably be categorized as stockpile materials and therefore no change to the standards was warranted. The Board did decide that valuation of goods acquired through barter or donated should be addressed under the inventory, operating materials and supplies, and stockpile materials standards.

OPERATING MATERIALS AND SUPPLIES

134 Respondents suggested that if a valuation method such as latest acquisition cost (LAC) is acceptable for inventory it should also be acceptable for operating materials and supplies. The Board agreed with this proposal since LAC approximates historical cost. Further, the Board believes that any method that approximates historical cost should be acceptable. The standard was revised accordingly.

STOCKPILE MATERIALS

135 Respondents indicated that the definition of stockpile materials would encompass routinely held reserves as well as major stockpiles of materials. It was the Board's intention to include only those items specifically identified by law as being "stockpiled." Items routinely used but held in unusually large quantities would not be included in this category but would remain components of inventory or operating materials and supplies; possibly categorized as held in reserve for future sale or use.

136 In addition, one respondent identified helium reserves as being mandated by law for "conservation" purposes. The Board concluded that it would be consistent to

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include these reserves in stockpile materials. The definition has been clarified to limit stockpile materials to items held in order to comply with legal requirements established for purposes of defense, emergency or conservation.

137 As was the case for operating materials and supplies, respondents indicated that use of LAC would be appropriate for stockpile materials. The Board reached the same conclusion for this standard; that any method that approximates historical cost should be acceptable. The standard was revised accordingly.

138 One respondent suggested that an exception to permit market valuation for items that are interchangeable, have a ready market, and for which the unit cost is not determinable be added to the standard. The inventory standard provides this exception and the respondent suggested that it be available for stockpile material so that items such as strategic petroleum reserves could be valued at market value. The Board concluded that since these items are not routinely sold in large quantities the recognition of holding gains/losses may have an adverse impact on measurement of operating performance. Therefore, the exception was not added to the standard for stockpile materials.

SEIZED AND FORFEITED ASSETS

139 A respondent explained at the public hearing that a good portion of the forfeited assets are seized and valued under conditions which make accurate appraisals extremely difficult. As a result, there have been values reported for assets well in excess of what is eventually realized. The determination of the market value prior to the actual sale of the item is very difficult. The respondent has found that when the best estimate of market value is made on an item by item basis, the total value is still found to be overstated.

140 To avoid overstating deferred revenue, the respondent recommended that a valuation allowance be created to adjust the reported value of assets in the financial statements. The valuation allowance would be based on historical trends or other relevant information; in a manner similar to that used to establish an allowance for uncollectible receivables. For example, information over the

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last six months may show sale proceeds were 5% to 10% less than appraised values. Further, the respondent believes that use of the valuation allowance would recognize the inherent difficulties in estimating market values and would present better financial information.

141 Although the proposal is not without merit, it may be an unnecessary exercise. Market value is an estimate of the amount to be realized upon disposal of the property and should take into account the marketplace in which the property is expected to be disposed of (e.g., auction, fire sale, retail or wholesale markets, etc.). The use of valuation allowances against any asset category is not prohibited, however, the Board does not believe it necessary to require the use of a valuation allowance in this circumstance.

142 One respondent requested that the standard require that, in addition to recording deferred revenue, deferred distributions be recorded. A respondent at the public hearing explained that historically as much as 50% of the forfeited property is eventually distributed to federal, state, and local law enforcement entities which participated in the case. It was further explained that once property has been forfeited, a participating state, local, or federal agency may have already applied to receive that asset because of its participation in the case. Therefore, the recording of deferred revenue could be accompanied, where appropriate, by the recording of an estimate of deferred distributions. The intent of this is to avoid reporting misleading information in the financial statements.

143 The deferred distribution would represent another level of estimates related to forfeited property. In discussions with representatives from other agencies that handle seized and forfeited property, the Board has been told that no reasonable estimate of deferred distributions was available.

144 In addition to the difficulty in estimating distributions, the Board notes that there is no legal requirement to make a specific distribution until an application has been approved. This is similar in a sense to dividends declared by for-profit enterprises. There is no legal obligation to make a payment until the actual declaration by the Board of Directors; and the entity does

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not record dividends payable until that time. Therefore, the Board has not revised the standard as suggested. However, the Board has added a disclosure requirement for any reasonable estimate of future distributions.

145 The comment letters also included proposals for miscellaneous changes to this standard:

1) In that the government does not have ownership, seized monetary instruments should be disclosed rather than reported on the face of the financials.

2) Seized property other than monetary instruments should be reported as assets, like monetary instruments, with a liability for possible remittance of equal value recorded.

3) For non-monetary forfeited assets the disclosure requirements are adequate to ensure information is available to users. Therefore, non-monetary forfeited assets should not be reported on the face of the financial statements.

4) At the time that forfeiture judgement is obtained, ownership of the property is effectively transferred to the federal agency and the government should recognize the revenue earned at that time rather than deferring it.

146 The first two suggestions relate to seized property. The Board considered these suggestions during its discussions of seized property. The Board did not revise the standard; this was based on (1) the desire to establish strong controls over monetary instruments and (2) the difficulties in valuing and uncertainties regarding disposition associated with seized non-monetary property.

147 The third and fourth items relate to forfeited property. The suggestion to disclose forfeited non-monetary instruments, item 3, would result in understatement of the entity's assets. Disclosure requirements should emphasize that the value reported is merely an "estimate" of the

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property's value. The suggestion to recognize revenue upon forfeiture, item 4, while theoretically correct was not adopted by the Board. Due to the difficulties in valuing forfeited property and the risk of overstating the revenue the Board decided to defer revenue recognition until the property was sold.

148 One respondent requested that the standard address valuation of property for which there is no value, which cannot be legally sold, but which can be donated to museums or other non-profit organizations (e.g., stuffed endangered species) or destroyed (e.g., narcotics). The standard was revised to clarify the disclosure requirements and to indicate that no financial value need be reported for these items. Entities are not prohibited from reporting information regarding the dollar value of illegal assets seized if they so chose. The standard only relates to financial recognition and disclosure.

149 One respondent indicated that the analysis of change in seizures disclosure requirement is very detailed and should not be required for agencies with only incidental seizure activity. The Board has indicated that the standard is not intended to be applied to immaterial items.

150 One respondent noted that the definitions of seized and forfeited property seem to be limited to monetary instruments, real property and tangible personal property. The respondent asked that this definition be extended to intangible assets (e.g., savings and loan charters). The Board did broaden the definition to address intangible property.

151 One respondent explained that the exposure draft can be interpreted to advise agencies to account for the assets through the seizing agency's property records and financial statements. However, in most cases, the seizing agency is different from the custodial agency which may take possession of seized property. In addition, there may be a central fund created to support activities of multiple agencies. It was recommended that the standard be modified to recognize the distinction between "seizing agencies" and "custodial agencies." A "central fund" would be responsible for accounting and reporting for the assets of the asset forfeiture fund.

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152 The exposure draft had defined "seized property" as being "in the actual or constructive possession of the seizing agency." The respondent has correctly pointed out that this is not always the case since custodial agencies frequently take possession and/or responsibility for seized property. Depending on the circumstances, each party may have a need to maintain property records regarding seized property. For example, a seizing agency may wish to track property that may be ultimately distributed to it. In addition, seizing agencies may maintain physical possession of the property during the forfeiture process. The Board has modified the definition to include seized property held by custodial agencies.

153 With regard to the request for a clear statement of which agency is to maintain records on seized property, the Board believes that seizing agencies may have a need for property records related to seized property and does not wish to preclude them from doing so. However, in preparing consolidated financial statements care should be taken to avoid double counting these items. With regard to forfeited property, ownership should be the determinant for an entity's recognition of an asset. However, an agency that maintains physical custody, but not ownership, of forfeited property is not precluded from maintaining property records although no asset should be recognized.

FORECLOSED PROPERTY

154 Many respondents objected to the requirement to value post-1991 foreclosed property at net present value (NPV). The primary objections to the use of NPV were:

-- NPV is not a more accurate valuation basis than net realizable value (NRV)

-- NPV does not improve the information presented

-- Difference between NPV and NRV is immaterial

-- Loss of comparability with commercial enterprises

-- Maintenance of two systems to value foreclosed property (pre-1992 and post-1991)

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is costly and unnecessary

-- Changes in existing systems would be complicated and expensive

-- Cash flows may not be forecast with sufficient accuracy to measure NPV

155 In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 (the Act) and to make financial reporting compatible with the budget. Since foreclosed property is a result of the original loan transaction or loan guarantee, reporting on this activity should be guided by the provisions of the Act.

156 An extensive discussion of the Board's overall decision to require present value accounting is presented in Recommended Accounting Standard No. 2, "Accounting for Direct Loans and Loan Guarantees" (see Appendix A). One of the objectives of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget. The Board believes that only by using the same basis can financial information be used to compare the actual results of operations with the budget.

157 However, the Board wishes to acknowledge that respondents may be correct in stating that in certain cases there may be only immaterial differences between net realizable value (or other methods) and NPV. The standard has been revised to indicate that if no material difference results, other valuation methods may be used for foreclosed property.

158 One respondent currently values foreclosed vessels at their acquisition price based on its own bid at the foreclosure sale. Following acquisition, the value is depreciated at one-percent per month. Gains or losses are recognized upon sale. The respondent believes that the current practice is more appropriate because: (1) the price paid at foreclosure sale represents the best valuation, (2) estimating future net cash flows requires assumptions and this would be less prudent than utilizing existing specific valuations, and (3) the entity has had to establish the value of the vessels in legal proceedings and has relied on

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the acquisition price to do so - utilizing a different value in financial records could jeopardize the entity's position in legal proceedings. The Board has not revised the standard as a result of this request. The Board believes that there are no unique circumstances in this case which would preclude conformance to the standard.

GOODS HELD UNDER PRICE SUPPORT AND STABILIZATION PROGRAMS

159 The proposed standard required that nonrecourse loans be adjusted at time of disbursement to recognize a loss if the market rate is lower than the loan rate. This constituted a departure from current practice that is to adjust the loan values to their expected net realizable value at report date. Respondents expressed concern that the proposed method would result in recognizing losses without consideration of the underlying economic transaction (i.e., will the loans be repaid).

160 Based on two respondents' comments, the Board found that the approach originally proposed ignored the "probability" component in recognizing unrealized losses; these losses have typically been recognized only if they are "probable and measurable. Nonrecourse loans, being short-lived, are similar in nature to notes or accounts receivable. Therefore, the Board referred to its recommended standard for accounts receivable. That standard states that:

> Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence.
>
> An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value. The allowance for uncollectible amounts should be reestimated on each financial reporting date and when information indicates that the latest estimate is no longer correct. (FASAB, Recommended Accounting Standard 1, Paragraphs 44 and 45)

161 In addition, one respondent indicated that the originally proposed standard would have excluded loss recognition due to factors other than fluctuations in the

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market rates. Losses can occur due to (1) farmers' misuse or handling of the pledged commodities, or (2) fraud. Clearly the concept of loss recognition should be broadened in order to recognize these events. The Board modified the standard for nonrecourse loans to be more consistent with the accounts receivable standard and to encompass the Board's current thinking on the liability project.

162 One respondent argued that purchase agreements constitute a contingent liability. The proposed standard would require recognizing a liability and a loss if the contract price exceeded the expected net realizable value of the commodities. It is clear that at any given time the market price may be lower than the contract price but that due to cycles in the harvest and post-harvest market this may not be an indication that the contract will be executed and a loss realized. The Board revised the standard to provide for loss recognition in connection with purchase agreements if the loss is both probable and measurable.

****

GLOSSARY

This glossary provides definitions for many terms used in this Statement. The definitions may be modified or superseded when relevant terms are considered or defined by the Board in future projects.

CENTRAL FUND: An entity created to support the seizure activities of multiple law enforcement agencies.

COLLATERAL: Real or personal property pledged as part or full security on a debt. ("Kohler's Dictionary for Accountants," W. W. Cooper and Yuji Ijiri, Prentice Hall, Inc., New Jersey, 1983)

CONSUMPTION METHOD: A method of accounting for goods, such as materials and supplies, where the goods are recognized as assets upon acquisition and are expensed as they are consumed.

CONTRA COUNT: One of two or more accounts which partially or wholly offset another or other accounts; on financial statements, they may be either merged or appear together. ("Kohler's Dictionary for Accountants")

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COST-BENEFIT ANALYSIS: The weighing of benefits against costs usually expressed as a ratio of dollar benefits to dollar costs for each of a variety of alternatives to provide a comparable basis of choice among them. ("Kohler's Dictionary for Accountants")

DEFAULT: The failure to meet any obligation or term of a credit agreement, grant, or contract. Often used to refer to accounts more than 90 days delinquent. (Treasury Financial Manual Supplement)

DIRECT LOAN: A disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular No. A-11, 33.5 (d))

DISCLOSURE: An explanation, or exhibit, attached to a financial statement, or embodied in a report (e.g., an auditor's) containing a fact, opinion, or detail required or helpful in the interpretation of the statement or report; an expanded heading or a footnote. ("Kohler's Dictionary for Accountants")

DISCOUNT: The difference between the estimated worth of a future benefit and its present value; a compensation for waiting or an allowance for returns from using the present value of these returns in other ways. ("Kohler's Dictionary for Accountants")

DISCOUNT RATE: An interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

END USER: Any component of a reporting entity that obtains goods for direct use in its normal operations. The component may also be a contractor.

FIRST-IN, FIRST-OUT (FIFO): A cost flow assumption; the first goods purchased or produced are assumed to be the first goods sold.

FORECLOSURE: A method of enforcing payment of a debt secured by a mortgage by seizing the mortgaged property.

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Foreclosure terminates all rights that the mortgagor has in the mortgaged property upon completion of due process through the courts. ("Treasury Financial Manual Supplement")

INTEREST RATE: The price charged per unit of money borrowed per year, or other unit of time, usually expressed as a percentage. ("Kohler's Dictionary for Accountants")

LAST-IN, FIRST-OUT (LIFO): A cost flow assumption; the last goods purchased are assumed to be the first goods sold.

LATEST ACQUISITION COST: Includes all amounts, except interest, paid to a vendor to acquire an item.

LOAN GUARANTEE: Any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender but does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (OMB Circular A-11, 33.5 (g))

LOSS: Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected. ("Kohler's Dictionary for Accountants")

LOWER OF COST OR MARKET: A valuation rule that recognizes impairment of asset values but avoids anticipated gains. The rule is typically applied to individual items or groups of like items, such as inventory or marketable securities. In this rule, "cost" refers to historical cost and "market" refers to the current replacement cost by purchase or production. ("Kohler's Dictionary for Accountants")

MARKET VALUE: The estimated amount that can be realized by disposing of an item through arm's length transactions in the marketplace; the price (usually representative) at which bona fide sales have been consummated for products of like kind, quality, and quantity in a particular market at any moment of time. For investments in marketable securities, the term refers to the market price of a security times the number of shares of that security held.

MOVING AVERAGE: An inventory costing method used in conjunction with a perpetual inventory system. A weighted average cost per unit is recomputed after every purchase.

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Goods sold are costed at the most recent moving average cost.

NET REALIZABLE VALUE: The estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal. ("Kohler's Dictionary for Accountants")

PURCHASES METHOD: A method of accounting for goods, such as materials and supplies, in which the acquisition cost is recognized as an expense upon purchase of the goods rather than upon their use.

PRESENT VALUE: The value now of a future sum or sums discounted assuming compound interest. (Kieso and Weygandt, Intermediate Accounting, 7th ed., p. 264)

RECOGNIZE: To determine the amount, timing, classification, and other conditions precedent to the acceptance and entry of a transaction. Hence, to give expression on the books of account; said of transactions. ("Kohler's Dictionary for Accountants")

RECORD: To give expression to a transaction on (or in) the books of account; to enter. ("Kohler's Dictionary for Accountants")

REPAIRABLE: An inventory item that is expected to be repaired when broken or worn out.

REPLACEMENT COST: The cost to reproduce an inventory item by purchase or manufacture. In lower of cost or market computations, the term "market" means replacement cost, subject to ceiling and floor limitations.

SELLING EXPENSE (COST): Expenses incurred in selling or marketing, e.g., salaries, commissions, and promotion expenses. ("Kohler's Dictionary for Accountants")

SPECIFIC IDENTIFICATION: An inventory system in which the seller identifies which specific items are sold and which remain in ending inventory.

STANDARD COSTS: Predetermined expected unit costs, which are acceptable for financial reporting purposes if adjusted periodically to reflect actual results.

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TITLE: The right to property; the means by which such right is established. ("Kohler's Dictionary for Accountants")

VALUATION (OR ACCOUNTING VALUATION): Valuation methods and bases are numerous and varied; and may be expressed quantitatively and in monetary terms. Application may be made to a single asset, a group of assets, or an entire enterprise, as determined by various bases and methods. ("Kohler's Dictionary for Accountants")

VALUATION ACCOUNT (ALLOWANCE OR RESERVE): An account that partly or wholly offsets one or more other accounts; for example, accumulated depreciation is a valuation account related to specific depreciable assets and allowance for bad debts is a valuation account related to accounts receivable. If a valuation account is deducted from the related asset or liability it is sometimes referred to as a contra-asset or contra-liability account. ("Kohler's Dictionary for Accountants")

VARIANCE: The difference for a year or less between the elements (direct material, direct labor, factory overhead) of standard cost and actual cost. The term applies to (a) a money difference or (b) changes in the character or purpose of amounts expended. ("Kohler's Dictionary for Accountants")

WEIGHTED-AVERAGE: A periodic inventory costing method where ending inventory and cost of goods sold are priced at the weighted-average cost of all items available for sale.

WRITE-OFF: An action to remove an amount from an entity's assets or financial resources. A write-off of a loan occurs when an agency official determines, after all appropriate collection tools have been used, that a debt is uncollectible. Active collection on an account ceases, and the account is removed from an entity's receivables. ("Treasury Financial Manual Supplement").

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Statement #4/Managerial Cost Accounting Concepts and Standards for the Federal Government

Executive Office of the President
Office of Management and Budget

"Managerial Cost Accounting Concepts and Standards for the Federal Government"

Statement of Federal Financial Accounting Standards
Number 4

July 31, 1995

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TABLE OF CONTNETS

EXECUTIVE SUMMARY (paragraphs 1-12)

INTRODUCTION (paragraphs 13-30)

Background
Users of Federal Government Cost Information
Objectives
Terminology
Materiality
Effective Date

PURPOSES OF USING COST INFORMATION (paragraphs 31-40)

Budgeting and Cost Control
Performance Measurement
Determining Reimbursements and Setting Fees and Prices
Program Evaluations
Economic Choice Decisions

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MANAGERIAL COST ACCOUNTING CONCEPTS (paragraphs 41-66)

MANAGERIAL COST ACCOUNTING STANDARDS (paragraphs 67-162)
Requirement for Cost Accounting (paragraphs 67-76)

Responsibility Segments (paragraphs 77-88)
Full Cost (paragraphs 89-104)

Inter-Entity Costs (paragraphs 105-115)

Costing Methodology (paragraphs 116-162)

APPENDIX A: Basis for Conclusions (paragraphs 163-270)

APPENDIX B: Glossary

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EXECUTIVE SUMMARY

1. The managerial cost accounting concepts and standards contained in this statement are aimed at providing reliable and timely information on the full cost of federal programs, their activities, and outputs. The cost information can be used by the Congress and federal executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance. The cost information can also be used by program managers in making managerial decisions to improve operating economy and efficiency.

2. The concepts of managerial cost accounting contained in this statement describe the relationship among cost accounting, financial reporting, and budgeting. The five standards set forth the fundamental elements of managerial cost accounting: (1) accumulating and reporting costs of activities on a regular basis for management information purposes, (2) establishing responsibility segments to match costs with outputs, (3) determining full costs of government goods and services, (4) recognizing the costs of goods and services provided among federal

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entities, and (5) using appropriate costing methodologies to accumulate and assign costs to outputs.

3. These standards are based on sound cost accounting concepts and are broad enough to allow maximum flexibility for agency managers to develop costing methods that are best suited to their operational environment. Also, the managerial cost accounting standards and practices will evolve and improve as agencies gain experience in using them. The following is a summary of the concepts and standards contained in this statement:

Managerial Cost Accounting Concepts

4. Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition, and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other.

Managerial Cost Accounting Standards

Requirement for cost accounting

5. Each reporting entity should accumulate and report the costs of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

Responsibility segments

6. Management of each reporting entity should define and establish responsibility segments. Managerial cost accounting should

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be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should be performed to determine the costs of outputs.

Full cost

7. Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

Inter-entity costs

8. Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.

9. Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities generally should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity.

Costing methodology

10. Costs of resources consumed by

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responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are most appropriate to the segment's operating environment and should be followed consistently.

11. The cost assignments should be performed using the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

12. These accounting standards need not be applied to items that are qualitatively and quantitatively immaterial. The Board recommends that the managerial accounting standards of this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

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INTRODUCTION

Background

13. Reliable information on the costs of federal programs and activities is crucial for effective management of government operations. In Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, Objectives of Federal Financial Reporting, issued in 1993, it is stated that the objectives of federal financial reporting are to provide useful information to assist internal and external users in assessing the budget integrity, operating performance, stewardship, and systems and control

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of the federal government.[Footnote 1]

[Footnote 1: Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting" (September 2, 1993), pars. 110 and 111, pages 34-35.]

14. Managerial cost accounting is especially important for fulfilling the objective of assessing operating performance. In relation to that objective, it is stated in SFFAC No. 1 that federal financial reporting should provide information that helps users to determine:

-- Costs of specific programs and activities and the composition of, and changes in, those costs;

-- Efforts and accomplishments associated with federal programs and their changes over time and in relation to costs; and

-- Efficiency and effectiveness of the government's management of its assets and liabilities.[Footnote 2]

[Footnote 2: Ibid., pars. 126-130, pages 39-40.]

15. It is further stated in SFFAC No. 1 that "The topics of costs and performance measurement are related because it is by associating cost with activities or cost objectives that accounting can make much of its contribution to reporting on performance."[Footnote 3] "Cost" is the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service. Costs incurred may benefit current and future periods. In financial accounting and reporting, the costs that apply to an entity's operations for the current accounting period are recognized as expenses of that period.

[Footnote 3: Ibid., par. 192, page 63.]

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16. The Chief Financial Officers Act of 1990 includes among the functions of chief financial officers "the development and reporting of cost information" and "the systematic measurement of performance."[Footnote 4] In July 1993, Congress passed the Government Performance and Results Act (GPRA) which mandates performance measurement by federal agencies.[Footnote 5] In September 1993, in his report to the President on the National Performance Review (NPR), Vice President Al Gore recommended an action which required the Federal Accounting Standards Advisory Board to issue a set of cost accounting standards for all federal activities.[Footnote 6] Those standards will provide a method for identifying the unit cost of all government activities.

[Footnote 4: 104 Stat. 2938 (See particularly 31 U.S.C. sec 902).]

[Footnote 5: 107 Stat. 285 (See particularly, 31 U.S.C. sections 1101, 1105, 1115, 1116-1119, 9703, 9704).]

[Footnote 6: Vice President Al Gore, "Creating A Government That Works Better & Costs Less," Accompanying Report of the National Performance Review (September 1993), p. 59.]

17. In early 1994, the Federal Accounting Standards Advisory Board (the Board) convened an advisory group to help develop standards for managerial cost accounting in the federal government. The group included members from government, business, and academe. Their views and proposals have been considered by the Board, and their work contributed greatly in developing this document.

Users of Federal Cost Information

18. The cost of government is a concern to the public as well as to the federal government itself. Most government service efforts and accomplishments cannot be measured in financial

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terms alone. Unlike private business, there is no "bottom line" or profit index to help measure public sector performance. However, government service efforts and accomplishments can be evaluated using both financial and non-financial measures, and "cost" is an important financial measure for government programs. Internal and external federal information users identified below will find these standards helpful in assessing operating performance, stewardship, systems, and control of the federal government.

19. Government managers are the primary users of cost information. They are responsible for carrying out program objectives with resources entrusted to them. Reliable and timely cost information helps them ensure that resources are spent to achieve expected results and outputs, and alerts them to waste and inefficiency.

20. Congress and federal executives, including the President, make policy decisions on program priorities and allocate resources among programs. These officials need cost information to compare alternative courses of action and to make program authorization decisions by assessing costs and benefits. They also need cost information to evaluate program performance.

21. Citizens, including news media and interest groups, are concerned with the costs and results of federal programs that affect their interests. They need program cost information to judge whether resources are allocated to programs rationally and if the programs operate efficiently and effectively.

Objectives

22. The managerial cost accounting concepts and standards presented here are intended for all the user groups identified above. These standards are aimed at achieving three general objectives:

-- Provide program managers [Footnote 7] with relevant and reliable information relating

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costs to outputs and activities. Based on this information, program managers can respond to inquiries about the costs of the activities they manage. The cost information will assist them in improving operational economy and efficiency;

[Footnote 7: Statement of Federal Financial Accounting Concepts No.1, "Objectives of Financial Reporting," defined "Program managers" as individuals who manage federal programs, and stated that "Their concerns include operating plans, program operations, and budget execution." SFFAC No. 1, par. 85, page 29.]

-- Provide relevant and reliable cost information to assist the Congress and executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance; and

-- Ensure consistency between costs reported in general purpose financial reports and costs reported to program managers. This includes standardizing terminology for managerial cost accounting to improve communication among federal organizations and users of cost information.

Scope of Standards

23. This statement contains managerial cost concepts and five standards for the federal government. The five standards address the following topics:

(1) Requirement for cost accounting,
(2) Responsibility segments,
(3) Full cost,
(4) Inter-entity costs, and
(5) Costing methodology.

The essence of each standard is briefly stated in a box followed by detailed explanations. However, both the words in the boxes and the entire text of

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explanations constitute the requirements of the standards.

24. These standards are based on sound cost accounting concepts and allow sufficient flexibility for agencies to develop managerial cost accounting practices that are suited to their specific operating environments. Also, it is expected that cost accounting standards and practices will evolve and improve as agencies gain experience in using them.

25. Other Statements of Federal Financial Accounting Standards (SFFAS) address recognition and measurement of assets and liabilities. For additional guidance, readers should consult: SFFAS No. 1, Accounting for Selected Assets and Liabilities; SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees; and SFFAS No. 3, Accounting for Inventory and Related Property. The Board is working on and will soon complete other recognition and measurement projects related to revenues, liabilities, property, plant, and equipment, and other elements of financial statements.[Footnote 8]

[Footnote 8: See FASAB Exposure Drafts, "Accounting for Liabilities of the Federal Government" (November 7, 1994); "Accounting for Property, Plant, and Equipment" (February 28, 1995); and "Revenue and Other Financing Sources" (Pending).]

Terminology

26. Managerial cost accounting information, to be useful, must rely on consistent and uniform terminology for concepts, practices, and techniques. Consistent and uniform use of terminology can help avoid confusion and mis-communication among organizations and individuals.

27. As a start toward developing consistent managerial cost accounting terminology within the federal government, this statement includes a glossary of basic cost accounting terms.

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Materiality

28. Except as otherwise noted, the accounting and reporting provisions of these accounting standards need not be applied to items that are qualitatively and quantitatively immaterial.

29. The determination of whether an item is material depends on the degree to which omitting information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission.

Effective Date

30. The Board recommends that the accounting standards of this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

Purposes of Using Cost Information

31. There are many different purposes for which cost information may be used by the federal government. The focus of this statement is on cost information needed to improve federal financial management and managerial decision making.

32. In managing federal government programs, cost information is essential in the following five areas: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees and prices, (4) program evaluations, and (5) making economic choice decisions. Each of these uses is discussed below.

Budgeting and Cost Control

33. Information on the costs of program activities can be used as a basis to estimate future costs in

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preparing and reviewing budgets. Once budgets are approved and executed, cost information serves as a feedback to budgets. Using cost information, federal managers can control and reduce costs, and find and avoid waste. For example, with appropriate cost information, federal managers can:

-- Compare costs with known or assumed benefits of activities, identify value-added and non-value-added activities, and make decisions to reduce resources devoted to activities that are not cost-effective;

-- Compare and determine reasons for variances between actual and budgeted costs of an activity or a product;

-- Compare cost changes over time and identify their causes;

-- Identify and reduce excess capacity costs; and

-- Compare costs of similar activities and find causes for cost differences, if any.

Performance Measurement

34. Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to ". . .improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results."

35. Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness. Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost

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information to show "cost-effectiveness." Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:

(1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;

(2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and

(3) Measures that relate efforts to accomplishments, Such as cost per unit of output or cost-effectiveness.

36. Thus, as stated previously, performance measurement requires both financial and non-financial measures. Cost is a necessary element for performance measurement, but is not the only element.

Determining Reimbursements and Setting Fees And Prices

37. Cost information is an important basis in setting fees and reimbursements. Pricing and costing, however, are two different concepts. Setting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies. Thus, the price of a good or service does not necessarily equal the cost of the good or the service determined under a particular set of principles. Nevertheless, cost is an important consideration in setting government prices. With certain exceptions, OMB requires: [Footnote 9]

[Footnote 9: OMB Circular A-25, User Charges (Revised July 8, 1993).]

-- With respect to goods and services that the government provides in its sovereign capacity to a particular group of individuals as a special benefit, user charges should be

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sufficient to recover the full cost of those goods and services; and

-- With respect to goods and services that the government provides under business-like conditions, user charges for those goods and services need not be limited to the recovery of full cost and may yield a net revenue.

38. Also, cost information is important in calculating reimbursements for products and services provided by one government agency to another. Even if fees or reimbursements do not recover the full costs due to policy or economic constraints, management needs to be aware of the difference between cost and price. With this information, program managers can properly inform the public, the Congress, and federal executives about the costs of providing the goods or services.

Program Evaluations

39. Costs of federal resources required by programs are an important factor in making policy decisions related to program authorization, modification, and discontinuation. These decisions are usually subject to policy constraints, and often require the consideration of social and economic costs and benefits affecting different sectors of the economy and society. Nevertheless, the costs of federal resources required are an important factor. Information on program costs can be used as a basis for cost-benefit considerations.

Economic Choice Decisions

40. Often, agencies and programs face decisions involving choices among alternative actions, such as whether to do a project in-house or contract it out; to accept or reject a proposal; or to continue or drop a product or service. Making these decisions requires cost comparisons among available alternatives.

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Managerial Cost Accounting Concepts

Managerial cost accounting should be a fundamental part of the financial management system and, to the extent practicable, should be integrated with other parts of the system. Managerial costing should use a basis of accounting, recognition, and measurement appropriate for the intended purpose. Cost information developed for different purposes should be drawn from a common data source, and output reports should be reconcilable to each other.

41. Managerial cost accounting should be an essential element of proper financial planning, control, and evaluation for any organization or activity that uses resources having monetary value. Managerial cost accounting is a basic part of the financial management system in that it supports and provides data to the budgetary and financial accounting functions and, by itself, provides useful information for both internal and external users.

Role of Managerial Cost Accounting in Financial Management

42. Managerial cost accounting is the process of accumulating, measuring, analyzing, interpreting, and reporting cost information useful to both internal and external groups concerned with the way in which the organization uses, accounts for, safeguards, and controls its resources to meet its objectives. Managerial cost accounting, therefore, is the servant of both budgetary and financial accounting and reporting because it assists those systems in providing information. Also, it provides useful information directly to management. These relationships are shown in Figure 1.

Figure 1: Financial Management Information Framework

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Common Data Source

43. The information flow within a financial management system begins with a basic information pool or common data source. This data source consists of all financial and programmatic information used by the budgetary, cost, and financial accounting processes. It includes all financial and much non-financial data, such as environmental data, that are necessary for budgeting and financial reporting.[Footnote 10] The common data source also includes evaluation and decision information developed as a result of prior reporting and feedback. Other types of data may be included based upon perceived needs and purposes related to the ultimate users of the information.

[Footnote 10: The makeup of core data and environmental data is discussed in Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," Chapter 7, and, therefore, a detailed discussion is not provided here.]

44. The common data source may include many different kinds of data. It is far more than the information about financial transactions found in the standard general ledger, although that is a significant part of the data source. Few organizations or entities maintain all these data in any one system or location. Furthermore, the use of the term "data source" is not meant to imply the use of computerized systems for source information. Instead, the term is used in a broad way to include many sources of information.

45. Managerial cost accounting, financial accounting, and budgetary accounting draw information as needed from the common data source. The data obtained by each of these is processed to attain specific objectives by reporting useful

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information.

Relationship to Financial Accounting

46. As shown in Figure 1 by their overlap, managerial cost accounting and financial accounting are closely related or integrated. To some degree, this is due to the historical development of cost accounting as a method for more detailed scorekeeping with the requirement to provide inventory values for external financial reporting purposes.[Footnote 11] In part, it is because cost information generally originates with transactions recorded for financial accounting purposes.

[Footnote 11: Coulthurst, Nigel and John Piper, "The State of Cost and Management Accounting," "Management Accounting," April 1986.]

47. While inventory valuation is still part of the fundamental relationship, managerial cost accounting serves financial accounting in several other ways. Fundamentally, managerial cost accounting should assist financial accounting in determining the results of operations during a fiscal period by providing relevant data that are accumulated to produce operating expenses. These data include the allocation of capitalized costs to periods of time or units of usage.

48. Traditionally, managerial cost accounting information pertaining to financial accounting has involved costs of past transactions and the assignment of transaction value to fiscal periods and outputs. These purposes and uses are closely aligned with the financial accounting activity and traditional external financial reporting. This past cost aspect has been acknowledged in Objectives of Federal Financial Reporting which states that "financial accounting is largely concerned with assigning the value of past transactions to appropriate time periods."[Footnote 12]

[Footnote 12: Statement of Federal Financial

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Accounting Concepts No.1, "Objectives of Federal Financial Reporting," par. 168, page 55.]

Relationship to Budgetary Accounting

49. Managerial cost accounting should also provide budgetary accounting with cost information. However, the two are not as closely aligned as is the case with financial accounting (see Figure 1). Mostly, this is because costs are usually recorded, accumulated, and allocated by managerial cost accounting on an accrual basis of accounting which is different from the obligation or cash basis generally used in budgetary accounting.

50. Still, managerial cost accounting does provide cost information to budgetary accounting for use in preparing yearly and long-term budgets for required materials, supplies, equipment, human resources, and other resources needed to produce different levels of outputs. Managerial cost accounting also helps in making many budgetary decisions such as those concerning future capital expenditures and purchase/lease alternatives.

51. It is important to note that the Board's authority does not extend to recommending budgetary standards or budgetary concepts, and that is not the purpose of this statement.[Footnote 13] However, the Board is committed to providing relevant and reliable cost accounting information that supports budget planning, formulation, and execution.

[Footnote 13: Memorandum of Understanding establishing the FASAB, October 10, 1990.]

Cost Information for Management Purposes

52. Managerial cost accounting produces information directly for management use, sometimes employing data produced by the budgetary and financial accounting processes. Cost information is used for many different purposes which can be generally classified into five types: performance

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measurement; cost reduction and control; determination of reimbursements and fee or price setting; program authorization, modification, and discontinuation decisions; and decisions to contract out work or make other changes in the methods of production.

53. To meet these needs, managerial cost accounting should use basic cost data and non-financial or programmatic data. For example, it tracks units of output produced and input used including the amount of labor in terms of employees or employee-hours. Sometimes, information from cost analysis is used to compare actual to predetermined or anticipated costs. An organization may use cost estimates, cost studies, and cost finding techniques.

54. While managerial cost accounting is concerned not only with past costs and future costs, one of its most important features is the use of present costs to assist management. This current cost aspect of managerial cost accounting is referred to in the Objectives of Federal Financial Reporting where is states that "accounting data may be further assigned, allocated, or associated with units of activity or production, segments of organizations, etc., within the same time period. These kinds of intraperiod allocations are developed most extensively in the branch of accounting called cost accounting. Neither the FASB nor the GASB has devoted much attention to this branch of accounting, but the FASAB, because of its unique mission, will need to do so."[Footnote 14] Managerial cost accounting information pertaining to present costs is most often used for controlling and reducing those costs, controlling work processes, and measuring current performance.

[Footnote 14: Statement of Federal Financial Accounting Concepts No. 1, "Objectives of Federal Financial Reporting," par. 174, page 56.]

Reporting Relationships

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55. Proper financial management requires that the three accounting processes work closely together to provide useful reporting to both internal and external users. The internal-external dual focus of federal reporting has been established in the Objectives of Federal Financial Reporting. It states that "The FASAB and its sponsors believe that any description of federal financial reporting objectives should consider the needs of both internal and external users and the decisions they make." In addition, it says that "the FASAB...considers the information needs of both internal and external users. In part, this is because the distinction between internal and external users is in many ways less significant for the federal government than for other entities." It goes on to classify the users of financial information into four major groups: program managers, executives, the Congress, and citizens.[Footnote 15] These categories include both internal and external users.

[Footnote 15: Ibid., pars. 23, 25, page 9; and par. 75, page 26.]

56. Federal financial reporting encompasses general and special purpose reports to meet the needs of the four user groups. Information produced by managerial cost accounting appears in or influences both types of reports.[Footnote 16] As discussed above, managerial cost accounting should provide information for use by both financial accounting and budgetary accounting. That information is used by those processes in producing both general purpose and special purpose reports.

[Footnote 16: The types of general purpose and special purpose reports are discussed in Statement of Federal Financial Accounting Concepts No.1, "Objectives of Federal Financial Reporting," Chapter 7.]

57. Managerial cost accounting also results in reports of its own. Most often these are special purpose reports designed for internal users, typically program and line managers. However,

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they may be for groups generally considered external users.

58. One of the most important aspects of reporting in which managerial cost accounting plays a large role is that of performance reporting. Measuring and reporting actual performance against established goals is essential to assess governmental accountability. Cost information is necessary in establishing strategic goals, measuring service efforts and accomplishments, and relating efforts to accomplishments. The importance of cost information in relation to performance measurement and performance reporting has been recognized in the Objectives of Federal Financial Reporting, which said "One reason for performing cost accounting is to assist in performance measurement" and it also stated that "The topics of cost and performance measurement are related because it is by associating cost with activities or 'cost objectives' that accounting can make much of its contribution to reporting on performance."[Footnote 17]

[Footnote 17: Ibid., par. 174, page 56; and par. 192, page 63.]

Basis of Accounting and Recognition/Measurement Methods

59. Costs may be measured, analyzed, and reported in many ways. A particular cost measurement has meaning only when considering its purpose. The measurement of costs can vary depending upon the circumstances and purpose for which the measurement is to be used. In Objectives of Federal Financial Reporting, it is stated that "the Board's own focus is on developing generally accepted accounting standards for reporting on the financial operations, financial position, and financial condition of the federal government and its component entities and other useful financial information. This implies a variety of measures of costs and other information that complements

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the information available in the budget [emphasis added]."[Footnote 18]

[Footnote 18: Ibid., par. 191, page 62.]

60. In addition, it is stated that "In defining the proper measurement, assignment, and allocation of cost for a given purpose, selecting the appropriate accounting method and whether to use full costing should be carefully considered."[Footnote 19] Further, it added that "The accrual basis of accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated."[Footnote 20]

[Footnote 19: Ibid., par. 196, page 64.]

[Footnote 20: Ibid., par. 197, page 64.]

61. Therefore, managerial cost accounting should provide cost information using a basis of accounting and recognition/measurement standards that are appropriate for the intended use of the information. When managerial cost accounting is used to supply information for use by financial accounting and financial reporting, that information should be consistent with the basis of accounting and recognition/measurement standards required by federal accounting principles. Traditionally this has meant the use of accrual accounting and historical cost measurement, particularly in general purpose reports.

62. When managerial cost accounting is used to supply information for the preparation and review of budgets, cost data should be consistent with the basis of accounting and recognition/measurement used in financial reporting, but may be adjusted to meet the budgetary information needs.

63. Special purpose cost studies and analyses are sometimes performed for decision making. In those studies and analyses, management may need to

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develop cost data beyond those currently reported in general purpose financial reports. For example, in making planning decisions, management may develop replacement costs and capital costs. However, the basis and methods used should be appropriate for the circumstances and consistent with the intended purposes.

Reconciliation of Information

64. Different bases of accounting will produce different costs for the same item, activity, or entity. This can confuse users of cost information. Therefore, reports that use different accounting bases or different recognition and measurement methods should be reconcilable, and should fully explain those bases and methods. Regardless of the type of report in which it is presented, cost information should ultimately be traceable back to the original common data source.

65. To be reconcilable, the amount of the differences in the information reported should be ascertainable and the reasons for the differences should be explainable. In some situations, informational differences may be clearly understandable without further explanation. However, other cases may require a narrative statement concerning the differences. In complicated situations, a schedule or table may be required to fully explain the differences.

66. Financial reporting has long recognized the necessity for reconciliation between information reported on different accounting bases. Reconciliations have been required in federal financial reports to show and explain significant differences between budget reports and financial statements prepared in accordance with generally accepted accounting principles.

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REQUIREMENT FOR COST ACCOUNTING

Each reporting entity [Footnote 21] should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

[Footnote 21: The term "reporting entity" as used in this docoment conveys the same meaning as defined in FASAB Statement of Recommended Accouynting Concepts No. 2, "Entity and Display" (May 1995).]

67. Cost information is essential to effective financial management and should play an important role in federal financial reporting. Managerial cost accounting processes are the means of providing cost information in an efficient and reliable manner on a continuing basis.

Need for Consistent Cost Accounting on a Regular Basis

68. To perform managerial cost accounting on a "regular basis" means that entities should establish procedures to accumulate and report costs continuously, routinely, and consistently for management information purposes. Consistent and regular cost accounting is needed to meet the second objective of federal financial reporting which states information should be provided to help the user determine the costs of providing specific programs and activities and the composition of, and changes in those costs. That objective also requires the reporting of performance information of federal programs and the changes over time in that performance in relation to the costs.

69. The requirement for managerial cost accounting on a regular and consistent basis supports recent legislative actions. The CFO Act of 1990 states that agency CFOs shall provide for the development and reporting of cost information

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and the periodic measurement of performance. In addition, the GPRA of 1993 requires each agency, for each program, to establish performance indicators and measure or assess relevant outputs, service levels, and outcomes of each program as a basis for comparing actual results with established goals. The nature of these legislative mandates requires reporting entities to develop and report cost information on a consistent and regular basis.

70. The managerial cost accounting processes consist of collecting data from the common data source, processing that data, and reporting cost and output information in general purpose and special purpose reports. Appropriate procedures and practices should also be established to enable the collection, measurement, accumulation, analysis, interpretation, and communication of cost information. This can be accomplished through the use of a cost accounting system or the use of cost finding techniques and other cost studies and analyses. A cost accounting "system" is an organized grouping of methods and activities designed to consistently produce reliable cost information.

Basic Cost Accounting Processes

71. Regardless of whether a reporting entity uses a cost accounting system or cost finding techniques, the methods and procedures followed should be designed to perform at least a certain minimum level of cost accounting and provide a basic amount of cost information necessary to accomplish the many objectives associated with planning, decision making, control, and reporting. The more important of these minimum criteria for cost accounting are associated with the standards in the remainder of this statement. Others are also important.

-- Responsibility Segments - Cost information should be collected by responsibility segments which have been identified by management and outputs should be defined for

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each responsibility segment.[Footnote 22]

[Footnote 22: See standard in this statement concerning responsibility segments.]

-- Full Costing - Each reporting entity should measure the full cost of outputs so that total operational costs and total unit costs of outputs can be determined. "Full cost" includes the cost of goods or services provided by other entities when the applicable criteria are met.[Footnote 23]

[Footnote 23: See standard concerning full costs and standard concerning inter-entity costing.]

-- Costing Methodology - The costing methodology used (e.g., activity-based costing, job order costing, standard costing, etc.) should be appropriate for management's needs and the operating environment.[Footnote 24]

[Footnote 24: See standard concerning costing methodology.]

-- Performance Measurement - Cost accounting should provide information needed to determine and report service efforts and accomplishments and information necessary to meet the requirements of the GPRA or interface with a system that provides such information. This includes the quantity of inputs and outputs and other non-financial information needed in the measurement of performance.

-- Reporting Frequency - Cost information should be reported in a timely manner and on a regular basis consistent with the needs of management and the requirements of both budgetary and financial reporting.

-- Standard General Ledger - Managerial cost accounting should be integrated with general financial accounting. Both depend on the standard general ledger for basic financial

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transaction data.

-- Precision of Information - Cost information supplied to internal and external users should be reliable and useful in making evaluations or decisions. At the same time, unnecessary precision and refinement of data should be avoided.

-- Special Situations - The managerial cost accounting processes should be designed to accommodate any of management's special cost information needs that may arise due to unusual or special situations or circumstances. If such cost information is needed on a regular basis, appropriate procedures to provide it should be developed.

-- Documentation - All managerial cost accounting activities, processes, and procedures should be documented by a manual, handbook, or guidebook of applicable accounting operations. This reference should outline the applicable activities, provide instructions for procedures and practices to be followed, list the cost accounts and subsidiary accounts related to the standard general ledger, and contain examples of forms and other documents used.

Complexity of Cost Accounting Processes

72. While each entity's managerial cost accounting should meet the basics discussed above, this standard does not specify the degree of complexity or sophistication of any managerial cost accounting process. Each reporting entity should determine the appropriate detail for its cost accounting processes and procedures based on several factors. These include the:

-- nature of the entity's operations;

-- precision desired and needed in cost information;

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-- practicality of data collection and processing;

-- availability of electronic data handling facilities;

-- cost of installing, operating, and maintaining the cost accounting processes; and

-- any specific information needs of management.

73. Some entities may find that they can purchase basic "off-the-shelf" cost accounting programs, systems, or processes, or adapt those of other federal agencies. All entities should consider using similar or compatible cost accounting processes throughout their component units to facilitate comparison and consolidation of cost information.

Cost Findings, Studies, and Analyses

74. A cost accounting system is a continuous and systematic cost accounting process which may be designed to accumulate and assign costs to a variety of objects routinely or as desired by the management. Such a system may be best for some reporting entities.

75. Some entities may not need a sophisticated system to perform detailed cost accumulation and assignment. They need to accumulate and report costs regularly as required by this standard, but they may determine and analyze costs through special cost studies and analyses. Also, some entities may use a combination of a system supplemented by cost studies.

76. Cost information may be developed and savings achieved in some cases by the use of special cost studies or cost analyses to develop information helpful in certain decision making situations. In addition, cost finding techniques may be used to determine the cost of products or services. Cost finding is a method for determining the cost of

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producing goods or services using appropriate procedures. Cost finding techniques may also be useful for computing costs in cases where the information is not needed on a recurring basis.

RESPONSIBILITY SEGMENTS

Management of each reporting entity should define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should also be performed to determine the costs of outputs.

77. The standard states that the management of each reporting entity should define and establish responsibility segments. This section explains the concept of responsibility segment, purposes of segmentation, and how responsibility segments can be structured.

Defining Responsibility Segments

78. A responsibility segment is a component of a reporting entity[Footnote 25] that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services. In addition, responsibility segments usually possess the following characteristics:

[Footnote 25: The term "reporting entity" referred to in this document conveys the same meaning as defined in FASAB Statement of Recommended Accounting Concepts No. 2 Entity and Display (May 1995).]

(1) Their managers report to the entity's top management directly;

(2) Their resources and results of operations can be clearly distinguished from those of other segments of the

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entity.[Footnote 26]

[Footnote 26: These two characteristics make responsibility segments, as the term is used in this document, differ from cost centers. A cost center can be at any level of an organization and may not report to the top management directly. As will be explained later, a responsibility segment can contain cost centers in itself.]

79. A responsibility segment is a unit for which managerial cost accounting is performed. Entities may use a centralized accounting system or segment-based systems to provide cost information for each segment. For each segment, managerial cost accounting should:

(1) Define and accumulate outputs, and if feasible, quantify each type of output in units;

(2) Accumulate costs and quantitative units of resources consumed in producing the outputs; and

(3) Assign costs to outputs, and calculate the cost per unit of each type of output.

80. Some reporting entities may have only one responsibility segment, if they perform one single mission or one type of service. Other reporting entities may have several responsibility segments. Also, a sub-organization of the federal government may be a reporting entity in itself and, at the same time, it may also be a responsibility segment of a higher level reporting entity to which it belongs. The Forest Service, for example, may be a reporting entity because it may meet the reporting entity criteria. As such, it may establish responsibility segments for itself. At the same time, the Forest Service may be regarded as a responsibility segment of the Department of Agriculture, of which it is a component.

81. However, for a given reporting entity, its

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management should establish one or more responsibility segments to perform managerial cost accounting functions.

Purposes of Segmentation

82. A basic purpose of dividing an entity into segments is to determine and report the costs of services and products that each segment produces and delivers. Many federal departments and agencies manage programs that produce a variety of goods and services. Accounting for entity-wide revenues and expenses in aggregate would serve financial reporting for the entity, but would not serve costing purposes. In order to determine the cost of each type of service or product, it is necessary to divide an entity into segments such that each segment is responsible for certain types of services or products. Each segment can then be used as a vehicle for accumulating costs incurred by the segment to match with its outputs. Each segment can use a cost methodology that is best suited to its operations.

83. Another important purpose of segmentation is to facilitate cost control and management. Cost information provided for each segment helps managers to examine costs of specific resources consumed and activities performed in each segment. Managers can analyze cost variances in both dollars and the units of resources consumed against budgets or standards. Since each segment performs a particular pattern of processes and activities to produce its output, managers can analyze those processes and activities to compare their costs with the value they contribute to the output.

84. For entities that consist of components engaging in diverse lines of activities, it is desirable to provide financial reports that display information for significant components individually and of the entity in its entirety.[Footnote 27] Some entities may find costs accumulated by segments useful in support of financial reporting by components.

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[Footnote 27: This point is discussed in FASAB Statement of Recommended Accounting Concepts No. 2, "Entity and Display," pars. 75-76, pages 25-26.]

85. For internal management, segmentation could also facilitate performance measurement. Since each segment is responsible for a mission, or a line of activity to produce a certain type of output, performance goals can be set for each segment based on its specific tasks and operating patterns. Information on costs, outputs, and outcomes related to each segment can be used to measure its performance against the goals. The results of the segment performance measurement could also support external reporting on performance measures for the entire reporting entity or its major programs.

Structuring Responsibility Segments

86. Reporting entity management should define and structure its responsibility segments. The designation of responsibility segments should be based on the following factors: (a) the entity's organization structure, (b) its lines of responsibilities and missions, (c) its outputs (goods or services it delivers), and (d) budget accounts and funding authorities. However, the predominant factor is the reporting entity's organization structure and its existing responsibility components, such as bureaus, administrations, offices, and divisions within a department.

87. The U.S. General Services Administration, for example, provides five distinct services: (1) managing public buildings, (2) distributing supplies, (3) providing travel and transportation services, (4) managing information resources (including communication and data processing services), and (5) disposal of real properties. Each of those service areas could be designated as a responsibility segment. The Department of Veterans Affairs (VA), among its other services, provides health care to veterans, pays veterans'

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compensation and pension benefits, and provides home loans and home loan guarantees to veterans. Each of these program areas could constitute a responsibility segment.

88. Since responsibility segments are major parts of an entity, some segments may carry more than one program. Some programs may be jointly managed by two or more segments. Thus, each segment must accumulate costs for each type of output produced for various programs. To accomplish this, a network of cost centers can be established within a segment to accumulate costs. Managers of each cost center will be provided with information to control and manage costs within their area of responsibility. Depending on operational patterns and cost methods, cost centers can be structured along different dimensions, such as organizational units, operating processes, and activities.

FULL COST

Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

89. This standard states that reporting entities should measure and report the full costs of their outputs in general purpose financial reports. "Outputs" means products and services generated from the consumption of resources. The full cost of a responsibility segment's output is the total amount of resources used to produce the output. This includes direct and indirect costs that contribute to the output, regardless of funding sources. It also includes costs of supporting services provided by other responsibility segments

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or entities. The standard does not require full cost reporting in federal entities' internal reports or special purpose cost studies. Entity management can decide on a case-by-case basis whether full cost is appropriate and should be used for internal reporting and special purpose cost studies.

Direct Costs

90. Direct costs are costs that can be specifically identified with an output. All direct costs should be included in the full cost of outputs. Typical direct costs in the production of an output include:

(a) Salaries and other benefits for employees who work directly on the output;

(b) Materials and supplies used in the work;

(c) Various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output; and

(d) Costs of goods or services received from other segments or entities that are used to produce the output (See discussions and explanations in the next section on "Inter-Entity Costs").

Indirect Costs

91. Indirect costs are costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include costs of general administrative services, general research and technical support, security, rent, employee health and recreation facilities, and operating and maintenance costs for buildings, equipment, and utilities. There are two levels of indirect

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costs:

(a) Indirect costs incurred within a responsibility segment. These indirect costs should be assigned to outputs on a cause-and-effect basis, if such an assignment is economically feasible, or through reasonable allocations. (See discussions on cost assignments in the "Costing Methodology" section.)

(b) Costs of support services that a responsibility segment receives from other segments or entities. The support costs should be first directly traced or assigned to various segments that receive the support services. They should then be assigned to outputs.

92. A reporting entity and its responsibility segments may incur general management and administrative support costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization costs, and they should be reported on the entity's financial statements (such as the Statement of Net Costs) as costs not assigned to programs.[Footnote 28]

[Footnote 28: A similar explanation is provided in FASAB Statement of Recommended Accounting Concepts No. 2, Entity and Display, par. 95, page 33.]

Certain Cost Elements

93. Costs of Employees' Benefits

Employee benefits include:

(a) Health and life insurance benefits for current employees covered in part by the government's contribution to health and life insurance premiums;

(b) Pension benefits for employees, their survivors, and dependents, covered by defined

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pension plans such as Civil Service Retirement System (CSRS), Federal Employees Retirement Plan (FERS), and Military Retirement System (MRS);

(c) Health and life insurance benefits for retired employees, their survivors and dependents, covered in part by the government's contribution to health and life insurance premiums, and referred to as "other retirement benefits" (ORB) in this document;

(d) Other postemployment benefits (OPEB) for terminated and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and workers compensation.

94. Most of the employee benefit programs are covered by trust funds administered by the Office of Personnel Management (OPM) and the Department of Defense (DoD). Contributions to the trust funds come from three sources: current and retired employees, employing agencies, and direct appropriations. The management expenses of the trust funds are paid with the funds' receipts.

95. Federal financial accounting standards require that the employing entity accrue the costs to the federal government of providing pension and ORB benefits to employees and recognize the costs as an expense when the benefits are earned.[Footnote 29] The employing entity should recognize those expenses regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds. This principle should also be applied to health and life insurance benefits for current employees and comparable benefits for military personnel. The costs of employee benefits incurred by responsibility segments should be directly traced or assigned to outputs.

[Footnote 29: FASAB Exposure Draft, "Accounting for Liabilities of the Federal Government" (November 7, 1994), pars. 62-99, pages 26-46.]

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96. OPEB costs include severance payments, counseling and training, health care, and workers compensation benefits paid to former or inactive employees. OPEB costs are often incurred as a result of such events as reductions in force or on-the-job injuries of employees. Federal financial accounting standards require that OPEB costs be reported as an expense for the period during which a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the accounting date.[Footnote 30]

[Footnote 30: Ibid., pars. 100-102, page 47.]

97. Since the recognition of OPEB costs is linked to the occurrence of an OPEB event rather then the production of output, in many instances, assigning OPEB costs recognized for a period to output of that period would distort the cost of output. In special purpose cost studies or cost findings, management may distribute OPEB costs over a number of years in the past to determine the costs of the outputs that the OPEB recipients helped to produce.

Costs of Public Assistance and Social Insurance Programs

98. Major costs of welfare, insurance, and grant programs are the costs of resources transferred from the federal government to individuals and state and local governments. Some of them are referred to as "transfer payments." The following are some typical public assistance and insurance programs:

-- Grants, such as aid to state and local governments;

-- Subsidies, such as agricultural commodity price support and stabilization programs;

-- Credit and insurance costs, such as the Family Education Loan Program and Savings

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Association Insurance;

-- Welfare payments such as Aid to Families with Dependent Children (AFDC); and,

-- Social insurance, such as the Old Age, Survivors, and Disability Insurance Program.

99. The full cost of such a program includes: (a) the costs of federal resources that have been or will be transferred to individuals and state/local governments, and (b) the costs of operating the programs. These two types of costs should be recognized on a basis of accounting that is prescribed within the Federal Financial Accounting Standards. These two types of costs should be separately identified so that each can be used for different analytic purposes.

100. The costs resulting from transfer payments are determined by the level of grants, subsidies, entitlement benefits, credit subsidies, or loss payments made under insurance and guarantee agreements. They are also determined by the number of eligible persons who receive the transfer payments. The program cost of AFDC, for example, depends on the average payment per family, the number of eligible families, and the federal government's share in the payments (some payments are made by state and local governments). Information on this type of cost is useful for making policy decisions about levels of subsidies or benefits, eligibility of recipients, and how transfer payments are made. This cost information is also useful for measuring the cost-effectiveness of a transfer payment program.

101. Program operating costs, on the other hand, are costs of managing the program and delivering the payments. They include the costs of personnel, supplies, equipment, and offices. The costs are related to such activities as screening benefit recipients for eligibility, keeping their accounts, making payments and collections, answering inquiries, etc. Information on this

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type of cost is useful in measuring the efficiency of program operations.

Costs related to Property, Plant and Equipment

102. Depreciation expense. General property, plant, and equipment are used in the production of goods and services. Their consumption is recognized as depreciation expense. The depreciation expense incurred by responsibility segments should be included in the full costs of the goods and services that the segments produce.

103. Recognizing property acquisition costs as expenses. The costs of acquiring or constructing federal mission and heritage property, plant, and equipment may be charged to expenses at the time the acquisition costs are incurred.[Footnote 31] Since the recognition of these expenses is linked to property acquisition rather than production of goods and services, those expenses should not be included in the full costs of goods and services. However, they are part of the costs of the entity or the program that makes the property acquisitions.

[Footnote 31: In FASAB Exposure Draft, "Accounting for Property, Plant, and Equipment," the Board proposed that the costs of acquiring or constructing "federal mission" and "heritage" property, plant, and equipment be recognized as expenses when the costs are incurred. See the ED, pars. 98-117, pages 29-34.]

Non-production costs

104. A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. Two examples of these non-production costs were discussed earlier: (1) OPEB costs that are recognized as expenses when an OPEB event occurs, and (2) certain property acquisition costs that are recognized as expenses at the time of acquisition. Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that

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are not accrued. Since these costs are recognized for a period in which a particular event occurs, assigning these costs to goods and service produced in that period would distort the production costs. In special purpose cost studies, management may have reasons to determine historical output costs by distributing some of these costs to outputs over a number of past periods. Such distribution may be appropriate when: (a) experience shows that the costs are recurring in a regular pattern, and (b) a nexus can be established between the costs and the production of outputs that may have benefited from those costs.

INTER-ENTITY COSTS

Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.

Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity.

105. As stated in the preceding standard, to fully account for the costs of the goods and services they produce, reporting entities should include the cost of goods and services received from other entities. Knowledge of these costs is helpful to top level management in controlling and assessing the operating environment. It is also helpful to

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other users in evaluating overall program costs and performance and in making decisions about resource allocations and changes in programs.

Inter-Entity Activities

106. Within the federal government, some reporting entities rely on other federal entities to help them achieve their missions. Often this involves support services, but may include the provision of goods. Sometimes these arrangements may be stipulated by law, but others are established by mutual agreement of the entities involved. Such relationships can be classified into two types depending upon funding methods.

-- Provision of goods or services with reimbursement -- In this situation, one entity agrees to provide goods or services to another with reimbursement at an agreed-upon price. The reimbursement price may or may not be enough to recover full costs. Usually the agreement is voluntarily established through an inter-agency agreement. Revolving funds can also be included in this group, because they are usually established to recover costs through sale of their outputs to other government entities. They are usually meant to be self-sustaining through their sales, without receiving additional appropriations. However,

they do not always charge enough to cover full costs.

-- Provision of goods or services without reimbursement -- One entity provides goods or services to another entity free of charge. The agreement may be voluntary, legally mandated, or inherently established in the mission of the providing entity.

107. Recently, consideration has been given to

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expanding the concept of inter-entity support within the federal government. Under this concept, entities could sell their outputs on a competitive basis. Entities would have the authority to purchase goods or services from any federal or private provider. This is seen as a way to improve government efficiency through competition since inefficient government providers would be forced to improve or stop providing these goods or services. This could result in consolidating support services in fewer governmental entities. Underlying this concept is the requirement that all costs be recognized in developing the price at which goods and services would be sold to other entities.

Accounting and Implementation Guidance

108. If an entity provides goods or services to another entity, regardless of whether full reimbursement is received, the providing entity should continue to recognize in its accounting records the full cost of those goods or services. The full costs of the goods or services provided should also be reported to the receiving entity by the providing entity.

109. The receiving entity should recognize in its accounting records the full cost of the goods or services it receives as an expense or, if appropriate, as an asset (such as work-in-process inventory). The information on costs of non-reimbursed or under-reimbursed goods or services should be available from the providing entity. However, if such cost information is not provided, or is partially provided, a reasonable estimate may be used by the receiving entity. The estimate should be of the cost of the goods or services received (the estimate may be based on the market value of the goods or services received if an estimate of the cost cannot be made). To the extent that reimbursement is less than full cost, the receiving entity should recognize the difference in its accounting records as a

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financing source.[Footnote 32] Inter-entity expenses/assets and financing sources would be eliminated for any consolidated financial statements covering both entities.

[Footnote 32: See Statement of Recommended Federal Accounting Concepts No. 2, Entity and Display, par. 65, page 21. See also, FASAB Exposure Draft, Accounting for Liabilities of the Federal Government, pars. 62-99, pages 26-46, which addresses accounting for pensions and other retirement benefits (ORB). The payment of pension and ORB costs for an entity by another entity has often been likened to providing goods and services.

In the case of pensions, employees of the reporting entity provide services to that entity and part of the salary-related cost is paid by a different entity. The pension administering entity does not provide goods or services to the reporting entity (other than normal pension administration services), but rather pays their costs directly. The difference is subtle but important. However, the accounting is similar. This document is consistent with the section of the liabilities exposure draft dealing with accounting for pensions and other retirement benefits.]

110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget, with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs. These particular inter-entity costs should be specified in accordance with this standard including the recognition criteria presented below. The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards.

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Recognition Criteria

111. Ideally, all inter-entity costs should be recognized. This is especially important when those costs constitute inputs to government goods or services provided to non-federal entities for a fee or user charge. The fees and user charges should recover the full costs of those goods and services.[Footnote 33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold outside the federal government. Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above.

[Footnote 33: OMB Circular A-25 addresses user charges by federal entities.]

112. However, the situation is often different with goods or services transferred within the federal government that do not involve eventual sales to entities outside the federal government. The federal government in its entirety is an economic entity. Therefore, it is reasonable to expect some flow of goods or services between reporting entities as those entities assist each other in fulfilling their missions and operating objectives. There are some cases in which the cost of non-reimbursed or under-reimbursed goods or services received from other entities need not be recognized as part of the cost of the receiving entity. The following general criteria are provided to help in determining the types of -- inter-entity costs that should or should not be recognized.

-- Materiality -- As with other accounting standards, the provisions of this standard need not be applied to immaterial items. However, in the context of deciding which inter-entity transactions are to be recognized, materiality, as used here, is directed to the individual inter-entity

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transaction rather than to all inter-entity transactions as a whole. Under this concept, a much more limited recognition is intended than would be achieved by reference to the general materiality concept.

In this context, then, materiality should be considered in terms of the importance of the inter-entity transaction to the receiving entity. The importance of the transactions, and thereby their recognition, should be judged in light of the following factors:

* Significance to the entity -- The cost of the good or service is large enough that management should be aware of the cost when making decisions.

* Directness of relationship to the entity's operations -- The good or service provided is an integral part of and necessary to the output produced by the entity.

* Identifiability -- The cost of the good or service provided to the entity can be matched to the entity with reasonable precision.

The determination of whether the cost is material requires the exercise of considerable judgment, based on the specific facts and circumstances of each transaction.

-- Broad, general support -- Some entities provide broad, general support to many, if not all, reporting entities in the federal government. Most often this type of support involves the establishment of policies and/or the provision of general guidance. The costs of such broad services should not be recognized as an expense (or asset) by the receiving entities when there is no reimbursement of costs. Thus the standard does not apply when support is of a general nature provided to all or most entities of the federal government.

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An example of this situation can be found in the Office of Management and Budget which establishes policy and provides general guidance to all parts of the executive branch of government. The costs of OMB should not be spread over all reporting entities because the services provided are (1) general and broad in scope, (2) provided to almost all reporting entities in the executive branch, and (3) not specifically or directly tied to the receiving entity's outputs.

On the other hand, some services provided, under certain circumstances, should still be recognized even though they may be considered broad and general in nature if such services are integral to the operations of the receiving entity. Such services include check writing by the Department of Treasury or legal activities performed by the Department of Justice. For example, when the issuance of checks is integral to the operations of an entity (e.g., the Internal Revenue Service and the Social Security Administration), the receiving entity should include the full cost of issuing checks in the full cost of its outputs. However, if the issuance of checks is insignificant and incidental to the operations of an entity, the entity should not normally recognize that cost.

113. The decision as to whether the cost of non-reimbursed or under-reimbursed goods and services should be recognized requires the use of judgement. None of the criteria listed above are, by themselves, fully or exclusively determinative. They should be considered in combination. Ultimately, inclusion or exclusion of the cost should be decided based on the specific facts and circumstances of each case, with consideration of the degree to which inclusion or exclusion would change or influence the actions and decisions of a reasonable person relying on the information provided.

Accounting Example

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114. The following tables provide an example of the accounting entries to be made when the receiving entity (Agency R) recognizes an expense for services received from a providing entity (Agency P) on a non-reimbursable basis. In the example, the full costs of these services to Agency P are $100,000.

115. Agency R recognizes an "Expense of services provided by Agency P" equal to the full cost of the services received. It also recognizes a financing source, "Services provided by Agency P," equal to the amount not reimbursed, which in this case is the full $100,000. Agency P recognizes an "Expense of services provided to Agency R" equal to the full cost of the services provided with a credit to "Appropriations used."

Table 1: Agency R's Accounting Entries *

	Debit	Credit
Expense of services provided by Agency P:	$100,000	
Services provided by Agency P:		$100,000

* This example shows the cost recognized as an expense. However, as discussed in the text, it may be an asset.

Table 2: Agency P's Accounting Entries

	Debit	Credit
Expense of services provided to Agency R:	$100,000	
Appropriated capital	$100,000	
Fund balance with Treasury		$100,000
Appropriated capital used		$100,000

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COSTING METHODOLOGY

Costs of resources consumed by responsibility segments should be accumulated by type of resource. Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units. The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are most appropriate to the segment's operating environment and should be followed consistently.

The cost assignments should be performed by the following methods listed in the order of preference: (a) directly tracing costs wherever feasible and economically practicable, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis.

116. This standard addresses two aspects of costing: cost accumulation and cost assignment. Each of them is explained and discussed below.

Cost Accumulation

117. Cost accumulation is the process of collecting cost data in an organized way. The standard requires that costs be accumulated by responsibility segments. The accumulation is for costs incurred within each responsibility segment, and does not involve the assignment or allocation of costs incurred by other supporting segments, which will be discussed in the latter part of this section.

118. In the section of this document relating to "Responsibility segments," it was explained that: "A responsibility segment is a component of a reporting entity, that is responsible for carrying out a mission, conducting a major line of

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activity, or producing one or a group of related products or services." The accumulation of costs by responsibility segments does not mean that each responsibility segment must have its own accounting system. The reporting entity may have a centralized accounting system, but the system should be capable of identifying costs with responsibility segments.

119. This standard also requires that the accumulated costs be classified by type of resource, such as costs of employees, materials, capital, utilities, rent, etc. When appropriate and cost effective, information on quantitative units related to various cost categories should be maintained. For example, staff-days may be reported for staff salaries and benefits, and gallons of gasoline consumed for gasoline costs. The quantitative units are useful for cost assignments, and are indispensable for measuring efficiency in using resources.

Cost Assignment

120. The term "cost assignment" refers to the process that identifies accumulated costs with reporting periods and cost objects. The assignment of costs to time periods is to recognize costs either as expenses or assets for each reporting period. It is governed by accounting standards on recognition of assets and expenses, and will not be addressed in this document. This section addresses cost assignment to cost objects. The word "assignment" used in this document includes various methods of attributing costs, such as direct tracing, cause-and-effect basis, and cost allocations.

121. The term "cost object" refers to an activity or item whose cost is to be measured.[Footnote 34] In a broad sense, a cost object can be an organizational division, program, activity, task, product, service, or customer. However, the purpose of cost accounting by a responsibility segment is to measure the costs of its outputs. Thus, the final cost objects of a responsibility

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segment are its outputs: the services or products that the segment produces and delivers, the missions or tasks that the segment performs, or the customers or markets that the responsibility segment serves. There may be intermediate cost objects that are used in the course of the cost assignment process.

[Footnote 34: Some literature, the CASB pronouncements for example, use the term "cost objective" for the same meaning.]

122. Some responsibility segments of an entity may provide supporting services or deliver intermediate products to other segments within the same entity. The costs of the supporting services and intermediate products should be assigned to the segments that receive the services and products. This is referred to as the intra-entity cost assignments. Also, in accordance with the inter-entity cost standard discussed in the preceding section, an entity should recognize inter-entity costs for goods and services received from other federal entities. The inter-entity costs should also be assigned to the responsibility segments that use the inter-entity services and products.

123. Thus, with respect to each responsibility segment, the costs that are to be assigned to outputs include: (a) direct and indirect costs incurred within the responsibility segment, (b) costs of other responsibility segments that are assigned to the segment, and (c) inter-entity costs recognized by the receiving entity and assigned to the segment. If a responsibility segment produces one kind of output only, costs of resources used to produce the output are assigned to the output.

124. This standard is intended to establish a principle, rather than a methodology, for cost assignment. Also cost assignments may be performed in cost findings and studies or may be performed within a system on a regular basis. In principle, costs should be assigned to outputs in

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one of the methods listed below in the order of preference:

(a) Directly tracing costs wherever economically feasible;

(b) Assigning costs on a cause-and-effect basis; and

(c) Allocating costs on a reasonable and consistent basis.

125. These principles apply to all levels of cost assignments including: (1) assigning inter-entity costs to segments, (2) assigning the costs of support services and intermediate products among segments of an entity (the intra-entity cost assignments), and (3) assigning direct and indirect costs to outputs.

Directly tracing costs to outputs

126. Direct tracing applies to resources that are directly used in the production of an output. Examples of such resources include materials that are used in the production, employees who directly worked on the output, facilities and equipment used exclusively in the production of the output, and goods or services received from other entities that are directly used in the production of the output.

127. The method of direct cost tracing usually relies on the observation, counting, and/or recording of the consumption of resource units, such as staff hours or days that are spent on a project or assignment, or gallons of fuel consumed in a transport mission. Direct tracing also applies to specific resources that are dedicated to particular outputs.

128. Direct cost tracing often minimizes distortion and ensures accuracy in cost assignments. However, it can be a relatively costly process. It should be applied only to items that account for a substantial portion of

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the cost of an output and only when it is economically feasible. For example, it is usually unnecessary to trace the cost of office supplies (pens, papers, computer disks, etc.) to various activities or outputs. The cost of so doing usually outweighs the benefit of the increased accuracy in assigning the resources.

Assigning costs on a cause-and-effect basis

129. For the costs that are not directly traced to outputs, it is preferable that they be assigned to them on a cause-and-effect basis. As mentioned earlier, the ultimate cost objects of a responsibility segment are its outputs. For costs that are not traced to the ultimate objects (outputs), intermediate objects can be established as links between resource costs and outputs. The links reflect a cause-and-effect relationship between resource costs and outputs. Costs that have a similar cause-and-effect relationship to outputs can be grouped into cost pools. (This similar relationship is referred to in some literature as the "cost pool homogeneity concept.")

130. Activities or work elements that contribute to or support the production of outputs are commonly used as intermediate objects. This is based on the premise that on one hand, outputs require the performance of certain activities, and on the other hand the activities cause costs. Thus, an activity is considered a linkage between the cause and the effect. (See also, discussions on Activity-Based Costing later in this section.) In its policy statement, the Cost Accounting Standards Board expressed a similar view:

> "The preferred presentation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity (input) of the function or functions represented by the pool of cost. This relationship can be measured in

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> circumstances where there is direct and definitive relationship between the function or functions and the benefiting cost objectives."[Footnote 35]

[Footnote 35: Cost Accounting Standards Board, Restatement of Objectives, Policies and Concepts, par. 2915.]

131. For example, a computer technology department provides technical support to other departments of an organization. The costs of the department may be assigned to other departments on a cause-and-effect basis through two steps. In the first step, the costs are assigned to the activities of the department, such as hardware installation and maintenance, software design and installation, or programming adjustments. In the second step, the costs of these activities are further assigned to other departments based on their consumption of the technical services.

132. Sometimes, an intermediate product, rather than an activity, can be used as a link between the costs and outputs. For example, a hospital laboratory's costs can first be assigned to various medical tests it runs. The costs of the tests can then be assigned to the operating units of the hospital that ordered the tests.

Allocating costs

133. Sometimes, it might not be economically feasible to directly trace or assign costs on a cause-and-effect basis. These may include general management and support costs, depreciation, rent, maintenance, security, and utilities associated with facilities that are commonly used by various segments.

134. These supporting costs can be allocated to segments and outputs on a prorated basis. The cost allocations may involve two steps. The first step allocates the costs of support services to segments, and the second step allocates those costs to the outputs of each segment. The cost

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allocations are usually based on a relevant common denominator such as the number of employees, square footage of office space, or the amount of direct costs incurred in segments.

135. Suppose the total cost of a personnel department for a fiscal year is $500,000, and it is allocated to two segments based on the number of employees of the two segments: segment A has 300 employees, and segment B has 200 employees. On the prorated basis, segment A should be allocated 60 percent, or $300,000 of the personnel cost, and segment B should be allocated 40 percent, or $200,000 of the personnel department cost. The allocation is shown below:

Table 3: The Allocation of the Personnel Dept. Costs

Segment	Employees	Percent	Allocated amount
A	300	60	$300,000
B	200	40	$200,000
Total	500	100	$500,000

136. For cost allocation purposes, indirect costs may be grouped into pools, and each pool is subject to one allocation base. Costs grouped into one pool should have similar characteristics. The allocation base should be used consistently to allow cost comparison from one period to another.

137. Cost allocation is a relatively simple method of assigning indirect costs to cost objects. Users of the cost information should be aware that distortions in product costing often result from arbitrary cost allocations. In most cases, there is little correlation between an indirect cost and the allocation base, and the allocation is arbitrary. To assist cost analyses and cost findings, cost accounting should segregate costs that are traced or assigned to outputs from costs that are allocated to outputs.

Assigning common costs

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138. Facility and personnel resources may be shared by two or more activities either at the same time or in different times during a fiscal year. For example, a military aircraft maintained for war readiness may be used in peacetime to transport cargo. As another example, a plant may be used to process two or more products.

139. The cost assignment principles discussed in this section should apply to assigning costs to activities or outputs that share the use of resources. Costs that can be traced to each of the activities (or outputs) should be assigned to them directly. These include direct operating costs of each of the activities. For the military aircraft used in peacetime to transport cargo, for example, the costs of fuel and supplies, additional personnel who worked on the cargo, and other costs incidental to the transportation should be directly assigned to the transportation services.

140. To determine the full cost of each of the activities or outputs that share resources, indirect common costs should be assigned to those activities. The term "common costs" refers to the costs of maintaining and operating facilities and other resources that cannot be directly traced to any one of the activities or outputs that share the resources.[Footnote 36 Common costs should be assigned to activities either on a cause-and-effect basis, if feasible, or through reasonable allocations.

[Footnote 36: This definition is adapted from Statement No. 1 on Management Accounting: Management Accounting Glossary, published by the National Association of Accountants (Montvale, New Jersey: 1991), page 15.]

141. Sometimes management may find it useful to designate primary and secondary activities that share resources. Primary activity is the primary purpose or mission for which the resources are made available. Secondary activities are those

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activities that are performed only if they will not interfere with the primary activity. Management can then determine two types of costs: (1) the costs that are necessary for the primary activity and are unavoidable even without the secondary activities, and (2) the costs that are caused by the secondary activities and are incremental to the costs of the primary activity. This type of cost information can be produced through cost findings, and may help management in making resource allocation and capacity utilization decisions.

Cost-benefit considerations

142. Throughout the discussions of this section, it is stated that a cost accumulation and assignment method would be used when it is economically feasible. A method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users.

143. As a general rule, directly tracing costs and assigning costs on a cause-and-effect basis are more expensive than cost allocations, because they require detailed analyses and record-keeping for costs and activities. However, they are preferable because they produce more reliable cost information than cost allocations.

Selecting a Costing Methodology

144. This standard does not require the use of a particular type of costing system or costing methodology. Federal entities are engaged in a broad range of diverse operations. A costing system appropriate for one type of operation may not be appropriate for other operations. At many federal agencies, cost accounting practices are either relatively new or experimental. It is too early to tell which cost systems are best for specific types of operations. As experience and research in cost accounting progress, reporting

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entities and responsibility segments may find a preferred costing methodology for their operations.

145. Agency and program management is in the best position to select a type of costing system that would meet its needs. In making the selection, management should evaluate alternative costing methods and select those that provide the best results under its operating environment.

146. The standard requires that a costing methodology, once adopted, be used consistently. Consistent use provides cost information that can be compared from year to year. However, this requirement does not preclude necessary improvements and refinements to the system or methodology, so long as the effect of any change is documented and explained. On the contrary, improvements are encouraged.

147. Several costing methodologies have been successful in the private sector and in some government entities. Four are briefly described below for agency consideration. It should be noted in particular that activity-based costing has gained broad acceptance by manufacturing and service industries as an effective managerial tool. Federal entities are encouraged to study its potential within their own operations. In the following paragraphs, activity-based costing will be introduced with other well known costing methodologies, namely job order costing and process costing. Standard costing is also mentioned as an important cost management tool. It is important to note that those costing methodologies are not mutually exclusive. Both activity-based costing and standard costing can be applied to job order or process costing systems.

Activity-based costing (ABC)

148. ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities

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consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs. The procedure is illustrated in the following figure.[Footnote 37]

[Footnote 37: The figure and the accompanying discussions are based on Robin Cooper, Robert S. Kaplan, Lawrence S. Maisel, Eileen Morrissey, and Ronald M. Oehm, Implementing Activity-Based Cost Management (Montvale, NJ: Institute of Management Accountants, 1992), pages 9-1.]

Figure 2: The Activity-Based
Two Stage Costing Procedure

RESOURCES ...(first stage)....ACTIVITIES

ACTIVITIES...(second stage)...OUTPUTS

149. Implementing an ABC system requires four major steps: (1) identify activities performed in a responsibility segment to produce outputs, (2) assign or map resources to the activities, (3) identify outputs for which the activities are performed, and (4) assign activity costs to the outputs. Each of the steps is briefly explained below.

(1) Identify activities. This step requires an in-depth analysis of the operating processes of each responsibility segment. Each process may consist of one or more activities required by outputs. Activities may be classified into unit-level, batch-level, product sustaining, and facility sustaining activities.{Footnote 39] Management may combine related small activities into larger activities to avoid excessive costing efforts.

[Footnote 39: Cooper, Kaplan, et. al., page 20.]

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(2) Assign resource costs to activities. This step assigns resource costs to the activities identified in step 1. The resource costs include direct and indirect costs usually recorded in general ledger accounts. Depending on feasibility and cost-benefit considerations, resource costs may be assigned to activities in three ways: (a) direct tracing; (b) estimation based on surveys, interviews, or statistical sampling; or (c) allocations.

(3) Identify outputs. This step identifies all of the outputs for which activities are performed and resources are consumed by a responsibility segment. The outputs can be products, services, or customers (persons or entities to whom a federal agency is required to provide goods or services). Omitting any output would result in overcharging costs to other outputs.

(4) Assign activity costs to outputs. In this step, activity costs are assigned to outputs using activity drivers. Activity drivers assign activity costs to outputs based on individual outputs' consumption or demand for activities. For example, a driver may be the number of times an activity is performed in producing a specific type of output (the transaction driver), or the length of time an activity is performed (the duration driver).

150. ABC can be used in conjunction with job order costing or process costing. For example, making direct loans to the public involves a series of processes, such as loan origination, credit review for individual applicants, preparing loan documents, valuation of collateral, making loan disbursements, computing fees and periodic payments, keeping records, and making collections. These are the "first category" activities that directly affect individual loans. ABC can be applied to this category of activities.

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151. The direct loan operations also involve "second category" activities, such as those performed by loan officers to review and assess a portfolio of loans and make policy changes that affect an entire portfolio. If ABC is not used, the costs of the loan officers may be allocated to direct loans based on the number of loans disbursed, or based on the staff hours spent on processing all the loans. However, such an allocation tends to be arbitrary, because some loans require more of their time than others. Under ABC, the costs of loan officers would first be assigned to their portfolio review and workout activities that they perform, then the activity costs would be assigned to the groups of loans for which the activities are performed.

152. A major advantage of using ABC is that it avoids or minimizes distortions in product costing that result from arbitrary allocations of indirect costs. By tracing costs through activities, ABC provides more accurate service or product costs. Experience in the private sector shows that by providing accurate cost measures, ABC has helped improve product costing, strategic pricing, and profit planning.

153. Also important is that ABC encourages management to evaluate the efficiency and cost-effectiveness of activities. Some ABC systems rank activities by the degree to which they add value to the organization or its outputs. Managers use such value rankings to focus their cost reduction programs. ABC encourages management to identify and examine (a) what activities are really needed (value-added activities) in order to accomplish a mission, deliver a service, or meet customer demand, (b) how activities can be modified to achieve cost savings or product improvements, and (c) what activities do not actually add value to services or products (non-value-added activities). ABC integrates with cycle time analysis and value-added analysis.

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Job order costing

154. Job order costing is a costing methodology that accumulates and assigns costs to discrete jobs. The word "jobs" refers to products, projects, assignments, or a group of similar outputs.

155. Each job has a number or code to accumulate costs. Resources spent are identified with the job code. Costs are traced to individual jobs to the extent economically feasible. Costs that cannot be directly traced are assigned to jobs either on a cause-and-effect basis or allocation basis.

156. Job order costing is appropriate for responsibility segments that produce special order products, or perform projects and assignments that differ in duration, complexity, or input requirements. Typical situations in the federal government in which job order costing would be appropriate are legal cases, audit assignments, research projects, and repair work for ships, aircraft, or vehicles.

Process costing

157. Process costing is a method that accumulates costs by individual processing divisions (organization divisions that perform production processes). These processing divisions are involved in a continuous production flow, with each division contributing towards the completion of the end products. The output of a processing division either becomes the input of the next processing division or becomes a part of the end product.

158. Each division accumulates costs, assigns the costs to its outputs, and calculates the unit cost of its output. For each period, divisions prepare a cost and production report, showing the costs, the completed units, and the work-in-process volume. When a certain number of completed units are transferred from a division to the next

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division, the costs of those units are also transferred and are eventually incorporated into the costs of the end product. Thus, the cost flow follows the physical flow of the production. The unit cost of the end product is the sum of the unit costs of all the divisions.

159. Process costing is appropriate for production of goods or services with the following characteristics: (a) the production involves a regular pattern of process, (b) its output consists of homogeneous units, and (c) all units are produced through the same process procedures. In the private sector, process costing is used by such industries as flour mills, steel foundries, oil refineries, and chemical processing plants. In government, it may be used by some activities that involve repetitive process procedures to deliver a large volume of similar goods or services. An example would be making entitlement benefit payments, which involves a series of consecutive processes for reviewing applications to establish their eligibility, computing the amount of benefits, and issuing checks.

Standard costing

160. Standard costs are carefully predetermined or expected costs that can be applied to activities, services, or products on a per unit basis. Horngren describes standard costing as follows:

"A set of standards outlines how a task should be accomplished in nonfinancial terms (minutes, board feet) and how much it should cost. As work is being done, actual costs incurred are compared with standard costs for various tasks or activities to reveal variances. This feedback helps discover better ways of adhering to standards, of altering standards, and of accomplishing objectives."[Footnote 39]

[Footnote 39: Horngren, Charles T. and George Foster, Cost Accounting, A Managerial Emphasis, 7th ed. (Prentice Hall, Englewood Cliffs: New Jersey, 1991),

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page 222.]

161. Many organizations frequently review and update the standards to assure that they encourage improvements in efficiency and are within an attainable range.

162. Standard costing helps managers to formulate budgets, control costs, and measure performance. It can be used in conjunction with job order costing, process costing, and activity-based costing. It can be applied to specific outputs or activities, and it can also be applied to a responsibility segment in aggregate by comparing total actual costs with total standard costs based on outputs produced within a certain time period. Typical situations in the federal government in which standard costing would be appropriate are operations that produce services or products on a consistently repetitive basis. Agencies are encouraged to use standard costing in those situations.

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APPENDIX A:
BASIS FOR CONCLUSIONS

The Nature of Concepts and Standards

163. The difference between accounting concepts and standards is significant. Statements of concepts are more general than statements of standards. Standards are intended to be specific guidance and authoritative in nature. Concepts generally do not contain specific recommendations that would, when issued by the Board's sponsors, become authoritative requirements for federal agencies. Concepts, instead, provide general guidance both to the Board and others. They are also intended to help preparers and users of financial information better understand federal accounting and financial reporting. While the differences can be easily stated, in reality the line between concepts and standards is often broad

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and presents many gray areas for interpretation.

164. When the Board began the project on managerial cost accounting, it anticipated the issuance of a recommended Statement of Concepts. Given the meager use of cost accounting within many federal agencies, a Statement of Concepts would provide both the Board and preparers of federal financial reports with overall guidance in the area and an indication of the future direction the Board might take in developing standards. However, as the Board and staff began working on the project, it became clear that action was needed to recommend standards for the development of cost information.

165. Cost accounting standards were needed because users of financial information, especially taxpayers and members of Congress, began putting more emphasis on the cost of government programs, products, and activities. The efforts to reduce government spending, control the deficit, and improve government functions necessitated information about the true costs of government. In addition, passage of the CFO Act and the GPRA required agencies to provide cost information as a part of improving their financial management and reporting. Furthermore, the NPR issued a recommendation that the Board move rapidly to recommend cost accounting standards.

166. The Board established the Cost Accounting Task Force to provide advise and guidance on the cost accounting project. On the task force were many individuals knowledgeable about cost accounting in the private sector as well as the limited federal cost accounting activities. The task force also recommended the establishment of cost accounting standards.

167. The Board issued the exposure draft as a recommended statement of standards. The Board knew, however, that since cost accounting is relatively new in the federal environment, the final statement necessarily would contain some conceptual material. Although the exposure draft

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did not present any direct questions concerning whether parts of the draft should be viewed as concepts, the issue did arise in public hearings held in November 1994, and January 1995. In addition, a few respondents who mailed in their comments addressed the point.

168. Most of those commenting on the issue stated that they viewed the exposure draft as being somewhat conceptual in nature. Many of those thought that this was appropriate and supported the document and the conceptual material it presented. A few respondents were concerned about the ability to audit some of the standards because of the conceptual nature of the document. Several suggested that the final statement be segregated into concepts and standards and both be issued in one statement.

169. The Board decided that some parts of the final statement would contain information that should be presented as concepts while other parts would be better presented as standards. Therefore, the final statement should be a "hybrid" issuance containing both concepts and standards. The title of the document was changed to "Managerial Cost Accounting Concepts and Standards for the Federal Government." (The Board decided that the material presented in the exposure draft as the first standard that addressed the relationship among managerial cost accounting, financial reporting, and budgeting should be presented as concepts. The other materials were more in the nature of standards.)

Relationship Among Cost Accounting, Financial Reporting, and Budgeting

170. The Board considers it important for financial preparers and users of financial reports to understand the relationship of cost accounting to the more traditional areas of general financial accounting, financial reporting, and budgeting. It views cost accounting as a basic and integral part of an entity's financial management system.

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Therefore, the Board included a standard on this relationship within the exposure draft.

171. The standard addressed the role of managerial cost accounting in financial management and explained how it provides cost information relevant to budgeting, financial reporting, management control, and many decision making processes. The standard discussed the use of a common data source for cost accounting, financial accounting, and budgeting. It explained how the costs may be determined using different bases of accounting and different recognition and measurement methods depending upon the intended use of the information. It also emphasized the need for reconciliation of cost data which may be presented differently in various financial reports. The standard stated that all cost information, regardless of how presented, should be traceable back to the original common data source.

172. Most exposure draft respondents who provided comments on this standard stated that the level of detail presented was about right given the desire of the Board to address cost accounting at a high level. Most respondents agreed with the need to draw cost accounting data from a common data source that is also the source of financial and budgetary data. Some respondents were concerned that the use of the term "data source" was too closely allied with automated or computerized operations and that the term may be misinterpreted. The Board, however, believes that the term is adequately explained. In fact, the exposure draft clearly stated that this term was not meant to imply the use of computerized systems for source information.

173. Data reconciliation for reports containing cost information developed on different bases of accounting or using different recognition or measurement methods received overwhelming support from respondents to the exposure draft. They said that the ability to reconcile differing cost information is necessary to ensure data integrity,

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avoid confusion on the part of financial statement users, and support stewardship responsibilities.

174. Many who commented on whether the exposure draft should be viewed as a statement of concepts or a statement of standards implied that this particular standard on relationships of cost accounting to other financial management functions was basically conceptual in nature. The Board agreed and concluded that this section is more in the nature of an explanation of how cost accounting provides useful information and how it fits in with the overall financial management system as opposed to a standard which places a requirement on an entity. The Board decided that this material would be better presented in the final statement as recommended concepts.

Requirement for Cost Accounting

175. The cost accounting task force recommended that a standard be included in the exposure draft requiring each reporting entity to establish cost accounting systems and procedures for its activities. They believed this was necessary to ensure the generation of required cost information.

176. The Board agreed to include the standard in the exposure draft. The standard defined "system" in a broad way as simply an organized grouping of methods and activities designed to consistently produce reliable cost information. The explanations and discussions section of the exposure draft contained information on several factors that would help managers decide how complex and sophisticated their cost accounting system should be. It noted that the system could be constrained by the (1) nature of the entity's operations, (2) precision needed in cost information, (3) practicality of data collection and processing, (4) availability of electronic data handling, (5) expected cost of the system itself, and (6) any specific management information needs.

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177. The exposure draft also listed ten minimum criteria that should be met by all managerial cost accounting systems. Four of these were related directly to the other standards in the exposure draft (responsibility segments, full costing, costing methodology, and unused capacity costs). The six remaining criteria were concerned with ensuring that the cost data produced was reliable, consistent, and useful. These criteria were (1) ensuring the ability to assist in measurement of performance, (2) reporting information on a timely and consistent basis, (3) integrating cost accounting with the standard general ledger, (4) determining a reasonable and useful level of data precision, (5) accommodating special information needs of management, and (6) documenting the system through a manual or handbook. The standard also allowed for the use of cost finding techniques and special cost studies or analyses.

178. A large number of respondents to the exposure draft supported the requirement for cost accounting systems. They stated that such a requirement is necessary to ensure that appropriate cost data are recorded. They also said that having a requirement for cost systems will help agencies to more easily meet the requirements of the CFO Act and the GPRA. Some qualified their support by stating that the standard should allow an exemption for small entities since establishment of a full cost accounting system may not be cost-beneficial to them. The Board decided that such an exemption would be inappropriate since the standards should apply to all federal activities. Furthermore, it should be far easier for small entities to perform managerial cost accounting in most cases.

179. Those who were negative toward the standard provided several reasons. Several expressed concern about whether accounting standard-setting bodies should require or determine how accounting data are produced. They noted that other accounting standard-setting organizations have stated only what information is required and how that information is displayed in financial

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statements, not how the information is developed.

180. The Board believes that it should not be constrained by what other standard-setters do. Other standard-setters so far have concerned themselves mainly with entities' external reporting. This is understandable because their mission is to assure that the financial position and results of operations are presented in a fair, reliable, and consistent manner to financial statement users who are external to the reporting entity.

181. FASAB is different in that it has determined that some of the users of federal government financial reports are internal to the government. Given the nature and size of the federal government, internal users often do not have the same type of access to cost information that may be available in commercial enterprises. In addition, the Board views cost accounting information as vital to both internal and external users. The Board has previously determined in its Objectives of Financial Reporting that cost information should be reported to meet the needs of Congress, federal executives, and others.

182. Some respondents to the exposure draft were concerned that the requirement for a cost accounting system, along with the system criteria, would not allow management enough flexibility. They seemed to consider the requirement for a system to mean that cost accounting activities had to be automated with computers and that software had to be developed and employed in a "full-blown" system, as one put it. They believe that such an elaborate system may not be needed in some cases where informal procedures or methods would suffice.

183. The Board does not intend to prescribe an elaborate managerial cost accounting system for every federal organization. It believed that the standard proposed in the ED was sufficiently broad to allow managerial flexibility in the system design. However, the Board does recognize that

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the term "system" may connotate to some a requirement for computerization and sophisticated methodologies.

184. Others stated that establishing the requirement for cost systems should be the responsibility of OMB or JFMIP. Some of the respondents were concerned about the degree to which the standard may overlap with JFMIP's responsibility to set requirements for cost accounting systems. The NPR recommends setting requirements for cost accounting systems as a responsibility of JFMIP, while asking the Board to provide the cost accounting standards.[|fOOTNOTE 40]

[Footnote 40: Office of the Vice President, Improving Financial Management, Accompanying Report of the National Performance Review (September 1993), page 24.]

185. The Board proposed the requirement for systems to ensure that cost information is produced and reported in a reliable and consistent manner, and emphasized that this was the intent. The point is not whether the information is produced through the use of a system or through other techniques. The Board believes that, in many cases, cost accounting systems will be established as a natural consequence of requiring cost information. Many government agencies are very large and complex organizations, and it is unrealistic to think that they can develop cost data without relying on a system to do so. Other small agencies or reporting entities may not need a system to develop cost data in a regular, consistent, and reliable manner.

186. The Board, therefore, changed the standard to emphasize producing cost accounting information in a reliable and consistent manner. This can be done through the use of cost accounting systems or cost finding techniques. In either case, the main intent of the original standard is preserved. In addition, the concerns expressed over whether the Board or some other organization should establish

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the requirement for cost "systems" are solved.

Responsibility Segments

187. As stated in the ED, a responsibility segment is a component of a reporting entity that is responsible for carrying out a mission, conducting a major line of activity, or producing one or a group of related products or services.

188. The proposal for using responsibility segments in the ED was based on the view that most federal departments and agencies are engaged in more than one line of activity, or producing more than one type of service or product. Furthermore, the activities that an agency performs may differ from each other significantly in required resources and operations. The ED used the Department of Veterans Affairs (VA) as an example. Among its activities, VA administers hospitals and nursing homes to provide health care to veterans, and it also administers direct home loan and loan guarantee programs. These lines of activities are significantly different in operation patterns. The Board believes that for entities that are engaged in diverse activities, identifying responsibility segments is necessary for identifying resources consumed by a distinct line of activity with the outputs of that activity.

189. A majority of respondents supported the requirement for responsibility segments and agreed with the advantages of the requirement. They expressed the view that segmentation provides a basic framework to trace and assign costs to outputs. They also believed that segmentation provides management with the flexibility of choosing a costing methodology that is best suited for a line of activity. The respondents also stated that information generated by responsibility segments can be used to measure performance and to assess accountability.

190. Several respondents, however, presented arguments against using responsibility segments. One such argument was that responsibility segments

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would constitute an unnecessary layer that conflicts with financial reporting and budgeting systems. The Board disagrees with this view. A responsibility segment is not, and should not be, an additional layer to the organization and the budget structure. It is an accounting mechanism to capture data generated in operations by various components of an organization in its existing structure. Organization and budget structures can be changed for better management but not for the sake of accounting. Accounting may influence but cannot dictate such changes.

191. The Board believes that accounting by segment will help provide information useful to program managers and other users of financial reports. Entity-wide financial reports provide information on the overall financial position and operating results of an entity in aggregate. Such reports, although useful for many purposes, are not sufficient for cost management. A fundamental undertaking of managerial cost accounting is to match costs with activities and outputs. The purpose of segmentation is to segregate entity-wide data by major lines of activities and their outputs. Information related to each segment should tell managers and other users of financial reports about the segment's specific outputs, the activities performed, and resources consumed to produce the outputs.

192. Furthermore, segment-based reporting need not be in conflict with entity-wide financial reporting. They can use a common source of data, such as accounting data collected by the standard general ledger or the budget execution reports. To perform segment-based accounting and reporting, the general accounting or budget execution data can be traced and assigned to segments. The Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, discusses a reporting approach similar to the segment-based accounting and reporting:

"With some organizations, and even suborganizations, the activities of one or

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more programs or other components are as important to the readers of financial statements as are activities of the entity as a whole. This would be particularly true for a department composed of many bureaus, administrations, agencies, services, etc., and particularly if their programs are dissimilar. In those instances, consideration should be given to the preferability of reporting the assets, liabilities, revenues, expenses, etc., of both the significant components individually and of the entity in its entirety."[Footnote 41]

[Footnote 41: FASAB Statement of Recommended Accounting Concepts 2, Entity and Display, par. 75, page 25.]

193. Another argument against requiring responsibility segments was that the requirement is overly prescriptive and would constrain agency management from selecting among various cost collection methods. The Board believes the standard gives management adequate flexibility in structuring cost accounting. As the standard states, it is for the management of each entity to decide how segments should be defined, and how similar products and services can be grouped into one segment.

194. Furthermore, segments are the largest components of an entity. Management has the flexibility to use any cost collection method within each segment. Within a segment, management may define sub-units, functions, projects, business processes, activities, or a combination of them as cost centers to accumulate costs. The costs accumulated at lower levels can then be aggregated to the segment level.

195. In fact, a segment may contain multiple levels of responsibility or cost centers. For example, if veterans health care is defined as one of the DVA's responsibility segments, this segment may define its hospitals, clinics, and nursing

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homes as responsibility centers. Each hospital, clinic, and nursing home may further define their functional units, activities, or business processes as cost centers.

196. Some respondents correctly pointed out that requiring broad responsibility segments, rather than prescribing traditional cost centers, provides opportunity for entities to use activity-based costing or any other costing methods that they may find appropriate.

197. Several respondents who supported the use of responsibility segments interpreted the wording of the proposed standard as requiring that each segment perform managerial cost accounting. They pointed out that for some entities, it is more effective and economical to perform centralized managerial cost accounting. Such centralized accounting is capable of accumulating costs by segments and assigning costs among them. The respondents requested that the wording be revised to provide this flexibility.

198. The Board agrees with this request. The Board believes that entity management should have the discretion to decide whether managerial cost accounting is performed at the entity or segment level, so long as the segment cost information is provided to managers and other users. Thus, the standard recommended in this statement does not require that responsibility segments perform managerial cost accounting.

Full Cost

199. As stated in the ED, the full cost of an output produced by a responsibility segment is the sum of direct and indirect costs that contribute to the output, including the costs of supporting services provided by other segments and entities.

200. The outputs of a responsibility segment are considered as cost objects.[Footnote 42] However, in most circumstances, the full costs of intermediate objects, such as activities,

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processes, projects, programs, or organization units, must also be measured in order to derive the full costs of their outputs. (See ED Par. 173) The full cost information related to outputs as well as those intermediate objects are useful in measuring efficiency and cost-effectiveness.

[Footnote 42: "Cost object" is defined as an activity, output, or item whose cost is to be measured. In a broad sense, a cost object can be an organizational division, a function, task, product, service, or a customer. See Glossary.]

Usefulness of full cost information

201. Program evaluation and authorization. Most respondents supported the full cost standard. They recognized that it is particularly important to determine and report the full cost of a program. Information on full costs of programs can be used in program evaluations. Such evaluations typically relate the full costs of programs to their outputs and outcomes. Decision-makers in the Congress and the federal government at all levels as well as the public should be provided with information on the full costs of programs and their outputs. The full cost information, when used with information on program outputs and outcomes, can aid the Congress and federal executives in making decisions on program authorization and modifications.

202. Cost awareness. Most respondents also agreed that the standard has the advantage of promoting cost awareness. Entity and segment managers should be aware of the costs that are incurred or assigned to their operations. Without the awareness, managing and controlling costs are impossible. The full cost information has not been available and will not likely to be without an accounting standard requiring it.

203. Setting fees and prices for government goods and services. Many respondents agreed that full cost should be considered as a primary basis for setting fees and reimbursements for government

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goods and services. As pointed out in the ED, it is a federal policy that, with certain exceptions, user charges (prices or fees) should be sufficient to recover the full cost of goods, services, and resources provided by the federal government as sovereign.[Footnote 43] The policy further states that when the government sells goods and services under business-like conditions rather than in a sovereign capacity, user charges should be based on market prices and may yield a net revenue in excess of the full cost. The objectives of the policy are to: (1) ensure that government goods and services are provided on a self-sustaining basis, (2) promote efficient allocation of national resources, and (3) allow fair competition with comparable goods and services provided by the private sector.

[Footnote 43: OMB Circular No. A-25, User Charges.]

204. To implement the policy, full cost information is necessary. Only with reliable full cost information can management ensure that user charges fully recover the costs.[Footnote 44] Even in some exceptional cases in which user charges are exempted or restricted by law, agencies that provide the goods and services would nevertheless need the full cost information to assess the extent to which costs are not recovered.

[Footnote 44: The standard of determining full cost discussed in this document, however, should not be construed as a standard for setting fees, prices, and reimbursements. Federal entities should comply with laws and regulations related to pricing policies in general and for specific types of goods and services. Those laws and regulations (including OMB Circular A-25) may prescribe costing requirements other than the full cost standard discussed in this document. Full cost defined by this standard can serve as a point of reference for managerial decisions. However, it is not intended to supersede any costing concept that management is required or permitted by law to use in pricing goods and services.]

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205. Making cost comparisons. Respondents agreed that the full cost of outputs provides a valid basis for cost comparisons. One of them emphasized the importance of calculating the unit cost of output on the full cost basis. The Board agrees with his view. If an output can be measured in units, its unit cost should be calculated on the full cost basis.

206. The unit cost of a service or product, calculated on a full cost basis, can be compared with a similar service or product produced by other entities either in the federal government or in the private sector. The comparison would not be valid if it is not conducted on a full cost basis.

207. One of the available cost management tools is trend analysis. In trend analysis, unit costs of a service or product over a number of consecutive periods are examined to find a trend of increases or decreases. This analysis can be valid only when the unit costs of all periods are measured on a consistent basis, such as the full cost basis. When the full cost basis is used, the analyst can further examine the components of the unit cost, such as direct labor and material costs, overhead costs, and costs of services received from other segments or entities. Through examining the various components of the full unit cost, program managers can pinpoint specific areas that contributed to cost increases or decreases.

208. If activity-based costing is used, the cost components would be associated with activities. The trend analysis for activity-based cost components can provide information related to the efficiency of the activities. Managers can also analyze the extent that the individual activities add value to program outputs and objectives.

Limitations of Full Cost Information

209. Several respondents cautioned the Board against "uncritical advocacy" of full costs. They pointed out that full cost is not relevant to all decision-making situations. They explained that

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some decisions require other cost concepts such as variable, differential, or incremental costs. Thus, some of them said that the Board should not singularly emphasize full cost.

210. The Board is aware of the notion that different cost concepts should be used for different purposes so that the use of a cost concept is relevant to a particular decision-making purpose. For this reason, the Board discussed the limitations and usefulness of full cost in the ED at length. (See ED pars 133 through 146.) Quoting from Anthony and Young, the ED pointed out that full costs are not appropriate for alternative choice decisions such as the decision to (1) add or drop a product or service, (2) perform work in-house or contract out for it, and (3) accept or reject a special request. For these decisions, the appropriate information is differential costs.[Footnote 45]

[Footnote 45: Robert N. Anthony and David W. Young, Management Control in Nonprofit Organizations, 5th ed. (Burr Ridge, Illinois: Richard D. Irwin Co., 1994) page 235.]

211. However, the full cost standard is an accounting standard, rather than a cost analysis or decision-making standard. It requires that full cost information be compiled and reported through cost accounting. In no way does it limit cost analysts and decision-makers to the use of full cost alone in all situations. The Board believes that when the full cost information, instead of any portion of it, is made available, analysts and decision-makers will have a comprehensive data source to develop the cost concepts that they need in their analyses.

212. Some respondents pointed out that full cost requires a complex process of cost assignments and allocations. The Board believes that the assignment of indirect costs is a necessary procedure to obtain full cost. It can be performed through an appropriate costing methodology. As discussed in the costing

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methodology section of the ED, some modern costing methodologies are available to make rational and reliable cost assignments. However, the Board must caution that the full cost information, like any other accounting information, can only be as good as how it is prepared. For example, it can be unreliable or inaccurate, if arbitrary or irrational cost allocations are used excessively. Thus, the Board recommended a costing methodology standard. Program managers should critically review costing methodologies and techniques used to derive the cost information.

Inclusion or Exclusion of Certain Costs

213. A number of respondents were opposed to the inclusion of accrued employee benefit costs and costs of services provided by other entities that are not reimbursed. (The subject of inter-entity costs will be discussed in the next section.) They argued that these costs are not funded with their budgetary resources and are beyond their control. A large portion of employee benefit costs, including accrued retirement benefit costs, are funded through appropriations to trust funds managed by OPM and DoD. The Board believes that as a principle, full cost should include the costs of all resources applied to a program, activity, and its outputs, regardless of funding sources. For financial reporting, the Board has stated its position that the full costs of employee pension and other retirement benefits determined on an actuarial basis, including the amounts that are funded to the trust funds directly, should be recognized as an expense in the employer entity's financial reports.[Footnote 46] The Board does not find a good rationale to depart from this principle in managerial costing.

[Footnote 46: FASAB Exposure Draft, Accounting for Liabilities of the Federal Government (Nov. 1994), pars. 80-99, pages 32-46.]

214. The ED states that some costs should be recognized as a period expense rather than the costs of goods and services (output costs).

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Examples include the costs of "other post employment benefits" (OPEB), reorganization costs, and acquisition costs of Federal "mission" and "heritage" property, plant, and equipment which are recognized as expenses at the time of acquisition.[Footnote 47] These costs will be recognized as expenses for the period in which the related events take place, and are referred to as "period expenses." The ED explained that since these expenses do not contribute to the outputs of the period in which they are incurred, they should not be included in the output costs.

[Footnote 47: "Federal mission PP&E" and "heritage assets" are explained in FASAB Exposure Draft, Accounting for Property, Plant, and Equipment (February 28, 1995), pars. 98-115, pages 29-33.]

215. The OPEB costs, for example, may be recognized as expenses for a period in which a reduction in force or an employee injury takes place.[Footnote 48] It is not appropriate to attribute the entire OPEB costs to the output costs of that period. Several respondents expressed the view that OPEB costs should be included in full cost. There is no doubt that OPEB costs, as well as other period expenses, are part of the full cost of an entity or a program. They may also be part of the full costs of outputs over many years in which the employees contributed to the production of the outputs. However, they are not the production costs for the period during which they are incurred. Thus, the Board concluded that in cost studies, management may distribute some of the period expenses, such as OPEB costs, to outputs over a number of past periods if (a) experience shows that the OPEB costs are recurring in a regular pattern , and (b) a nexus can be established between the OPEB costs and the outputs produced in those past periods. The Board finds no reason to change this position.

[Footnote 48: FASAB Exposure Draft, Accounting for Liabilities of the Federal Government (Nov. 7, 1994), pars. 100-102, pages 47-48.]

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216. Some respondents contended that full cost should include unused capacity costs. As will be explained in a later section on unused capacity costs, the Board has decided not to recommend a standard on measuring unused capacity costs. Thus, to assure valid cost comparisons, full costs should not exclude unused capacity costs.

Controllable and Uncontrollable Costs

217. Some respondents believed that the managers of a responsibility segment should be held accountable only for costs that they can control, and their performance should not be evaluated for costs beyond their control. They found that the full cost reporting would obscure the distinction between controllable and uncontrollable costs. For performance measurement or other purposes, some entities may want to make a distinction between controllable and uncontrollable costs with respect to an individual responsibility segment or a cost center. The full cost information need not interfere with this distinction. This standard does not require the use of full cost for internal reports. If some entities choose full cost for internal reporting, the internal reports can provide a distinction between controllable and uncontrollable costs with respect to individual segments.

218. Ultimately, most costs are controllable at a certain level of the entity. If some of them are not controllable at a lower level of the organization, they may very well be controllable at a higher level. Each segment should concern itself with the costs that are assigned to it on a cause-and-effect basis. These costs are often incurred because of a segment's demand and use of services from other segments or entities. Although the service-receiving segment has no control over the efficiency in producing the service, it can influence the costs by changing the demand for the service. For an entity's top management, full cost reporting provides it with an overview of how the entity's various costs, including the general and administrative costs,

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are incurred and assigned to the entity's segments. The full cost reporting also makes the entity's top management aware of the costs of services that it receives from other entities. The management can closely review those costs and determine whether actions are needed to control them.

Centralized Accounting

219. The proposed standard in the ED states that "Responsibility segments should be capable of measuring the full costs of their outputs." Several respondents stated that the full costs of segments, programs, and their outputs can be more effectively measured by entities through centralized accounting, rather than by individual segments. They further stated that it would not be cost-beneficial for segments to measure and report the full costs of their activities and outputs on a regular basis (such as monthly basis). The Board agrees that many entities may find it more economical and effective to measure full costs through centralized accounting. Moreover, the Board believes that it should be for entity management to decide as to how frequently the full cost information should be made available in its internal reports. Thus, the wording of the standard has been changed. The full cost requirement is now limited to external reporting via general purpose financial reports.

Costs of Outcomes

220. A respondent suggested that in addition to the full cost of outputs, the standard should also require reporting the full cost of program outcomes. As discussed in the ED, the Board believes that performance measurement of a program requires three major elements: the full cost of the program, its outputs, and its outcomes. (See ED pars 37 and 38) The full cost of a program and its outputs, once measured according to this standard can be related to the outcome of the program to measure its cost effectiveness.

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221. This standard does not require a direct measurement of the cost of outcomes because in most instances, program outcomes need to be measured with methodologies beyond those discussed in this document. GPRA defined "outcome measure" as an "assessment of the results of a program activity compared to its intended purpose."[Footnote 49] Many programs' policy objectives and intended results are socio-economic or scientific in nature, or involve national defense. The assessment of the program results require expert knowledge in those areas. Thus, unlike costs and outputs, outcomes are not always measured in quantitative or monetary terms.

[Footnote 49: The Government Performance and Results Act of 1993, PL 103-62, sec 4.]

222. Moreover, unlike costs and outputs that are measured for each accounting and reporting period, such as a quarter or a year, outcome measurement may be long-term in nature. For example, the Senate Report on GPRA states that "Outcome measurement cannot be done until a program or project reaches a point of maturity (usually at least several years of full operation for programs continuing indefinitely) or at completion." Although all programs cost money, some of them may produce positive results, while others may produce no results or negative results.

223. Because of the complexities in measuring outcomes, the costing principles and methodologies discussed in this document cannot be used to measure the cost of outcomes. The Board believes that the full cost of a program and its outcome should be measured independently, using methodologies appropriate to costs and to outcomes. Once each of them is measured, they can then be related to review the cost-effectiveness of the program.

Inter-Entity Costs

224. It is not unusual in the federal government for one agency to provide goods or services to

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another agency. Sometimes this may be required by law, and often it is a very efficient method of conducting business for the agencies involved and for the government as a whole. In many cases, the agency receiving such goods or services will reimburse the providing agency in accordance with some agreed-upon price. Often, however, there is no charge, or there is a charge that is not sufficient to cover the providing agency's full cost. When such "free" or lower-than-cost items are used in the production of the receiving agency's outputs, the result can be an understatement of the full cost of final outputs by the receiving agency.

Survey of Non-Reimbursed Costs

225. The Board recognized that these non-reimbursed or under-reimbursed goods and services could distort the determination of a reporting entity's full cost of outputs, but it was uncertain of the extent to which this occurs. To identify examples of non-reimbursed inter-entity costs, the Board conducted a limited survey of federal agencies. Of the 22 agencies responding to the survey request, 13 indicated that they provide some type of service or good that is not reimbursed. These covered a wide range of activities, but most of the costs involved were for salaries and salary-related benefits of those employees performing the work. In most cases, the costs were funded through direct appropriations to the providing agencies; however, those agencies could not specifically identify the total amounts involved. Several provided estimates, which ranged from $360 thousand dollars per year to about $180 million per year. Several examples of non-reimbursed inter-entity activities identified in the survey are listed below by providing entity:

-- Department of Agriculture -- Provides market data, pesticide data, food specification information, water supply forecasts, and

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other agricultural information. Thirty-six federal agencies regularly receive all or some of this information.

-- Department of Commerce -- Provides accounting and grant administration services, computer access and reports, and consultation services to several agencies.

-- Department of State -- Provides space and facilities for other agencies in its buildings in the U.S. and overseas.

-- General Services Administration -- In some cases, it provides policy and regulatory development services, property management services, and contract award and administration to other agencies without reimbursement.

-- National Science Foundation -- Administers a research grant program on engineering and computer science for the Department of Defense.

226. The Board noted that the survey was restricted to non-reimbursed costs between different agencies. As such, the results did not necessarily represent all of the kinds and amounts of transactions and costs between different reporting entities. The survey was also limited to those non-reimbursed costs which the agencies could easily identify in order to respond quickly to the questionnaire. Nevertheless, there were indications that some non-reimbursed costs may be significant in amount.

Usefulness of Recognition

227. Some respondents to the exposure draft stated that recognition of inter-entity[Footnote 50] costs would have limited usefulness for managers since they cannot control the cost of items provided by other agencies. In some circumstances, they cannot control the amounts of

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inter-entity goods or services that must be used in the production of their outputs.

[Footnote 50: Full cost, as discussed in the full cost standard, contemplates both intra-entity costs and inter-entity costs applicable to a responsibility segment. This standard elaborates on inter-entity costs. Intra-entity costing is accomplished through the costing methodology selected for use within the reporting entity since these costs are passed among responsibility segments.]

228. The Board realizes that recognition of non-reimbursed or under-reimbursed inter-entity costs will not always have the same degree of usefulness for all levels of management. However, as stated in the standard on full costs, to fully account for the costs of the goods and services they produce, reporting entities will need to include the cost of goods and services received from other entities. Cost reduction and control, performance evaluation, and process improvement depend on knowledge of the full costs of producing outputs, including production costs incurred by other federal entities. These costs are most important for use by the entity's top-level management (and to a lesser degree by line managers) in controlling and assessing the operating environment and in making decisions about how best to acquire those goods and services. Knowledge of full cost, including the extent of inter-entity costs, is also important to external users, especially the Congress and taxpayers, in making decisions concerning various programs and allocating resources throughout the government.

229. In addition, the Board believes that, without the recognition of non-reimbursed and under-reimbursed inter-entity costs, the receiving entity has little incentive to control the use of these resources. While they may appear to be "free" to the receiving entity, the costs are absorbed somewhere in the government. If the receiving entity were charged for these costs, top-level management would then have more

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incentive to economize and control the use of these resources as well as make better decisions concerning how and where to acquire them. This would help reduce overall costs to the taxpayer and provide the other benefits associated with full-costing by responsibility segment.

230. The recognition of all inter-entity costs is also important when an entity produces goods or services that are sold outside of the federal government. For the entity to recover the government's full cost on the sale, knowledge of the total cost, including costs incurred by other federal entities, is vital to the establishment of an appropriate price.

The Use of Estimates

231. The standard places the responsibility on the providing entity to supply the receiving entity with information on the full costs of non-reimbursed or under-reimbursed inter-entity goods and services. This is appropriate since only the providing entity is likely to have such information. Implementation of the standard on full costing should make this requirement fairly easy for the providing entity to fulfill. If, for some reason, the providing entity cannot or does not supply the cost information, the receiving entity has no way to recognize the costs other than through estimation.

232. The Board anticipated this possibility, and requires the receiving entity to use an estimate of the cost of those goods and services if the actual cost information is not provided. The estimate must be reasonable and should be aimed at determining realistic costs incurred by the providing entity. However, if such a cost estimate cannot be made, the receiving entity may base the estimate on the market value of the goods or services.

233. Some respondents to the exposure draft stated

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that the use of estimates would be too problematic and unreliable and that the receiving entity would not have enough information to make the estimate. Some were concerned that the use of estimates would cause arguments between reporting entities over the cost. Others were concerned that some entities do not have experienced personnel to make such estimates. A few were concerned about the audit implications of using an estimate.

234. Some respondents expressed concern over the possible use of market values in making the estimate. Some of these respondents stated that government-type goods and services are not often produced outside government and, therefore, such market values may not exist. Others stated that market value does not always bear a direct relationship to true cost or that market values change too rapidly to be of any use.

235. The Board realizes the problems associated with the use of estimates. However, implementation of the other managerial cost accounting standards in this statement by the providing entities should considerably lessen the need for receiving entities to make estimates of inter-entity costs. The Board also believes that, if the inter-entity costs meet the recognition criteria established by the standard, and cost information is not received, then use of a reasonable estimate of cost is preferable to no recognition at all.

236. Estimates are often used in accounting and financial reporting. The recognition of cost based on estimation is not new and can be reliable so long as the estimate is reasonable and based on a rational and systematic method. The Board also realizes that the use of estimation necessarily implies the use of professional judgement. This does not negate the value of the estimate to users of the financial information and should not present a problem in relation to audit requirements.

237. The Board realizes that market values may

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not always be available for many kinds of inter-entity goods and services. Nevertheless, if such values are available, they can be a good basis for estimating cost if no other basis can be established. Although market values may not be directly related to costs of production and they may fluctuate, they may also be viewed as a fairly reliable guide to the costs an entity might have to incur to obtain inter-entity goods and services from a non-governmental source. As with the determination of all estimates, use of market values as an estimation basis requires the use of judgement and professional care.

238. The Board also realizes that there may be some implementation problems such as disagreements with providing entities over an estimated cost or with the lack of trained personnel to make estimates. These problems are of a practical nature and can be resolved by management. In that regard, they are not unlike other problems faced when implementing any new or changed accounting standard such as making changes to systems and methods and training personnel on the new requirements. Both providing and receiving entities should work closely with each other to resolve any costing problems just as they would to solve any non-accounting related situations.

Recognition Criteria

239. It is clear to the Board that the recognition of each and every non-reimbursed or under-reimbursed inter-entity cost is not possible. The federal government is a very large and complex entity and it is normal to expect some flow of goods and services between its activities as a natural and reasonable method of completing missions and objectives. The Board decided that only certain non-reimbursed or under-reimbursed inter-entity costs should be addressed. The standard, therefore, includes criteria for recognition which will limit the application of the standard to only those items deemed most

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significant and important.

240. The criteria address the materiality of the non-reimbursed inter-entity cost, whether it is a part of broad and general support for all entities, and whether it is needed to help determine a price to non-governmental entities. The materiality criterion considers materiality in the context of the importance of the item to the receiving entity. Under this criterion, whether an item of inter-entity cost is recognized depends upon three points. The first of these is significance to the receiving entity, i.e. whether the item is important enough that management should be aware of its cost in decision making circumstances. The second is the degree to which the goods or services are an integral and necessary part of the receiving entity's output. The third is the degree to which the good or service can be matched to the specific receiving entity with reasonable precision.

241. The criterion of broad and general support recognizes that some entities provide support to all or most other federal entities, generally as a matter of their mission. The costs of broad and general services should not be recognized by the receiving entity when no reimbursement has been made. However, if the service is an integral and necessary part of the receiving entity's operations and outputs, those costs should be recognized.

242. The criteria also recognize that there are certain cases in which inter-entity costs need to be recognized because there could be an effect upon a resulting price to a non-governmental entity. If a federal entity sells outputs to a non-federal entity, it is usually required to recover the full cost of those goods or services. While cost is not the sole determinant of final price, knowledge of the actual full cost of production to the government as a whole is necessary to ensure that the price is appropriately established at a level that will recover all costs.

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243. Most of the respondents to the exposure draft agreed with the recognition criteria. However, a few were concerned about how the criteria might be interpreted and whether the standards were too general in nature. The Board realizes that considerable judgement is required to apply these criteria and notes that the specific facts and circumstances in each case must be considered. This concern, along with other implementation concerns, led the Board to make certain decisions about implementation discussed below under "Implementation Issues."

Consolidation

244. The standard requires that, when non-reimbursed or under-reimbursed inter-entity costs are recognized, the receiving entity should recognize the full costs of the goods or services received as an expense (or asset) and, to the extent that reimbursement is less than full cost, the difference is to be recognized as a financing source. At the same time, of course, the providing entity would continue to recognize the full costs of goods and services provided, and any off-setting reimbursements, in its accounting records. Several respondents to the exposure draft were concerned about the possibility of "double-counting" of costs and others raised concerns about the ability to eliminate these transactions in consolidations.

245. Both the providing entity and the receiving entity are separate reporting entities. Each should recognize in its accounting records and financial reports the true costs of operations and any revenues received. The providing entity incurs a cost in providing the goods or services even though they are sent to another entity. It may also receive a partial payment or reimbursement. These transactions and events should be reflected in its accounting. The receiving entity, as a separate reporting entity, should also recognize its total cost of

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production. The full cost of non-reimbursed or under-reimbursed goods or services ultimately contributing to its outputs should be reflected in the costs of production. To the extent that reimbursement is not made for those costs, the receiving entity is utilizing a separate source of financing, namely the providing entity. Again, this fact is reflected in the accounting. The result is that costs recognized but not actually paid are off-set by the imputed financing source. While the entity's financial position is not affected, the real costs of production are reflected.

246. The only possibility for "double-counting" of costs occurs when consolidated financial reports are prepared for a reporting entity that includes both the providing entity and the receiving entity. In preparing such statements, the standard calls for elimination of the inter-entity transactions. In effect, this is no different from the elimination of transactions for which full reimbursement has been made. The only additional transaction to be eliminated is the recognition of the imputed financing source by the receiving entity. The recognition of costs by both the providing entity and the receiving entity and any actual reimbursements would be eliminated anyway if payment for the inter-entity costs were made.

247. The Board realizes that identification and tracking of transactions that must be eliminated for consolidated reports can become complex and difficult. However, this is a practical implementation problem that management should be able to overcome through the use of transaction coding or some other identification method. It likely will require changes in methods and systems currently in use and may require additional training of personnel. The Board has decided upon a method to ease implementation problems as discussed below.

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Implementation Issues

248. As discussed above, the Board realizes that there may be problems in implementing the standard on inter-entity costing. Recognition of non-reimbursed or under-reimbursed inter-entity costs is a new concept to federal entities and involves

a new way of thinking about costs. There is concern that application of the standard may be inconsistent among federal entities. In addition, there could be problems, particularly at first, in developing estimates of costs; in revising accounting systems and procedures to accommodate these requirements; and in training personnel to accomplish the task. Furthermore, the Board recognizes the concern that some have about the elimination of inter-entity cost transactions for consolidated reporting since the accounting procedures may be complicated.

249. As a result of these problems and concerns, the Board has expressed the need to take a measured, step-by-step, practical approach to implementation of this standard. Therefore, the Board has decided that, in implementing the standard, it recommends that OMB, with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing and OMB should then issue guidance identifying those costs. OMB should consider the requirements of the standard including the recognition criteria in developing the guidance and it should also consider suggestions and information provided by Treasury, GAO, and other agencies. The Board anticipates the largest and most important inter-entity costs will be identified first, followed by others as entities gain experience in the application of the standard. This approach is seen as a practical way to ensure uniformity in the application and implementation of the standard and to provide time and experience in overcoming any other practical problems which may arise. Also, the Board may recommend specific inter-entity costs for recognition in possible future recommended

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standards.

Costing Methodology

250. The ED discussed cost accumulation and assignment principles. The ED states that costs should be accumulated by responsibility segments, and the accumulated costs should be classified by type of resource such as costs of employees, material, capital, utilities, rent, etc. The ED states that "The accumulation of costs by responsibility segments does not mean that each responsibility segment must have its own accounting system. The reporting entity may have a centralized accounting system, but the system should be capable of identifying costs with responsibility segments." (See ED par. 170)

251. The ED discussed three cost assignment principles: (a) directly tracing costs wherever feasible and economically practical, (b) assigning costs on a cause-and-effect basis, or (c) allocating costs on a reasonable and consistent basis. These principles apply to costs of services provided by a segment to other segments, as well as assigning costs to ultimate outputs of a segment.

252. The ED then provided brief descriptions of available costing methodologies: activity-base costing (ABC), job order costing, process costing, and standard costing. The ED pointed out that these costing methodologies are not mutually exclusive. For example, standard costing can be used within ABC. ABC and standard costing combined can then be used with either job order costing or process costing.

253. Most respondents believed that the requirement for cost accumulation by responsibility segment is appropriate. Some of them stated that costs are accumulated at levels lower than segments such as cost centers, processes, or activities within a segment. Such accumulation is consistent with the standard so long as the costs will be aggregated at the

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segment level. Some of the respondents stated that the requirement is currently feasible because their systems are designed to accumulate expenses by segments and by resource types. Others, however, stated that they must upgrade their general accounting systems in order to meet the standard requirement.

254. All the respondents agreed with the cost assignment principles. One respondent, while supporting the principles, stated that the principles should be explicitly ranked by preference. The Board intended to express an preference among the principles. It stated in the proposed standard that direct cost tracing should be used "wherever it is feasible and economically practical." The Board further stated in the ED that "for the costs that are not directly traced to outputs, it is preferable that they be assigned to them on a cause-and-effect basis." (See ED par. 182) However, for cost-benefit considerations, assigning costs by allocations cannot be avoided. The Board emphasized that cost allocations should be performed on a rational basis. It also cautioned that allocations can be arbitrary and thus may result in distortions. (See ED par. 190) To make the intent of preference more explicit, the Board has added words to the standard to indicate that the principles are listed by preference.

255. All the respondents approved the descriptions
of available costing methodologies. Some of them stated that the materials included are clear and provide adequate guidance. The respondents agreed with the Board's position that because federal activities are highly diverse, it is not practical to require a particular costing method for a particular type of activity at this time. However, it is appropriate to require that each entity select a costing methodology that is best suited to its operations and use that methodology consistently.

256. The Board encouraged government entities to

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study the potential use of ABC in their operations (ED par. 200). This was well received by the respondents. Eighteen respondents supported ABC. Most of them said that ABC can be effective when combined with any of the other costing methodologies. Seven respondents from federal agencies stated that they believed ABC is appropriate for their activities and were considering using it. In addition, two respondents stated that the use of standard costing should also be encouraged. The Board continues to believe that as federal agencies are going through stages in the development of their managerial costing, more sophisticated and refined costing methods, such as ABC and standard costing, should be considered and used to minimize arbitrary cost allocations and to improve full cost information.

257. The Board considered whether the costing methodology section should be recommended as a concept or a standard. It concluded that it should be a standard. The Board believes that cost accumulation and assignment principles contained in this section are definitive and should be followed by federal entities. Only by adhering to the principles and by continuous refinement of costing methodologies, can reliable full cost information be achieved.

Unused Capacity Costs

258. The ED proposed a standard, which, if adopted, would have required that entities measure the cost of unused operating capacity and report it as a separate expense. For this purpose, some entities, such as DoD, must separate operating capacity from "readiness capacities" which are reserved for war and emergency mobilization rather than normal operations. The operating capacity can be measured in terms of "practical capacity" which is the maximum units of output that the available capacity can produce taking the normal

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stoppage and interruptions into consideration. Unused capacity is the excess of practical capacity over actual outputs.

259. A number of respondents appreciated the importance of the proposed requirement. They stated that capacity cost information would be very useful in improving the cost and capacity management of federal agencies. Several respondents from the private sector urged that the proposal be adopted immediately.

260. Most respondents from federal agencies, however, stated that capacity measurements involve very complex issues and are not feasible to implement at this time. If the proposed requirement were adopted, agencies would encounter two major types of difficulties. First, they lack guidance on defining and measuring various types of capacity. For example, respondents from DoD stated that it is difficult to develop criteria that can be used to differentiate defense operating capacity costs from mobilization capacity costs. Civilian agencies engaging in administrative, policy making, and regulatory activities also indicated difficulties in defining their practical capacities. Second, respondents of many agencies stated that they do not have the accounting capability to provide reliable capacity measures. Without such capability, unused capacity costs could be improperly estimated and the resulting information could be misleading.

261. Many respondents were also opposed to the proposed standard on the basis of cost-benefit considerations. They estimated that accounting for capacity costs would require substantial time and efforts to implement. This would require the use of their limited accounting personnel and equipment. Respondents from some agencies do not perceive that they have an over-capacity problem. Thus, it is very uncertain whether capacity accounting results, if produced, could be used to improve their operations.

262. After considering the responses to the ED,

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the Board is convinced that it is premature to recommend capacity accounting either as a standard or as a concept. The Board is aware that federal agencies have limited personnel and other resources for accounting. They must devote those limited resources to improving general financial reporting and to establishing the more fundamental elements of managerial cost accounting. Thus, it would not be cost beneficial to implement capacity costing at this time.

263. Managing capacity costs is a part of cost management. Although this document does not recommend a standard for measuring capacity costs, the full cost information required by the full cost standard will help management in identifying capacity utilization problems. Some respondents stated that the capacity accounting concepts would be useful to capital intensive, industrial-type activities and activities that deliver repetitive services that are measurable in units. The Board is aware that there are on-going research efforts on the subject in the private accounting communities. Thus, the Board may reconsider capacity accounting in the future.

Effective Date

264. The Board holds the view that managerial cost accounting has been needed across the federal government for a long time. Since the standards are quite general and address only the highest levels of cost accounting, the Board felt that they should be implemented quickly. The earlier managerial cost accounting is started, the earlier the benefits will be seen in managing and controlling federal programs and activities. The Board also believes that an effective date far into the future would not serve to quickly change the government's tendency to neglect cost accounting. Therefore, in the exposure draft, the effective date was set for fiscal periods beginning after September 30, 1995 (i.e., beginning in fiscal year 1996).

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265. A majority of respondents to the exposure draft commented that this date was too early and said that they foresee problems with implementation at September 30, 1995. Many reasons were given for a delay in implementation. Chief among these were (1) difficulty in obtaining funding to make necessary changes in financial systems before September 30, 1995, (2) a lack of trained accounting personnel and equipment, and (3) a need for time to develop or modify appropriate cost accounting methodologies and systems and develop management awareness and support. Respondents suggested implementation dates ranging from one to five years after the fiscal year 1996 date given in the exposure draft.

266. The Board recognized the validity of the concerns of many respondents over funding, training, and development of costing activities. However, it also recognized that federal agencies must be able to develop cost information very soon to meet the requirements of the GPRA. It also noted that reporting entities do not have to possess sophisticated cost accounting systems to meet the requirements in these standards. Federal agencies can take a gradual approach to the development of cost systems, if necessary, while developing basic cost information through other means in the short term.

267. Nevertheless, the Board agreed that the implementation date in the exposure draft may be a problem for many federal agencies since cost accounting is relatively new to most of them and the recommended implementation date is very near. The Board decided, therefore, to delay the implementation date by one additional year and make the standards effective for periods beginning after September 30, 1996, with earlier implementation encouraged.

268. Early on in the development of the managerial
cost accounting project, the task force determined that many problems can result in cost accounting from the use of similar terms to mean different

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things. It concluded that the use of consistent cost accounting terminology is necessary to avoid confusion and mis-communication. Therefore, it recommended that the Board attach a glossary to the exposure draft which would define many of the cost accounting terms used.

269. The Board agreed with this recommendation. It also decided that the establishment of uniform cost accounting terminology within the federal government is so important that the glossary should contain not only definitions for terms used in the statement, but also definitions for other important cost accounting terms even if those terms are not used directly in the text of the statement. This glossary would serve as the beginning of a uniform and consistent cost accounting terminology for use within the federal government.

270. Comments were received from only one respondent to the exposure draft concerning the glossary. That respondent did not suggest changing any of the definitions provided in the glossary, but only suggested some additions. The Board decided that the glossary is sufficient for the time being and should be retained in the final statement as an appendix. However, it also decided that it may issue additions to the glossary at a later date as more federal agencies gain experience in the development of cost information, and as the need for additional standard definitions becomes apparent.

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APPENDIX B: GLOSSARY

Activity - The actual work task or step performed in producing and delivering products and services. An aggregation of actions performed within an organization that is useful for purposes of activity-based costing.

Activity Analysis - The identification and description

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of activities in an organization. Activity analysis involves determining what activities are done within a department, how many people perform the activities, how much time they spend performing the activities, what resources are required to perform the activities, what operational data best reflect the performance of the activities, and what customer value the activity has for the organization. Activity analysis is accomplished with interviews, questionnaires, observation, and review of physical records of work. It is the foundation for agency process value analysis, which is key to overall review of program delivery.

Activity-Based Costing - A cost accounting method that measures the cost and performance of process related activities and cost objects. It assigns cost to cost objects, such as products or customers, based on their use of activities. It recognizes the causal relationship of cost drivers to activities.

Actual Cost - An amount determined on the basis of cost incurred including standard cost properly adjusted for applicable variance.

Avoidable Cost - A cost associated with an activity that would not be incurred if the activity were not performed.

Common Cost - The cost of resources employed jointly in the production of two or more outputs and the cost cannot be directly traced to any one of those outputs.

Common Data Source - All of the financial and programmatic information available for the budgetary, cost, and financial accounting processes. It includes all financial and much non-financial data, such as environmental data, that are necessary for budgeting and financial reporting as well as evaluation and decision information developed as a result of prior reporting and feedback.

Controllable Cost - A cost that can be influenced by the action of the responsible manager. The term always refers to a specified manager since all costs are controllable by someone.

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Cost - The monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service.

Cost Accounting Practice - Any disclosed or established accounting method or technique which is used for measurement of cost, assignment of cost to accounting periods, and assignment of cost to cost objects.

Cost Allocation - A method of assigning costs to activities, outputs, or other cost objects. The allocation base used to assign a cost to objects is not necessarily the cause of the cost. For example, assigning the cost of power to machine activities by machine hours is an allocation because machine hours are an indirect measure of power consumption.

Cost Assignment - A process that identifies costs with activities, outputs, or other cost objects. In a broad sense, costs can be assigned to processes, activities, organizational divisions, products, and services. There are three methods of cost assignment: (a) directly tracing costs wherever economically feasible, (b) cause-and-effect, and (c) allocating costs on a reasonable and consistent basis.

Cost Driver - Any factor that causes a change in the cost of an activity or output. For example, the quality of parts received by an activity, or the degree of complexity of tax returns to be reviewed by the IRS.

Cost Finding - Cost finding techniques produce cost data by analytical or sampling methods. Cost finding techniques are appropriate for certain kinds of costs, such as indirect costs, items with costs below set thresholds within programs, or for some programs in their entirety. Cost finding techniques support the overall managerial cost accounting process and can represent non-recurring analysis of specific costs.

Cost Object (also referred to as Cost Objective) - An activity, output, or item whose cost is to be measured.

In a broad sense, a cost object can be an organizational division, a function, task, product,

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service, or a customer.

Differential Cost - The cost difference expected if one course of action is adopted instead of others.

Direct Cost - The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities. A cost that is specifically identified with a single cost object.

Estimated Cost - The process of projecting a future result in terms of cost, based on information available at the time. Estimated costs, rather than actual costs, are sometimes the basis for credits to work-in-process accounts and debits to finished goods inventory.

Expense - Outflow or other using up of resources or incurring liabilities (or a combination of both), the benefits from which apply to an entity's operations for the current accounting period, but do not extend to future periods.

Fixed Cost - A cost that does not vary in the short term with the volume of activity. Fixed cost information is useful for cost savings by adjusting existing capacity, or by eliminating idle facilities. Also called Non-Variable Cost or Constant Cost.

Full-Absorption Costing - A method of costing that assigns (absorbs) all labor, material, and service/manufacturing facilities and support costs to products or other cost objects. The costs assigned include those that do and do not vary with the level of activity performed.

Full Cost - The sum of all costs required by a cost object including the costs of activities performed by other entities regardless of funding sources.

Incremental Cost - The increase or decrease in total costs that would result from a decision to increase or decrease output level, to add a service or task, or to change any portion of operations. This information helps in making decisions such as to contract work out,

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undertake a project, or increase, decrease, modify, or eliminate an activity or product.

Indirect Cost - A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.

Inter-Entity - A term meaning between or among different federal reporting entities. It commonly refers to activities or costs between two or more agencies, departments, or bureaus.

Job Order Costing - A method of cost accounting that accumulates costs for individual jobs or lots. A job may be a service or manufactured item, such as the repair of equipment or the treatment of a patient in a hospital.

Managerial Cost Accounting System - The organization and procedures, whether automated or not, and whether part of the general ledger or stand-alone, that accumulates and reports consistent and reliable cost information and performance data from various agency feeder systems. The accumulated and reported data enable management and other interested parties to measure and make decisions about the agency's/segment's ability to improve operations, safeguard assets, control its resources, and determine if mission objectives are being met.

Opportunity Cost - The value of the alternatives foregone by adopting a particular strategy or employing resources in a specific manner. Also called Alternative Cost or Economic Cost.

Outcome - The results of a program activity compared to its intended purposes. Program results may be evaluated in terms of service or product quantity and quality, customer satisfaction, and effectiveness.

Outputs - Any product or service generated from the consumption of resources. It can include information or paper work generated by the completion of the tasks of an activity.

Performance Measurement - A means of evaluating

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efficiency, effectiveness, and results. A balanced performance measurement scorecard includes financial and nonfinancial measures focusing on quality, cycle time, and cost. Performance measurement should include program accomplishments in terms of outputs (quantity of products or services provided, e.g., how many items efficiently produced?) and outcomes (results of providing outputs, e.g., are outputs effectively meeting intended agency mission objectives?). See Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting, page 65.

Process - The organized method of converting inputs (people, equipment, methods, materials, and environment), to outputs (products or services). The natural aggregation of work activities and tasks performed for program delivery.

Process Costing - A method of cost accounting that first collects costs by processes and then allocates the total costs of each process equally to each unit of output flowing through it during an accounting period.

Process Value Analysis - Tools and techniques for studying processes through customer value analysis. Its objective is to identify opportunities for lasting improvement in the performance of an organization. It provides an in-depth review of work activities and tasks, through activity analysis, which aggregate to form processes for agency program delivery. In addition to activity-based costing, quality and cycle time factors are studied for a complete analysis of performance measurement. Each activity within the process is analyzed, including whether or not the activity adds value for the customer.

Product - Any discrete, traceable, or measurable good or service provided to a customer. Often goods are referred to as tangible products, and services are referred to as intangible products. A good or service is the product of a process resulting from the consumption of resources.

Responsibility Center - An organizational unit headed by a manager or a group of managers who are responsible for its activities. Responsibility centers can be

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measured as revenue centers (accountable for revenue/sales only), cost centers (accountable for costs/expenses only), profit centers (accountable for revenues and costs), or investment centers (accountable for investments, revenues, and costs).

Responsibility Segment - A significant organizational, operational, functional, or process component which has the following characteristics: (a) its manager reports to the entity's top management; (b) it is responsible for carrying out a mission, performing a line of activities or services, or producing one or a group of products; and (c) for financial reporting and cost management purposes, its resources and results of operations can be clearly distinguished, physically and operationally, from those of other segments of the entity.

Service - An intangible product or task rendered directly to a customer.

Standard Costing - A costing method that attaches costs to cost objects based on reasonable estimates or cost studies and by means of budgeted rates rather than according to actual costs incurred. The anticipated cost of producing a unit of output. A predetermined cost to be assigned to products produced. Standard cost implies a norm, or what costs should be. Standard costing may be based on either absorption or direct costing principles, and may apply either to all or some cost elements.

Support Costs - Costs of activities not directly associated with production. Typical examples are the costs of automation support, communications, postage, process engineering, and purchasing.

Traceability - The ability to assign a cost directly to a specific activity or cost object by identifying or observing specific resources consumed by the activity or cost object.

Uncontrollable Cost - The cost over which a responsible manager has no influence.

Unit Cost - The cost of a selected unit of a good or

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service. Examples include dollar cost per ton, machine hour, labor hour, or department hour.

Value-Added Activity - An activity that is judged to contribute to customer value or satisfy an organizational need. The attribute "value-added" reflects a belief that the activity cannot be eliminated without reducing the quantity, responsiveness, or quality of output required by a customer or organization. Value-added activities should physically change the product or service in a manner that meets customer expectations.

Variable Cost - A cost that varies with changes in the level of an activity, when other factors are held constant. The cost of material handling to an activity, for example, varies according to the number of material deliveries and pickups to and from that activity.

Variance - The amount, rate, extent, or degree of change, or the divergence from a desired characteristic or state.

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board" was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the federal government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are

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published for comment as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard is published by OMB and GAO and then becomes effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

--Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board

--Mission Statement: Federal Accounting Standards Advisory Board

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The Board expresses its appreciation to Managerial Cost Accounting Task Force members listed below for their contribution to developing the Exposure Draft of the Statement.

C. Morgan Kinghorn, Chairman
Internal Revenue Service
Rein Abel
Cost Accounting Standards Board
Frank Bankes
Navel Sea Systems Command
Regina Begliutte
Defense Performance Review
James Brimson
Activity Based Management Institute
Debra Carey
Department of Interior
Tom Cuny
Congressional Budget Office
Ted David
. Department of Agriculture
Joseph J. Donlon
Internal Revenue Service

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Diane Eggert
Department of Agriculture
Dale Geiger
California State University, San Marcos
William Gilfillan
Department of Veterans Affairs
John Glover
Department of Defense
Dianne Guensberg
General Accounting Office
Chris Hendrix
Ernst & Young
Robert S. Kaplan
Harvard Business School
Joe Kehoe
Coopers & Lybrand
Richard Loeb
Cost Accounting Standards Board
Ronald Longo
Office of Management and Budget
Allan Lund
Department of Treasury
Pete Poulos
Department of Defense
Norman Richards
General Services Administration
Justine Rodriguez
Office of Management and Budget
Hank Steininger
Grant Thornton
John Simonette
Coopers & Lybrand

Work Group Members:

Clifton A. Williams
Internal Revenue Service
Richard C. Mayo
FASAB
Larry J. Modlin
FASAB

****

FASAB BOARD MEMBERS

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Elmer B. Staats, Chairman

James L. Blum

Donald H. Chapin

Martin Ives

Norwood Jackson

Gerald Murphy

James E. Reid

Cornelius E. Tierney

Alvin Tucker

****

Ronald S. Young, Executive Director

Project Staff:
Richard C. Mayo
Larry J. Modlin

Federal Accounting Standards Advisory Board
750 First Street, Suite 1001
Washington, D.C. 20002

Telephone (202) 512-7350
FAX (202) 512-7366

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END.

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Accounting for liabilities
SFFAS No. 5

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Executive Office of the President
Office of Management and Budget

"ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT"

Statement of Federal Financial Accounting Standards
Number 5

September 1995

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**********From Inside Front Cover**********

APPLICABILITY, MATERIALITY, AND TERMINOLOGY

These standards apply to general purpose financial reports of U.S. Government reporting entities. These standards need not be applied to immaterial items. Statement of Federal Financial Accounting Concepts No. 2 (SFFAC No. 2), "Entity and Display", lists criteria for defining Government reporting entities. Paragraph 78 of "Entity and Display" notes that some of a reporting entity's components may be required by law or policy to issue financial statements in accordance with accounting standards other than those recommended by the FASAB and issued by the OMB and the GAO, e.g., accounting standards issued by the Financial Accounting Standards Board or by a regulatory agency. Those components should continue to apply the standards used in these reports. The reporting entities of which the components are a part, however, need to be sensitive to differences that may arise from different accounting standards. If these differences are material, the standards recommended by the FASAB and issued by the OMB and the GAO should be applied. In such cases, the components would need to provide any additional disclosures or different measurements required by the accounting standards issued by the OMB and the GAO that would not be required by the other standards.

The word "disclosure" in FASAB's recommended standards indicates reporting information in notes or narrative that is regarded as an integral part of the basic financial statements, while "supplemental" indicates reporting information in schedules or narrative regarded as "required

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supplementary information" as that term is used in accounting and auditing standards. Government auditing standards require little auditing assurance for required supplementary information. "Other accompanying information" refers to unaudited information that accompanies the audited financial statements. "Required supplementary stewardship information" is a new category of information FASAB proposes in its exposure draft, "Supplementary Stewardship Reporting", with the expectation that OMB and GAO will in collaboration agree upon audit procedures that would be appropriate to apply to this information. These terms are intended to indicate the Board's expectations regarding the minimum auditor's responsibility for the information, not its specific location within general purpose financial reports.

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EXECUTIVE SUMMARY
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a This Statement establishes accounting standards for liabilities of the federal government not covered in Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities", and in Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees." This Statement defines "liability" as a probable future outflow or other sacrifice of resources as a result of past transactions or events. [FN 1:Liabilities recognized according to the standards in this Statement include both liabilities covered by budgetary resources and liabilities not covered by budgetary resources. Liabilities covered by budgetary resources are liabilities incurred that will be covered by available budgetary resources encompassing not only new budget authority but also other resources available to cover liabilities for specified purposes in a given year. Liabilities not covered by budgetary resources include liabilities incurred for which revenues or other sources of funds necessary to

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pay the liabilities have not been made available through congressional appropriations or current earnings of the reporting entity. Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress. (Adapted from OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements.")]

b The Statements of Federal Financial Accounting Standards (SFFAS) and Concepts (SFFAC) referred to in this document are statements recommended by the Federal Accounting Standards Advisory Board (FASAB), approved by the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General (the Principals) and issued by the Office of Management and Budget (OMB) and the General Accounting Office (GAO).

c This Statement defines the recognition points for liabilities associated with different types of events and transactions (***Figure 1 IS AVAILABLE IN HARD COPY ONLY***).[FN 2: Recognition means reporting a dollar amount on the face of the basic financial statements.]

-- A liability arising from reciprocal or "exchange" transactions (i.e., transactions in which each party to the transaction sacrifices value and receives value in return) should be recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., a federal employee performs services in exchange for compensation).

-- A liability arising from nonreciprocal transfers or "nonexchange" transactions (i.e., transactions in which one party to the transaction receives value without directly giving or promising value in return, such as grant and certain entitlement programs) should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits,

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goods, or services [FN 3: Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (e.g., estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).

-- Government-related events are nontransaction-based events that involve interaction between federal entities and their environment. The event may be beyond the control of the entity. A liability is recognized for a future outflow of resources that results from a government-related event when the event occurs if the future outflow of resources is probable and measurable (see paragraphs 33 and 34 for the definitions of probable and measurable, respectively) or as soon thereafter as it becomes probable and measurable. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damage and to the extent that the amount of the payment could be estimated reliably. Government-related events also include hazardous waste spills on federal property caused by federal operations or accidents and catastrophes that affect government-owned property.

--Government-acknowledged events are events that are of financial consequence to the federal government because it chooses to respond to the event. A liability is recognized for a future outflow of resources that results from a government-acknowledged event when and to the extent that the federal government formally acknowledges financial responsibility for the event and a nonexchange or exchange transaction has occurred. The liability for a nonexchange

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transaction should be recognized for any unpaid amounts due as of the reporting date and the liability for the an exchange transaction should be recognized when goods or services have been provided. The liability includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (Examples of government-acknowledged events include toxic waste damage caused by nonfederal entities and damage from natural disasters).

d In addition to discussing the general liability recognition principle, the Statement includes several specific federal liability accounting standards which are summarized below.

-- Contingencies - A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized, may be disclosed [FN 4: "Disclosure" in this document refers to reporting information in notes regarded as an integral part of the basic financial statements.], or may not be reported at all, depending on the circumstances.[FN 5: In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent

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liability.] Contingencies should be recognized as a liability when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

-- Capital leases - In a lease transaction, the lessee should report a liability when one or more of four specified capital lease criteria are met (see detailed criteria on paragraph 43). The amount to be recorded by the lessee as a liability[FN 6: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception." (See SFFAS No. 6, "Property, Plant, and Equipment".)] under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.

-- Federal debt - Federal debt transactions are recognized as a liability when there is an exchange between the involved parties. Fixed-value securities are securities that have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) values net of any unamortized discount or premium. Amortization of the discount or the premium should normally follow the interest method; in certain cases, the straight line method is permitted (see paragraph 50). Variable-value securities should be originally valued and periodically revalued at their current value on the basis of the regulations or offering language. The related interest cost of the federal debt

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includes the accrued (prorated) share of the nominal interest incurred during the accounting period, the amortization amounts of discount or premium for each accounting period, and the amount of change in the current value for the accounting period for variable-value securities.

-- Pensions, other retirement benefits, and other postemployment benefits - The liability and associated expense for pensions and other retirement benefits (including health care) should be recognized at the time the employee's services are rendered. The expense for postemployment benefits should be recognized when a future outflow or other sacrifice of resources is probable and measurable based on events occurring on or before the reporting date. Any part of that cost unpaid at the end of the period is a liability. The aggregate entry age normal actuarial cost method should be used to calculate the expense and the liability for the pension and other retirement benefits for the administrative entity financial statements, as well as the expense for the employer entity financial statements. The employer entity should recognize an expense and a liability for postemployment benefits when a future outflow or other sacrifice of resources is probable and measurable on the basis of events that have occurred as of the reporting date.

-- Insurance and guarantee programs - All federal insurance and guarantee programs [FN 7: Social insurance is considered to be a separate program type not included within insurance and guarantee programs. See social insurance discussion in FASAB ED, "Supplementary Stewardship Reporting."] (except social insurance and loan guarantee programs [FN 8: Accounting for federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" (August 23, 1993).]) should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. Insurance and guarantee programs

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should recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported. The change in a contingent liability during the reporting period should also be recognized as a component of expense. Life insurance programs should recognize a liability for future policy benefits in addition to the liability for unpaid claims incurred. All federal insurance and guarantee programs (except life insurance and loan guarantee programs) should also report as required supplementary stewardship information (RSSI) the expected losses that are based on risk inherent in the insurance and guarantee coverage in force.

******* FIGURE 1 : "LIABILITY RECOGNITION SUMMARY" APPEARED HERE IN THE HARD COPY TEXT **********

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TABLE OF CONTENTS
****

EXECUTIVE SUMMARY
-- Paragraphs a-d

INTRODUCTION
-- Paragraphs 1-18
PURPOSE
-- Paragraph 1
SCOPE
-- Paragraphs 2-7
OBJECTIVES OF FINANCIAL REPORTING
-- Paragraphs 8-10
ENTITY AND DISPLAY
-- Paragraphs 11-12
EFFECTIVE DATE
-- Paragraph 13
STRUCTURE OF THIS DOCUMENT
-- Paragraphs 14-18

LIABILITY STANDARDS
-- Paragraphs 19-121
DEFINITION AND GENERAL PRINCIPLES FOR RECOGNITION OF A LIABILITY
-- Paragraphs 19-34

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_5.pdf.

CONTINGENCIES
-- Paragraphs 35-42
CAPITAL LEASES
-- Paragraphs 43-46
FEDERAL DEBT AND RELATED INTEREST COST
-- Paragraphs 47-55
PENSIONS, OTHER RETIREMENT BENEFITS,
AND OTHER POSTEMPLOYMENT BENEFITS
-- Paragraphs 56-96
INSURANCE AND GUARANTEES
-- Paragraphs 97-121

APPENDIX A: BASIS FOR CONCLUSIONS
-- Paragraphs 122-193
EXCHANGE AND NONEXCHANGE TRANSACTIONS
-- Paragraphs 126-133
CONCLUSION ON SOCIAL INSURANCE
-- Paragraphs 134-136
IMPACT OF COMMUNICATING INFORMATION IN
GENERAL PURPOSE FEDERAL FINANCIAL REPORTS
-- Paragraphs 137-141
RELATIONSHIP TO LIABILITY RECOGNITION
PRINCIPLES USED BY PRIVATE SECTOR ENTITIES
-- Paragraphs 142-143
CONCLUSION ON CONTINGENCIES
-- Paragraphs 144-147
CONCLUSION ON PENSIONS, OTHER RETIREMENT
BENEFITS AND OTHER POSTEMPLOYMENT BENEFITS
-- Paragraphs 148-181
VETERANS MEDICAL CARE COST
-- Paragraphs 182-184
CONCLUSION ON INSURANCE AND GUARANTEES
-- Paragraphs 185-193

APPENDIX B: LIABILITY RECOGNITION AND MEASUREMENT
MATRIX ****THIS MATRIX IS AVAILABLE IN HARD COPY
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GLOSSARY

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INTRODUCTION

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PURPOSE

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1 The purpose of this Statement is to establish accounting standards to recognize and measure liabilities in general purpose federal financial reports, which are issued for both internal and external users. Appendixes provide background, rationale, and examples of how to apply this standard to liabilities associated with federal programs' transactions and events.

SCOPE

2 This Statement articulates a general principle that should guide preparers of general purpose federal financial reports. It also provides more detailed guidance regarding liabilities resulting from deferred compensation, insurance and guarantees (except social insurance), certain entitlements, and certain other transactions. The Statement addresses liabilities not covered in Statement of Federal Financial Accounting Standards (SFFAS) Number 1, "Accounting for Selected Assets and Liabilities", and in Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees."

3 The concept of a liability in this document is consistent with those in Statements Number 1 and 2. The definition amends the stated definition of a liability in SFFAS Number 1. This Statement establishes accounting for liabilities not covered in SFFAS No. 1 and 2. Statement Number 1 addresses only those selected liabilities that routinely recur in normal operations and are due within a fiscal year. The liabilities covered in Statement Number 1 are accounts payable, interest payable, and other current liabilities, such as accrued salaries, accrued entitlement benefits payable, and unearned revenue. [FN 9: Adapted from Statement of Federal Financial Accounting Standards (SFFAS) Number 1, "Accounting for Selected Assets and Liabilities" (March 30, 1993), p. 25.]

4 Statement Number 2 addresses liabilities specifically arising from direct loans and loan

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guarantees. Loan guarantees are "any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender, but they do not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions."[FN 10: OMB Circular No. A-11 as cited in Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" (August 23, 1993), p. 46.]

5 The general conceptual definition of "liability" underlying this Statement is similar in some respects to that articulated by the Financial Accounting Standards Board (FASB) but the FASAB made certain modifications to the private sector concept to apply it within the federal context. Also, as is explained in the Basis for Conclusions, the specific standards dealing with pensions, other retirement benefits, and postemployment benefits differ from those the FASB has published.

6 This Statement requires certain disclosures about existing liabilities. The Statement, however, does not fully address information about stewardship responsibilities, including social insurance,[FN 11: Stewardship responsibilities are further discussed in "Supplementary Stewardship Reporting."] related to future financial reporting periods. Such information may be reported in a supplementary stewardship report, pursuant to standards now being developed (see FASAB's ED, "Supplementary Stewardship Reporting"). Information about projected future outflows is vital to making informed decisions about public policies, including the level of benefits promised under current law and the level of revenues/premiums required to liquidate the liability (if any).

7 The recognition of social insurance programs[FN 12: Social insurance programs are income transfer programs financed by compulsory earmarked taxes and in certain cases also include

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general revenues of the federal government.] presented the Board with significant theoretical and practical problems. The exposure process for the draft liability standard brought forth strongly held positions about social insurance. Upon reconsideration of the issues the Board concluded that, regardless of the technical merits of the arguments concerning the nature of social insurance programs, it was questionable whether adequate information concerning social insurance could be presented by means of a single, point-in-time number on a Balance Sheet. The Board modified the draft standard so it would require several measures of social insurance to be presented. The Board decided that, given the sensitivity and magnitude of social insurance, the new proposal should receive additional exposure to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and presented in the "Supplementary Stewardship Reporting" Exposure Draft. (For more details see the Basis for Conclusions).

OBJECTIVES OF FEDERAL FINANCIAL REPORTING

8 When developing accounting standards for the federal government, the significant environmental differences between the federal government and the private sector must be kept in mind. Statement of Federal Financial Accounting Concepts Number 1, "Objectives of Federal Financial Reporting", discusses the federal accounting and financial reporting environment. It notes the following:

-- The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities

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within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

9 The objectives of federal financial reporting were designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government. The four objectives are discussed under the headings (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control. These objectives were used as a basis to develop the Liability Statement. The Board believes that the operating performance objective has special relevance to decisions about recognition and measurement of liabilities in general purpose federal financial reports. That objective reads as follows:

"Federal financial reporting should assist report users in evaluating the service efforts, cost, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities."[FN 13: Statement of Federal Financial Accounting Concepts Number 1, 'Objectives of Federal Financial Reporting" (Sept. 2, 1993).]

10 At the same time, the Board recognizes that the third objective, dealing with stewardship, is equally important.

"Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide

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information that helps the reader to determine:

-- whether the government's financial position improved or deteriorated over the period;

-- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and

-- whether government operations have contributed to the nation's current and future well-being.

Examples of information relevant to this objective include:

-- the amount of assets, liabilities, and net assets (or net position);

-- an analysis of government debt, its growth, and debt service requirements;

-- changes in the amount and service potential of capital assets; and
the amount of contingent liabilities and unrecognized obligations [FN 14: The term "obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.] (such as the probable cost of deposit insurance)."

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses.

ENTITY AND DISPLAY

11 SFFAC Number 2, "Entity and Display" is a concept statement that provides a framework for defining the meaningful reporting units for general purpose federal financial reports with consideration of the relationships among the budgetary, organizational, and programmatic units. The Concept Statement also describes in general terms the nature of general purpose federal

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financial reports, including their names and formats. Agreement on the concepts of entity and display is necessary to establish standards for presenting general purpose federal financial reports.

12 The "Entity and Display" and Liability Statements are interrelated in several ways. Decisions on each affected the other. For example, the "Entity and Display" Concept Statement suggests what reporting units should report liabilities and, in general terms, how these liabilities should be displayed. The provisions of the Concept Statement that contemplate presentation of information about future stewardship responsibilities as well as information about events and transactions that have occurred are related to the selection of events and transactions to be recognized.[FN 15: See Statement of Federal Financial Accounting Concepts (SFFAC) Number 2, "Entity and Display" (April 20, 1995).]

EFFECTIVE DATE

13 The accounting standards presented in this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

STRUCTURE OF THIS DOCUMENT

14 This document has three sections, two appendixes, and a glossary. The first section, the executive summary, precedes this section. This introduction constitutes the second section. The remaining section and appendixes are described below.

Liability Standards

15 This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, capital leases, federal debt, pensions, other

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postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

Appendix A: Basis For Conclusions

16 This appendix summarizes considerations that members of the Board deemed significant in reaching the conclusions in the Statement.

Appendix B: Liability Recognition and Measurement Matrix

17 The Liability Recognition and Measurement Matrix illustrates the measurement attributes and recognition points for several transactions and events (***THIS MATRIX IS AVAILABLE IN HARD COPY ONLY***).

Glossary

18 The glossary defines various terms used in this Statement.

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LIABILITY STANDARDS

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DEFINITION AND GENERAL PRINCIPLE FOR RECOGNITION OF A LIABILITY

19 A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize [FN 16: Recognition means reporting a dollar amount on the face of the basic financial statements.] probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.[FN 17: This document uses the

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term "nonexchange transaction" in a way similar to FASB's "nonreciprocal transfer." That is, it implies a one-way flow of resources, services, or promises between two parties. "Transaction" in the phrase "nonexchange transaction" does not include reclassification, closing, and similar "internal" entries to the accounting records, though some accountants use the term in that broader sense. "Probable" means more likely than not. "Measurable" means reasonably estimable.]

Events and Transactions

20 The existence of a past event (which includes transactions) is essential for liability recognition. An event is a happening of financial consequence to an entity.[FN 18: "Consequence" is defined as something of importance or significance.] An event may be an internal event that occurs within an entity, such as transforming raw materials into a product. An event may also be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, a theft, vandalism, an injury caused by negligence, or an accident.

21 As the term is used in this Statement, a transaction involves the transfer of something of value. Transactions may be either exchange transactions or nonexchange transactions. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting.

22 An exchange transaction arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.[FN 19: Executory contracts where goods and services have not been received are not generally recognized as liabilities in financial accounting, although they

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are generally recognized as obligations in governmental budgetary accounting.]

23 An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs. The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.

24 A nonexchange transaction arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services [FN 20: Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).

25 Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

26 An event is defined as a happening of financial consequence to an entity. For federal

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financial reporting, some events may be other than transaction based and these events may be classified in one of two categories: (1) government-related events or (2) government-acknowledged events.

27 Government-related events are nontransaction-based events that involve interaction between the federal government and its environment. The event may be beyond the control of the federal entity. In general, a liability is recognized in connection with government-related events on the same basis as those that arise in exchange transactions. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably. [FN 21: The vast majority of claims against the United States Government stemming from tortious government conduct are adjudicated under the Federal Tort Claims Act (FTCA), which provides for both administrative and judicial resolution. Administrative awards under the established threshold are paid from agency appropriations. Administrative awards in excess of the established threshold are paid from the judgment appropriation. Court judgments and compromise settlements by the Department of Justice are paid from the judgment appropriation regardless of amount. This Act means that, for certain types of events it is not necessary for the government to acknowledge financial responsibility separately for each individual event as is the case for events described in paragraph 30.]

28 Government-related events include:

(1) cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations, that are in effect as of the Balance Sheet date, to clean up (i.e., remove, contain, or dispose of);[FN 22: See SFFAS No. 6, "Accounting

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for Property, Plant, and Equipment" for a detailed discussion of cleanup cost.]

(2) accidental damage to nonfederal property caused by federal operations; and

(3) other damage to federal property caused by such factors as federal operations or natural forces.[FN 23: The subjects of valuing assets and of measuring asset impairments--thus measuring the loss to be recognized--are beyond the scope of this Statement. See SFFAS No. 6, Accounting for Property, Plant, and Equipment for a discussion on the impairment or loss of federal property.]

29 Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.

30 Government-acknowledged events are those nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event. The federal government has broad responsibility to provide for the public's general welfare. The federal government has established programs to fulfill many of the general needs of the public and often assumes responsibilities for which it has no prior legal obligation.

31 Consequently, costs from many events, such as toxic waste damage caused by nonfederal entities and natural disasters, may ultimately become the responsibility of the federal government. But these costs do not meet the definition of a "liability" until, and to the extent that, the government formally acknowledges financial responsibility for the cost from the event and an exchange or nonexchange transaction has occurred. In other words, the federal entity should recognize the liability and expense when both of the following two criteria have been met (1) the Congress has appropriated or authorized (i.e.,

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through authorization legislation) resources and (2) an exchange occurs (e.g., when a contractor performs repairs) or nonexchange amounts are unpaid as of the reporting date (e.g., direct payments to disaster victims), whichever applies.

32 The following example illustrates the liability recognition of government-acknowledged events. A tornado damages a U.S. town and the Congress appropriates funds in response to the disaster. This event is of financial consequence to the federal government because the federal government chooses to provide disaster relief to the town. Transactions resulting from this appropriation, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or nonexchange transactions. In the case of exchange transactions, amounts payable for goods and services provided to federal entities are recognized when the goods are delivered or the work is done. In the case of nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.

Probable Future Outflow or Other Sacrifice of Resources

33 "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. If budget authority has not yet been

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provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.[FN 24: See Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities", (March 30, 1993), app. A, p. 25.]

Measurability

34 "Measurability" means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable. Liabilities reported in the financial report are measured by different attributes specified by various accounting standards. Several different measurement attributes are used for different items in present practice (e.g., fair market value, current cost, present value, expected value, settlement value, and historical cost).

CONTINGENCIES

35 A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).[FN 25: Contingencies are different from "subsequent events" as used in the accounting/audit literature. Subsequent events are events or transactions that occur subsequent to the Balance Sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements.]

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36 This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can range from probable to remote. The probability classifications are as follows:

-- Probable: The future confirming event or events are more likely than not to occur.

-- Reasonably possible: The chance of the future confirming event or events occurring is more than remote but less than probable.

-- Remote: The chance of the future event or events occurring is slight.

37 The following are some examples of loss contingencies:

-- collectibility of receivables,
-- pending or threatened litigation, and
-- possible claims and assessments.

Criteria for Recognition
of a Contingent Liability

38 A contingent liability should be recognized when all of these three conditions are met: [FN 26: The unit of analysis for estimating liabilities can vary according to the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, SFFAS Number 2, "applies to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category."

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Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" p.9. See the standard on Insurance and Guarantees in this document for a description of incurred but not reported (IBNR) claims.]

-- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).[FN 27: In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.]

-- A future outflow or other sacrifice of resources is probable (e.g., the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is more likely than not to be settled in favor of the claimant).

-- The future outflow or sacrifice of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount).

39 The estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency

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should be disclosed.

Criteria for Disclosure of a Contingent Liability

40 A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. "Disclosure" in this context refers to reporting information in notes regarded as an integral part of the basic financial statements.

41 Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

42 In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose federal financial reports. Specifically, contingencies classified as remote need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.

CAPITAL LEASES

43 Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:

-- The lease transfers ownership of the

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property to the lessee by the end of the lease term.

-- The lease contains an option to purchase the leased property at a bargain price.

-- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.

-- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.

44 The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.[FN 28: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception." See SFFAS No. 6, Accounting for Property, Plant, and Equipment.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.

45 The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by

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the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.

46 During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability.[FN 29: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.]

FEDERAL DEBT AND RELATED INTEREST COST

47 This standard applies to all securities or other debt instruments issued by the U.S. Treasury or other federal agencies. It encompasses debt issued to the public and debt issued to federal accounts by other federal accounts.[FN 30: This includes but is not limited to debt issued by the U.S. Treasury to trust funds, agency borrowings from Treasury, and trust fund borrowings from other trust funds.]

48 Accounting for the federal debt should identify the amount of the outstanding debt liability of the federal government at any given time and the related interest cost for each accounting period. This entails valuing securities initially at their sales price or proceeds, ultimately at the amount paid to the holder at maturity, and in the intervening period

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in a way that fairly expresses the federal government's liability.

Accounting for Federal Debt Securities[FN 31: Figure 2 (available in Hard Copy only) lists various categories and examples of federal debt securities.]

49 Federal debt securities fall into two major categories for accounting purposes: fixed value securities and variable value securities.

Fixed Value Securities

50 Fixed value securities have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) value net of any unamortized discount or premium. Securities sold at face (par) have no discount or premium and should be valued at face (par). Securities sold at a discount will increase in value between sale and maturity; securities sold at a premium will decrease in value. Amortization of the discount or premium may follow the straight line method or the interest method.[FN 32: For an explanation and an example of the interest method of amortization, see Appendix B of SFFAS No. 1.] Either method is acceptable in the cases of

-- short-term securities that have a maturity of 1 year or less, and

-- longer-term securities for which the amount of amortization under the straight-line method would not be materially different from the amount of amortization under the interest method.

51 In all other cases, the interest method for amortizing any discount or premium should be used.

Variable Value Securities

52 Variable value securities have unknown redemption or maturity values at the time of issue. Values of these securities can vary on the

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basis of regulation or specific language in the offering. These securities should be originally valued and periodically revalued at their current value, on the basis of the regulations or offering language.

Related Interest Cost

53 The related interest cost of the federal debt include:

-- the accrued (prorated) share of the nominal interest incurred during the accounting period,

-- the amortization amounts of discount or premium for each accounting period (based on the same amortization method used to account for the related debt liability) for fixed value securities, and

-- the amount of change in the current value for the accounting period for variable value securities.

Retirement Prior to Maturity

54 For those securities that are retired prior to the maturity date due to a call feature of the security, or because they are eligible for redemption by the holder on demand, the difference between the reacquisition price and the net carrying value of the extinguished debt should be recognized currently in the period of the extinguishment as losses or gains.

Old Currencies Issued by the Federal Government[FN 33: Old currencies include National and Federal Reserve Bank Notes, Old Demand Notes, Old Series currency, and silver certificates classified as public debt pursuant to 31 U.S.C. 5119.]

55 Pursuant to federal law, old currencies issued by the federal government and not yet redeemed or written off are identified as a federal debt liability at face value and do not

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bear any interest.

**********FIGURE 2: VARIOUS CATEGORIES AND EXAMPLES OF FEDERAL DEBT SECURITIES APPEARED HERE IN THE HARD COPY TEXT **********
[FN 34: These tables are intended to illustrate current practice only and are not to be considered authoritative.]

PENSIONS, OTHER RETIREMENT BENEFITS, AND OTHER POSTEMPLOYMENT BENEFITS

56 Employee benefits of federal civilian and military personnel and veterans[FN 35: Veterans' compensation included in this category is a measurable program benefit that directly relates to a veteran's prior military service and is not the type of benefit included in general fund benefit programs. For example, compensatory income payments for injuries sustained in the line of duty (i.e., VA disability compensation benefits) are employee benefits, while entitlement benefits (i.e., VA pension) are accounted for as general fund benefits. (Also see Appendix A: Basis for Conclusions.)] include pensions and postemployment and retirement benefits other than pensions. Pension plans[FN 36: This standard addresses "defined benefit plans," which define the future benefits that will be paid in terms of such factors as age, years of service, or compensation. The amount of benefit depends on a number of future events incorporated in the plan's benefit formula.] provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. The actuarially determined liability and expense of the plan, including all its provisions, is part of the pension plan's liability and expense estimate.

57 In addition to or in lieu of pension

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benefits, a liability for postemployment and other retirement benefits may be incurred outside the pension plan. Postemployment benefits other than pensions (OPEB) include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.[FN 37: Special termination benefits (such as specially authorized separation incentive programs) are considered other postemployment benefits and should be recognized as such.] Inactive employees are those who are not currently rendering services to their employers and who have not been terminated, but who are not eligible for an immediate annuity, including those temporarily laid off or disabled. OPEB include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity.[FN 38: The terms "employer entity" and "administrative entity" are used in this document to distinguish between entities that employ federal workers and thereby generate the employee costs, including pension cost, and those that are responsible for managing and/or accounting for the pension or the other employee plan. For example, entities that receive "salaries and expense" appropriations are employer entities, while the Office of Personnel Management is an administrative entity because it administers the civilian retirement benefit plans.]

58 Retirement benefits other than pensions (ORB) are all forms of benefits to retirees or their beneficiaries provided outside the pension plan. Examples include health and life insurance. Retirement health care benefits are the primary ORB expense. They present unique measurement problems.

59 Pension benefits, OPEB, and ORB are exchange transactions because the employee performs service in part to receive the deferred compensation provided by the plans (such as future pension and medical care benefits). For pension and other retirement benefits, the expense is recognized at

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the time the employees' services are rendered. For OPEB, the expense is recognized at the time the accountable event occurs. Any part of that cost unpaid at the end of the period is a liability.

60 This Statement is intended to specify the accounting objectives. With regard to pensions and ORB, if estimates, averages, or such devices can reduce the cost of applying this Statement, their use is appropriate provided the results do not materially differ from a detailed application of the standard.

Pensions

61 Pension benefits include all retirement, disability, and survivor benefits financed through a pension plan, including unfunded pension plans. Federal civilian and military employees are covered primarily under the following three defined benefit retirement plans: Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS), and Military Retirement System (MRS). To the extent that federal employees are covered by social insurance programs (such as Social Security), the taxes they pay to the program and the benefits they will eventually receive are to be accounted for on the same basis used to account for other program participants. However, the payments to social insurance plans that agencies must make are operating costs. Similarly, to the extent that federal employees are covered by defined contribution plans (i.e., the Thrift Savings Plan, which is like a 401(k) plan), federal payments to the plan are expenses, but the plan itself is not covered under this standard.

62 This Statement establishes standards of accounting for pension expense and related pension liability for federal government employers and administrative agencies.

Accounting for the Pension Plan

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63 This section covers federal pension plans. The entity that administers the plan (i.e., the "administrative entity") should account for and report the plan in accordance with this standard.[FN 39: In addition to the requirements of this standard, which deals with general purpose financial reports, federal plans report annually pursuant to P.L. 95-595, which calls for statements of net assets available for benefits, a statement of accumulated benefits, and other statements.] A subsequent section covers federal employer entities.

64 Attribution Methods--The "aggregate entry age normal" actuarial cost method should be used to calculate the pension expense, the liability for the administrative entity financial statements, and the expense for the employer entity financial statements. The aggregate entry age normal method is one under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages; and it should be applied to pensions on the basis of a level percentage of earnings. The portion of this actuarial present value allocated to a valuation year is called the "normal cost." The portion not provided for at a valuation date by the actuarial present value of future normal cost is called the "actuarial accrued liability."[FN 40: Adapted from Actuarial Standards of Practice No.4, "Measuring Pension Obligations" (Jan. 1990), p. 31.] The plan, however, may use other actuarial cost methods if it explains why aggregate entry age normal is not used and if the results are not materially different.

65 Assumptions--For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS), the best available actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4, "Measuring Pension Obligations," as revised from time to time by the Actuarial Standards Board.[FN 41: The

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Actuarial Standards Board is a board within the American Academy of Actuaries that sets professional standards of actuarial practice.] Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.

66 In addition to complying with the guidance in the preceding paragraph, the interest rate assumption should be based on an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term federal government borrowing rate). The underlying inflation rate and the other economic assumptions should be consistent. The rate used to discount the pension obligation should be equal to the long-term expected return on plan assets.

67 The administrative entity should disclose the assumptions used. Administrative entities are encouraged to consult with one another to achieve the maximum consistency among assumptions used for financial reports. Smaller federal administrative entities may employ the assumptions used by any of the three primary plans where appropriate or their own assumptions. If they use assumptions that differ from all of the primary plans, a footnote should explain how and why the assumptions differ from one of those plans.

68 Assets should be reported separately from the pension liability rather than reporting only a net liability. Assets of federal pension plans should be carried at their acquisition cost, adjusted for

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amortization, if appropriate. For investments in market-based and marketable securities, the market value of the investment should be disclosed.[FN 42: See SFFAS Number 1, "Accounting for Selected Assets and Liabilities."]

69 Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses--Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior service. This results in a gain to the extent that previously recognized benefits are reduced. As explained in the next paragraph, the accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the pension liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

70 The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.

71 Accounting by the Administrative Entity-- The administrative entity should account for and report the pension liability in its financial report, using the aggregate entry age normal actuarial method. The liability is the actuarial

present value of all future benefits, based on projected salaries and total projected service, less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. Projected salaries should reflect an estimate of the future compensation levels of the individual employees involved, including future changes attributed to the general price level, productivity, seniority,

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promotion, and other factors.

72 The administrative entity should report a pension expense for the net of the following components:

-- normal cost;

-- interest on the pension liability during the period;

-- prior (and past) service cost from plan amendments (or the initiation of a new plan) during the period, if any; and

-- actuarial gains or losses during the period, if any.

The individual components should be disclosed.

73 The administrative entity should report revenue for the sum of amounts received from the employer entity representing contributions from:

-- the employer entity and

-- its employees.[FN 43: The administrative entity may also receive financing from the General Fund to cover prior service or other cost for which contributions from employer entities are not provided.]

The employer entity's contribution represents intragovernmental revenue.[FN 44: Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.]

An illustration of the accounting for the administrative entity (and the employer entity) is explained in the following section entitled "Accounting Illustration."

Employer Entity Accounting

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74 The federal employer entity should recognize a pension expense in its financial report that equals the service cost[FN 45: "Service cost" is defined as the actuarial present value of benefits attributed by the pension plan's benefit formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost."] for its employees for the accounting period, less the amount contributed by the employees, if any. The measurement of the service cost should require the use of the plan's actuarial cost method and assumptions, and therefore the factor to be applied by the employer entities must be provided by the plan and/or the administrative entity.

75 The employer entity's pension expense should be balanced by: (a) a decrease to its "fund balance with Treasury" for the amount of its contribution to the pension plan, if any; and if this does not equal the full expense, by (b) an increase to an account representing an intragovernmental imputed financing source entitled, for example, "imputed financing - expenses paid by other agencies." The latter represents the amount being financed directly through the pension plan's administrative entity.

76 In special instances when an employer entity is also the administrative entity, that is, when there is no separate pension plan (e.g., the Coast Guard), the employer entity should report the liability and recognize the pension expense for all components of cost. The liability and the expense should be accounted for as described in the preceding section for the administrative entity without reference to transactions with external employer entities.

Accounting Illustration

77 Tables 1-4 provide an example in which the employer entity recognizes an "employer's pension expense" in an amount equal to the service cost attributable to its employees during the

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accounting period, less the employees' own contributions. The expense in this example is more than the contribution that the employer entity is required by law to pay. The difference between the employer's pension expense and the employer's contribution is credited to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The employer entity transfers its contribution and that of its employees to the administrative entity.

78 The administrative entity recognizes revenue for: (1) contributions from the employer entity, (2) contributions from the employees, and (3) interest on the plan's investments. The administrative entity recognizes expense for the net of the pension cost components.

Assumptions are as follows:

-- Total normal cost of employees for the accounting period is $160,000.

-- The employer's pension expense is $100,000. The employer entity would calculate its pension expense on the basis of information received from the plan and/or the administrative entity. Its pension expense is equal to its share of the service cost of its employees' pensions.

-- According to current law, the employer entity is authorized in its appropriation to pay $60,000 for employee pensions.

-- The employees contribute $60,000 to the pension fund.

-- No general fund appropriations made directly to the administrative agency are involved in these transactions, as they could be under actual operations.

Entry #1 -- Employer entity's entry to record pension expense:

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DR. Employer's Pension Expense	$100,000
CR. Appropriations Used	$60,000
CR. Imputed Financing - Expenses Paid by Other Entities	40,000

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Table 1
Employer Entity's Other Financing Sources as They Should Appear on Its Statement of Changes in Net Position

FINANCING SOURCES:[FN 46: SFFAC No. 2, "Entity and Display" presents a change in the way revenue and other financing sources are reported. This illustration reflects the new concepts.]

Appropriations Used.....$60,000
Imputed financing $40,000

Note: Imputed financing covers the difference between (1) the employer entity's contribution transferred to the administrative entity pursuant to law (exclusive of the employees' contributions) and (2) the employer's pension expense calculated on the basis of information received from the administrative entity--as shown immediately below.

Employer Entity's Cost as It Should Appear on the Statement of Net Cost

COST :

Employer's pension cost....$ 100,000

Note: This is the employer entity's service cost of employee pensions. The employer entity would calculate this amount using factors provided by the plan and/or the administrative entity. Also to be transferred to the administrative entity is the amount withheld from employees' wages, as called for under the terms of the plan. The employees' contribution is not an expense of the employer entity.
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**Note: The above table and those that follow in the sections on pensions and ORB are presented for illustrative purposes only; the responsibility for defining the form and content of a financial statement prepared pursuant to the Chief Financial Officers Act, as amended, is the responsibility of the Office of Management and Budget.

Entry #2 -- Administrative entity's entry to record revenue received from employer entity:

DR. Fund Balance with Treasury $120,000
CR. Retirement Program Revenue - Contribution Received from Employer Entity $60,000
CR. Retirement Program Revenue - Contribution Received from Employees $60,000

Entry #3 -- Administrative entity's entry to record revenue from interest on investments in Treasury securities:

DR. Fund Balance with Treasury $XXX,XXX
CR. Interest Revenue $XXX,XXX

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Table 2

Administrative Entity's Revenue as It Should Appear on the Statement of Net Cost

LESS OTHER EARNED REVENUES:

Contributions received from employer entities	$ 60,000
Contributions received from employees	60,000
Interest on investments	XX,XXX
Total other earned revenues	$ XXX,XXX

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Note: Contributions are amounts transferred to the administrative entity from the employer entity representing its contribution--and that of its employees--for the employees' pensions.
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Entry # 4 -- Administrative entity's entry to record its pension expense:

DR. Pension Expense $XXX,XXX
CR. Pension Liability $XXX,XXX

****
Table 3

Administrative Entity's Pension Expense

Normal cost $160,000
Interest on pension liability XXX
Prior serv. costs (gains) (if any) XXX
Actuarial gains(losses) (if any) XXX

Total pension expense .....$ XXX,XXX

**Note: The $160,000 represents 100 percent of the normal cost--as calculated by plan actuaries--for the one employer entity in this example. According to law, $60,000 of this amount is to be contributed by the employer entity and $60,000 is to be contributed by the employees themselves. The remaining $40,000 is a liability of the pension plan (covered by future financing sources). The pension expense is reported on the Statement of Net Cost in accordance with paragraph 72.
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Table 4

Administrative Entity's Pension Liability:

Beginning balance $ XX,XXX,XXX
Add: additional pension expense

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incurred (as calculated in table 3)	XXX,XXX
Less: payments made to beneficiaries	XXX,XXX
Ending liability balance	$ XX,XXX,XXX

Note: The liability balance should be reported on the administrative entity's Balance Sheet.
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Other Retirement Benefits (ORB)

79 ORB include all retirement benefits other than pension plan benefits.[FN 47: See Appendix A: Basis for Conclusions, for a discussion of reporting medical costs for veterans.] ORB are provided outside the pension plan by an employer to a former employee or the employee's beneficiary upon retirement. The predominant ORB in the federal government is retirement health care benefits, and they are the focus of this section.[FN 48: Accounting for life insurance is described in a separate section of the liability standard. However, to the extent that premiums paid by covered individuals and employer entities do not fully cover the retirement life insurance cost of employees, the employer entities would account for the additional cost as described in this section.]

80 Future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare (part A). Also, medical plans do not vest like pensions in which, after a fixed number of years of service, an employee has a right to receive payment. To receive ORB benefits the employee must retire with health care benefits provided by the organization.

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81 This Statement establishes standards of accounting for ORB expense and related ORB liability for federal government employers and administrative agencies.

Accounting for the ORB Plan

82 Attribution Method--The aggregate entry age normal actuarial cost method should be used to calculate the ORB expense and liability for the administrative entity's financial statements, and the expense for the employer entity's financial statements. As indicated in the pension section, aggregate entry age normal is a method under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages. It should be applied to ORB on the basis of service rendered by each employee. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion not provided for at a valuation date by the actuarial present value of future normal cost contributions is called the actuarial accrued liability.[FN 49: Adapted from Actuarial Standards of Practice No. 4, p. 31. Also see Actuarial Standard of Practice No. 6 "Measuring and Allocating Actuarial Present Values of Retiree Health Care and Death Benefits," Actuarial Standards Board (1988).] Unlike federal pensions, retiree health care benefits do not depend on future salary levels of individual employees but rather are allocable to each employee on a per person basis. Plans may use other actuarial cost methods if they explain why aggregate entry age normal is not used and if the results are not materially different.

83 Assumptions--Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for pensions and (2) a health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The rate used to

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discount projected benefits should be equal to the long-term expected return on plan assets if the plan is being funded or on other long-term assumptions (for example, the long-term federal government borrowing rate) for unfunded plans. The administrative entity should disclose the assumptions used.

84 The accrual period should be based on expected retirement age rather than the age when the employee first becomes eligible.

85 Assets should be reported separately from the ORB liability rather than merely reporting the net liability. Assets of federal ORB plans should be carried at their acquisition cost, adjusted for amortization, if appropriate.[FN 50: See SFFAS No. 1, "Accounting for Selected Assets and Liabilities."] For investments in market-based and marketable securities, the market value of the investment should be disclosed.

86 Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses--The standard for ORB is the same as that for pensions. Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior service resulting in a gain to the plan to the extent that previously recognized benefits are reduced. The accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the ORB liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

87 The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.

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88 Accounting for the ORB Plan--The ORB plan should be accounted for in a way that is very similar to that described above for pensions. The administrative entity should account for and report the ORB liability in its financial report, using the aggregate entry age normal method. The liability is the actuarial present value of all future benefits less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. The administrative entity should report an ORB expense for the net of the following components:

-- normal cost,

-- interest on the ORB liability during the period,

-- prior (and past) service costs from plan amendments (or the initiation of a new plan) during the period, if any,

-- any gains/losses due to a change in the medical inflation rate assumption; and

-- other actuarial gains or losses during the period, if any.

The individual components should be disclosed.

89 The administrative entity should report revenue for the sum of amounts received, if any, from the employer entity representing contributions from:

-- the employer entity and

-- its employees.

The employer entity's contribution represents intragovernmental revenue.[FN 51: Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.] An illustration of the accounting

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for the administrative entity (and employer entity) is provided in the following section entitled "Accounting Illustration".

Employer Entity Accounting

90 The federal employer entity should account for and report the ORB expense in its financial report in a manner similar to that used for pensions. The employer's ORB expense should be recognized in an amount equal to the total service cost[FN 52: "Service cost" is defined as the actuarial present value of benefits attributed to services rendered by employees during an accounting period. The term is synonymous with "normal cost".] for its employees for the accounting period, less the amount contributed by its employees, if any. The measurement of the service cost requires use of the plan's actuarial cost method and assumptions. The cost factor should be provided to the agencies on a per employee basis by the administrative entity and/or the plan.

91 The employer entity's ORB expense should be balanced by (a) a decrease to the employer entity's "fund balance with Treasury" for the amount of its contributions to the ORB plan, if any; and, if this does not equal the full expense, (b) by an increase to an account representing an intragovernmental financing source entitled, for example, "imputed financing - expenses paid by other entities." The latter represents the amount being financed directly through the ORB plan.

92 In special instances when an employer entity is also the administrative entity, the employer entity should report the liability and recognize the ORB expense for all components of cost. For example, the entity is paying its retirees' ORB on a pay-as-you-go basis. The liability and the expense should be accounted for as described in the preceding section for the administrative entity accounting without reference to transactions with external employer entities.

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Accounting Illustration

93 Tables 5-8 provide an example where the employer entity recognizes an "employer's ORB expense" in an amount equal to the service cost attributable to its employees during the accounting period. In this example, neither the employer entity nor its employees contribute to the plan. The employer's ORB expense is offset by a credit to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The administrative entity recognizes a revenue and other financing source for contributions from the General Fund. The administrative entity recognizes an expense for the total ORB expense.

Assumptions are as follows:

-- Total normal cost of employees for the accounting period is $10,000.[FN 53: This is the amount attributable to the government for its share of future medical care costs for future retirees. Although this simplified illustration does not show contributions other than those from the General Fund, current retirees pay premiums for their health insurance that partially defray the cost of the program. Federal civilian retirees pay approximately 25-30 percent of the total health benefit premium.]

-- The employer's ORB expense is $10,000. The employer entity should calculate its expense on the basis of factors received from the plan and/or the administering entity. For example, the plan-supplied factor is $100 per employee (or full-time equivalent); if the employer has 100 employees, the expense would be $10,000. (The employer's ORB expense equals the service cost of its employees' retirement health care.)

-- The employer and employees do not make contributions to a fund. The cost of retirement health care is paid for by General Fund appropriations directly to the administrative entity on a pay-as-you-go basis.

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Entry #5 -- Employer entity's entry to record ORB expense:

DR. Employer's ORB Expense $10,000
CR. Imputed Financing-Expenses Paid by Other Entities $10,000

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Table 5

Employer Entity's Other Financing Sources as They Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:
Imputed financing Expenses paid by other entities $10,000

Note: Imputed financing "Expenses paid by other entities" covers the annual expense for the employer entity's employees as shown immediately below.

Employer Entity's Cost as It Should Appear on the Statement of Net Cost

COST :
Employer's ORB cost .....$ 10,000

Note: This is the annual ORB service cost of the employer entity's employees. The employer entity would calculate this amount using factors provided by the administrative entity.
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Table 6

Administrative Entity's Other Financing Sources as It Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:

Appropriations used..... $ XX,XXX

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Note: Since, in this example, contributions are not required from the employer entity or its employees, all benefits must be paid with appropriations from the General Fund.
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Entry #6 -- Administrative entity's entry to record its ORB expense.

DR. ORB Expense $XX,XXX
CR. ORB Liability $XX,XXX

****

Table 7

Administrative Entity's ORB Expense

Normal cost	$ 10,000
Interest on ORB liability	XX,XXX
Prior service costs (gains) (if any)	XX
Actuarial gains (losses) (if any)	XX
Total ORB expense	$ XX,XXX

Note: The $10,000 represents 100% of the service cost attributable to the employer entity in this example, as calculated by plan actuaries. The ORB expense (as calculated above) would be reported on the Statement of Net Cost in accordance with paragraph 88.
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Table 8

Administrative Entity's ORB Liability

Beginning balance	$ X,XXX,XXX
Add: additional ORB expense incurred (as calculated in table 7)	XX,XXX
Less: payments made on behalf of beneficiaries	XX,XXX
Ending liability balance	$ X,XXX,XXX

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Note: The liability balance should be reported on the administrative entity's Balance Sheet.
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Other Postemployment Benefits (OPEB)

94 OPEB are provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans. Inactive employees are those who are not currently rendering services to the employer but who have not been terminated, including those temporarily laid off or disabled. Postemployment benefits can include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment, workers' compensation, and veterans' disability compensation benefits paid by the employer entity.

95 The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.

96 Most OPEB liabilities should be short-term because the benefits will be paid in the near future. Some OPEB, however, could be longer term.

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For example, a liability for workers' compensation or veterans' disability compensation might be long-term for some injuries since federal employer entities might be required to reimburse the program for many years.[FN 54: Both the federal employee unemployment program and the federal workers' compensation program are financed by direct reimbursements from federal employers.] Also, certain specially authorized separation incentive programs could provide for payments that extend over many future years.

INSURANCE AND GUARANTEES

Nature of Federal Insurance and Guarantee Programs[FN 55: In the federal government, the aspects of insurance and guarantees are frequently commingled within the same program. Therefore, this Statement treats the terms as a single type of activity.]

97 Insurance and guarantee programs are federal programs that provide protection to individuals or entities against specified risks. Many of these programs were established to assume risks that private sector entities are unable or unwilling to assume [at least at prices that beneficiaries of the program can afford (in some cases) or want to pay (in other cases)] or to subsidize the provision of insurance to achieve social objectives. Program participants pay fees or premiums for specific services. These funds are commonly held in revolving funds within the federal government; losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims and/or have authority to borrow from the Treasury.

98 For accounting purposes, private sector insurance and guarantee contracts are customarily divided into two types. The first type provides insurance protection for a fixed period. The insurer may cancel the coverage or adjust the

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provisions of coverage at the end of any coverage period, for example, by adjusting the amount of premiums charged or changing the conditions under which coverage is provided. Most property insurance and health insurance offered by private insurers is of this type.

99 The second type of insurance or guarantee contract is one in which the insurer cannot cancel the insurance or the insured is guaranteed the ability to renew it. The insurer must provide coverage for an extended period until the insured event occurs or can no longer occur, or when the insured party allows the policy to lapse. Examples of this type of insurance offered by private insurers include whole and guaranteed renewable term life insurance, annuities, and title insurance.

100 Federal programs provide protection against many types of risk for individuals and entities. These include life insurance; medical insurance; and insurance against damage to property (homes, crops, and airplanes) or other assets (deposits and pension benefits) caused by perils such as flooding and other natural disasters, war-risk, and insolvency.

101 For federal insurance and guarantee programs, there often is no explicit contract. For example, the federal government, acting through the Pension Benefit Guaranty Corporation (PBGC), functions as an insurer of pension benefits, but the "contract" with employers and pension plans is implicit in federal law, not explicit in contracts between PBGC and employers. Moreover, the PBGC itself has no power to set premiums or to change the terms of coverage, though it may recommend changes to the Congress. The Congress has occasionally raised premiums and changed other factors, such as pension plan funding requirements, in an effort to achieve the statutory intent that the program be self-financing without appropriations from general revenue.[FN 56: Further details on PBGC may be found in "Controlling Losses of the Pension Benefit Guaranty Corporation", Congressional

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Budget Office, January 1993.] Companies with defined benefit pension plans must participate, but may (and sometimes do) elect to terminate their defined benefit pension plans.

102 Federal insurance programs also differ from private insurance in that they are not subject to the same market forces (e.g., competition for business and for capital) and regulatory requirements (e.g., for capitalization) that apply to privately owned insurers. In particular, federal insurance, unlike private insurance, is not extended with the intent of earning a profit. Some programs operate deliberately at a loss, as when disabled veterans are offered life insurance at premiums set for healthy participants. Other programs offer insurance covering catastrophic or systemic risks, where large losses can occur all at once, as in war-risk or deposit insurance. At most, federal insurance programs are expected just to meet anticipated costs, leaving them vulnerable to unfavorable surprises.

103 For this reason, the issue in accounting for federal insurance and guarantee programs is when to recognize net expected losses. In this respect, federal insurance programs are similar to federal credit programs. The federal government extends credit on terms and conditions designed to subsidize particular borrowers or encourage particular activities for social policy reasons. As soon as a federal direct loan or loan guarantee is obligated, the federal government is committed to bear whatever loss, through defaults or interest subsidies, is inherent in the terms and the conditions under which the credit is extended. The government is likewise committed when federal insurance is extended to additional policyholders, either for an additional fixed period, or to cover additional amounts of assets.

Accounting for Liabilities of Federal Insurance and Guarantee Programs

104 All federal insurance and guarantee programs

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(except social insurance and loan guarantee programs[FN 57: Social insurance is considered to be a different type of program not included within insurance and guarantee programs. See social insurance discussion in the FASAB ED, "Supplementary Stewardship Reporting". Accounting for all federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" (August 23, 1993).]) should recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. The standard requires recognition of the liability that is known with certainty plus an accrual for a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. Insurance and guarantee programs should recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported and contingencies that meet the criteria for recognition. Life insurance programs should recognize a liability for future policy benefits (a liability to current policyholders that relates to insured events, such as death or disability) in addition to the liability for unpaid claims incurred. (See Contingencies section for the criteria for disclosure of a contingent liability.)

105 Risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs) and will be considered in the context of the Stewardship reporting. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force.

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Additional Disclosures for Insurance and Guarantee Programs Administered by Government Corporations

106 When financial information pursuant to FASB's standards on federal insurance and guarantee programs conducted by government corporations is incorporated in general purpose financial reports of a larger federal reporting entity, the entity should report as RSSI what amounts and periodic change in those amounts would be reported under the "risk assumed" approach referred to in this section (see par. 105). In other words, in addition to the liability for unpaid claims from insured events that have already occurred (including any contingent liability that meets criteria for recognition), such reporting entities should also report as RSSI risk assumed information.

Illustrations of the Application of the Standard

107 Table 9 [**Availiable in Hard Copy Only**] illustrates the application of the liability recognition, disclosure, and supplementary reporting standards for six federal insurance and guarantee programs. Two of these, flood and crop insurance, offer fixed period annual insurance. A third, deposit insurance, also can be said to offer fixed period annual insurance, though in practice it is continually renewed at the option of the insurer.[FN 58: In effect, FDIC's options are to renew the insurance coverage or to assume losses of the institution; only Congress can reduce or eliminate the deposit insurance program.] A fourth program listed, overseas private investment insurance, offers a fixed period multi-year written contract. The fifth program, life insurance, offers coverage that in practice is noncancelable by the insurer and guaranteed renewable by the insured, continuing until the insured event has occurred or the policy is cancelled by the insured. Finally, the pension benefit guarantee program is included as an example of noncancelable insurance. Pension

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insurance is characterized here as noncancelable with respect to vested guaranteed benefits earned by covered employees to date, on the assumption that this coverage would remain in effect even if the Congress ended the program.

108 The column numbered (3) in the table shows the point at which the standard requires a liability to be recognized for insurance and guarantee programs except life insurance. Column (3) recognizes all unpaid claims and expected claims resulting from insured events that have already occurred, whether floods, crop damage, overseas investment losses, bank closures and insolvencies, deaths, or pension plan terminations. The liability for unpaid claims is the estimated amount needed to settle claims relating to insured events that have occurred on or before the reporting date. This liability includes a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable.

109 The liability at the end of any period should be the expected unpaid net loss inherent in insured events that have occurred, including any claims --both claims reported and when appropriate, claims incurred but not reported (IBNR)-- and any contingent liabilities that meet the criteria for recognition. When payments and losses extend beyond the current year, net losses should be calculated on a present value basis to reflect the time value of money. The expense for claims incurred in the reporting period should be recognized in that period. Changes in estimates of claim cost resulting from the present value calculations, the continuous review process, and differences between estimates and actual payments for claims should be recognized as charges against operations of the period in which the estimates are changed or payments are made.

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110 Liability recognition for life insurance programs spans over columns (3) and (4). The column numbered (4) in the table shows the point at which the standard requires liability recognition for life insurance and supplementary reporting for other insurance and guarantee programs. The supplementary reported amounts represent the present value of unpaid expected losses based on the risk assumed as a result of insurance coverage net of associated premiums.

********** TABLE 9 : "LIABILITY RECOGNITION, SUPPLEMENTARY INFORMATION AND DISCLOSURE FOR FEDERAL INSURANCE AND GUARANTEE PROGRAMS" APPEARED HERE IN THE HARD COPY TEXT **********

111 Insurance programs are on-going and may be viewed as having long term characteristics. Thus, from a broader, longer term perspective, the liability to be recognized (column 3), and the amount to be reported as supplementary information (column 4) may be conceptually different and materially different from each other. From the broader perspective column (4) could be a longer term measure and a probabilistic estimate of future costs of these programs.

112 For noncancelable or guaranteed renewable insurance also, a difference arises between columns (3) and (4). Thus, for pension guarantees, column (3) shows the net present value of losses arising from plans that have already been terminated or that are more likely than not to be terminated. This is the amount to be recognized as a liability. Column (4) shows the net present value of the expected loss inherent in the risk assumed as a result of coverage on the guaranteed and vested benefit amounts. This number should be reported as supplementary information. It will generally be larger than the liability because it includes a provision for the additional losses that are expected to arise because some plan sponsors currently in good

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financial condition will in the future face bankruptcy with pension assets too small to cover the vested benefits that were guaranteed.

113 The liability for life insurance includes both the liability for unpaid claims, including IBNR (i.e., column 3), and a liability for net future policy benefit outflows (i.e., column 4). The liability for future policy benefits represents the expected present value of future outflows to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders. The liability is estimated using appropriate financial or actuarial methods that include assumptions, such as estimates of expected investment yield, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made and in accordance with existing law and related policy (see specific whole life insurance standard below). Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in which the changes occur. The effects of changes in relevant law or policy would be recognized when those changes occur.

114 The assessments of losses expected based on the risk assumed may be made by appropriate actuarial or financial methods that include information and assumptions applicable to the economic, legal, and policy environment in force at the time the assessments are made. Since all future events are uncertain, indicators of the range of uncertainty around expected estimates, including indicators of the sensitivity of the estimates to changes in major assumptions, should also be reported.

Whole Life Policies

115 Some VA life insurance programs are whole life policies.[FN 59: Whole life policies provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon

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death of the insured. A level premium is usually paid for policies of this type. The premium may be paid annually or more frequently.] These programs operate in a manner similar to private sector mutual life insurance enterprises,[FN 60: A mutual company is an incorporated entity without private ownership interests which operates for the benefit of its policyholders and their beneficiaries. With limited exceptions, mutual companies issue only participating policies. In a mutual company, participating policyholders have the right to vote for members of the company's board of directors or trustees. In some states, the insurance laws provide that upon liquidation of a mutual insurance company, the net assets are distributed among the existing policyholders of the company, and the prior policyholders have no claim against such assets.] except that the regulations and market forces that control the private sector are different for these federal programs. VA life insurance policyholders are issued participating policies, and a portion of the earnings from those policies is returned to policyholders in the form of dividends. The following paragraphs specifically address the accounting required for federal whole life insurance programs.

116 The premiums collected by the insurer are used to pay benefits and other cost, and the balance is usually invested to yield additional income. These assets would be fund balances with Treasury or investments. Encompassed in the liability (also referred to as policy reserves) is cash surrender value and the liability for future policy benefits. The cash surrender value is the portion of premiums paid or other amount recoverable on an insurance policy if immediately canceled. The liability for future policy benefits is the present value of future outflows to be paid to (or in behalf of) policyholders, less the present value of future related premiums. In general, for whole life policies, the liability for future policy benefits should be no less than the cash surrender value that accrues to the benefit of policyholders.

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Accounting for Liabilities of Federal Whole Life Insurance Programs

117 All federal reporting entities with whole life insurance programs should follow the standards as prescribed in the private sector standards (and as these private sector standards are amended) when reporting the liability for future policy benefits, in addition to the required disclosures described below. [FN 61: The applicable private sector standards are as follows, FASB SFAS 60 "Accounting and Reporting by Insurance Enterprises," FASB SFAS 97 "Accounting and Reporting by Insurance Enterprises for Certain Long- Duration Contracts and for Realized Gains and Losses from the Sale of Investments," and FASB SFAS 120 "Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts" and AICPA Statement of Position (SOP) 95-1 "Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises."

For those federal entities with "mutual enterprise-type" whole life insurance programs, FASB SFAS 120 should be followed. SFAS 120 states that mutual life insurance enterprises shall apply SFAS 60 or 97, as appropriate, to participating life insurance contracts unless those contracts meet both of the following conditions:

-- The contracts are long-duration participating contracts that are expected to pay dividends to policyholders based on actual experience of the insurer.

-- Annual policyholder dividends are paid in a manner that identifies divisible surplus and distributes that surplus in approximately the same proportion as the contracts are considered to have contributed to divisible surplus (commonly referred to in actuarial literature as the contribution principle).

If the participating life insurance contracts meet

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the above conditions SOP 95-1 should be followed.]

118 A liability for future policy benefits relating to participating life insurance contracts should be equal to the sum of:

a. the net level premium reserve for death and endowment policy benefits,

b. the liability for terminal dividends, and

c. any premium deficiency.[FN 62: The liability for future policy benefits is consistent with the liability required by SOP 95-1. Net level premium reserve is the excess, if any, of the present value of future guaranteed death endowment benefits over the present value of future net premiums. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contracts. The dividend fund interest rate is the interest rate determined at policy issuance used to determine the amount of the dividend fund. It is the rate used to credit interest to the dividend fund, and against which experience is measured to determine the amount of the interest portion of dividends paid to individual policyholders. Terminal dividends are dividends to policyholders calculated and paid upon termination of a contract, such as on death, surrender, or maturity. If the payment of terminal dividends is probable and the amount can be reasonably estimated, the liability should be recognized. (AICPA SOP 95-1, Glossary, p. 33)]

119 An assessment should be made to compare the liability for future policy benefits using actuarial assumptions applicable at the time the contract is made (contract assumptions) with the liability for future policy benefits using assumptions that consider current economic conditions and experience (current conditions). Actual mortality, morbidity, and termination rates should be used when determining experience. For

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economic conditions, the nature and the mix of current and expected investments should be considered with expected long-term yields.

120 A premium deficiency occurs if the liability for future policy benefits using current conditions exceeds the liability for future policy benefits using contract conditions; the difference should be recognized as a charge to operations in the current period.

Additional Whole Life Insurance Disclosure

121 All components of the liability for future policy benefits (i.e., the net level premium reserve for death and endowment policy and the liability for terminal dividends) should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or reducing federal support in the form of appropriations related to administrative cost or subsidies).

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APPENDIX A: BASIS FOR CONCLUSIONS
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122 This appendix summarizes considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

123 This Statement addresses recognition and measurement of liabilities in the general purpose financial reports of federal reporting entities. The unique circumstances of the federal government, most notably its role as the vehicle through which citizens express their sovereign power, meant that the Board had to resolve some

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new issues in order to define exactly how to apply accrual concepts in federal financial reports.

124 The Board's deliberations on liabilities were based on certain ideas about the distinction between exchange and nonexchange transactions, the importance of reporting cost of services provided by the federal government, and the impact of information on decisionmakers. These ideas are explained in the following paragraphs.

125 Many users of federal financial reports are familiar with accounting concepts and standards published by the Financial Accounting Standards Board (FASB) for private sector entities, and the Governmental Accounting Standards Board (GASB) for state and local government entities. Because such users might assume that identical concepts and standards are used by the federal government if differences are not explained clearly, this appendix compares certain concepts underlying the federal standard with concepts that govern recognition and measurement of liabilities in financial reports of private sector entities and state and local governments in the United States. Finally, this appendix also explains the basis for specific conclusions regarding social insurance, contingencies, federal employee pensions, other retirement benefits, other postemployment benefits, and insurance and guarantee programs.

EXCHANGE AND NONEXCHANGE TRANSACTIONS

126 As noted in SFFAC No. 1, "Objectives of Federal Financial Reporting": "The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or promises to provide them."[FN 63: P. 53, paragraph (16c).] In some transactions, consideration of value is exchanged: there is a reciprocal or two-way flow. Other transactions, such as grants and other transfer payments are nonexchange transactions (i.e., there is a nonreciprocal transaction--

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normally a one-way flow).

127 The federal government is the vehicle through which citizens of the nation exercise their sovereign power. In this role, the federal government is responsible for taking collective action at the national level "to promote the general welfare. "Thus the government undertakes many programs that do not involve reciprocal transfers between the government as an entity and its counterparties. Examples include disaster relief, grants to state and local governments, subsidies, and other transfer programs for individuals. The federal government has a propensity to assume such burdens because it is the agent by which the society, through its elected officials, accomplishes transfers between groups of citizens to enhance their well-being.

128 A taxpayer or a donor may, in fact, receive a benefit of some sort, such as the opportunity to live in a safe, secure environment; to improve one's standard of living; and to receive specific benefits, such as visits to national parks and travel over highways. But it is not ordinarily said that the benefit to the individual taxpayer or donor is of value comparable to that of the consideration given. Therefore, these are classified as nonexchange transactions. For this Statement, the significance of the distinction between exchange and nonexchange transactions arises from the nature of the obligation that is created when one party to a transaction provides a product or service to the other party in return for a promise that something of value will be exchanged for it.

129 Obligations become legally enforceable claims against the federal government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing between various programs is whether an exchange is involved. For example, the federal government may not contract for and receive goods or services and then arbitrarily decide not to honor the contract. Similarly,

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under existing law, the federal government may be financially responsible for certain damage and injury it causes.

130 In other cases, the obligation may be more a matter of what is perceived as equitable and good public policy than a legally enforceable claim. Although there may be a high probability that a grant, a subsidy, or an income transfer will be made or will continue in future years, the recipients of such grants, subsidies, or transfers do not have a right to receive such payments in the future from the federal government as do those who receive payments in exchange for service they have performed.

131 However, it is possible to make meaningful estimates of the future amounts required to continue present policies regarding such programs. These estimates are relevant to certain decisions and should be disclosed or otherwise reported, as discussed further in "Supplementary Stewardship Reporting." In the context of the Board's definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute a liability.

132 In the case of federal liabilities, some future outflows of resources are so likely that they should be recognized as accounting liabilities in general purpose federal financial reports before all the other events necessary to create a legally enforceable claim against the government exists.[FN 64: Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress.] Two important examples of such substantive accounting liabilities are the pensions and retirement health care promised federal workers in return for their service.

133 An exchange can in substance be said to have occurred in such cases, even if the government has

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not yet made an outlay of cash or other financial resources. Service has been exchanged for a promise of future payment or health care. Such charges are properly assignable to the current period in financial reports. This exchange implies, for example, that general purpose federal financial reports should recognize the financial effects of the promise to provide health care to retired federal workers as that obligation accrues during their years of service, regardless of whether the budget includes a provision for this item. This is true even though unfunded liabilities of the federal government reported on the financial statements cannot be liquidated without the enactment of an appropriation. Also, as a sovereign entity, the payment of all liabilities other than for contracts can be abrogated by the federal government.

CONCLUSION ON SOCIAL INSURANCE

134 The recognition, measurement and display of obligations for social insurance programs presented the Board with significant theoretical and practical problems. From the theoretical perspective, the Board considered whether social insurance programs resulted in exchange or nonexchange transactions, or whether they contained both exchange and nonexchange features. The Board also considered the problems of articulation between the operating statement and the Balance Sheet, specifically whether the process of reporting a year-to-year change in a Balance Sheet liability might affect the usefulness of an operating statement measure of performance. Finally, the Board considered the difficulty of determining an appropriate measure of the obligation assumed, whether such a measure were to be presented on the face of the Balance Sheet or in the notes.

135 In the exposure draft "Accounting for Liabilities of the Federal Government", the majority of the Board concluded that social insurance programs were entitlement programs developed to carry out the sovereign

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responsibilities of the government, financed primarily by compulsory earmarked taxes. The Board favored characterizing social insurance obligations as nonexchange transactions, and limiting recognition of a liability to any unpaid amounts due as of the reporting date. A significant majority of the respondents, however, agreed with an alternative view, which expressed the notion that social insurance programs contained both exchange and nonexchange features, and that there was a need for recognizing a liability at least equal to the present value of future payments due to recipients currently eligible for benefits.

136 Upon reconsideration of the issues, the Board concluded that the most appropriate approach from both the Balance Sheet and Statement of Net Cost perspectives would be: (1) to include a line item entitled "social insurance obligations" in a separate section of the Balance Sheet following the liability section and before the equity section; (2) to make note disclosure of supplementary data resulting from several approaches for measuring the obligation, and (3) to report the annual financial outflows of current financial resources on the Statement of Net Cost. The Board also decided that, given the sensitivity and magnitude of social insurance, this new position should receive additional exposure, to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and consolidated in "Supplementary Stewardship Reporting."

IMPACT OF COMMUNICATING INFORMATION IN GENERAL PURPOSE FEDERAL FINANCIAL REPORTS

137 FASAB recognizes that extensive information about probable and possible future federal outlays is available now in many special purpose reports on various federal programs. In that sense, the

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financial reports prepared pursuant to this Statement are not likely to reveal information that is new in an absolute sense. Analysts working for the various executive agencies, congressional committees, private interest groups, "think tanks" and universities are, collectively, aware of this information and much more. Nevertheless, the Board believes that presenting liabilities and stewardship responsibilities in the general purpose federal financial reports can be valuable in several ways. There are at least four reasons for this belief.

138 First, analysts typically know a lot about certain programs, but only those programs. Currently it is difficult, if not impossible, to assemble comprehensive information prepared on a comparable basis for the federal government as a whole. In many cases, this is also true for significant component units. General purpose federal financial reports attempt to provide a way of presenting comprehensive information.

139 Second, much of this information has no impact on individual decisionmakers, such as program managers, unless it is conveyed in a way that facilitates, or even requires, suitable attention to it. For example, information about federal pension plans and retirement benefits conveyed in an actuarial report or in the narrative section of the "Budget of the United States Government" may have an impact on certain congressional decisions, but is unlikely to influence managers' decisions about whether to use federal employees, invest in labor-saving equipment, or contract out to accomplish a given task. If the information is to have such an impact, it must be reported in a way more directly associated with the activities the manager is responsible for. Associating the expenses and liabilities reported in the general purpose federal financial report with the outputs of responsibility centers is able to accomplish this direct association.

140 Third, the mere requirement to assemble and

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report these data will, in some cases, affect federal managers, who, like everyone, tend to manage what they measure. Some observers believe, for example, that the prospect of having to comply with FASB's Statement 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," caused corporate managers and others to focus increased attention on the need to manage the cost of promises they had made to provide health care to retirees, even before the statement became effective.

141 Fourth, financial reports prepared and audited pursuant to federal accounting standards may reasonably be expected to possess a certain credibility and to command a certain amount of attention from various users, sufficient to affect decisions about federal government public policy. They will provide a source of information that should complement what is provided by the "Budget of the United States Government." An important collateral benefit arises from the processes of preparing, auditing, and publishing annual financial statements. Experience demonstrates that these processes improve the reliability of information and of control systems, thereby enhancing both decisionmaking and accountability in general.

RELATIONSHIP TO LIABILITY RECOGNITION PRINCIPLES USED BY NONFEDERAL ENTITIES

142 FASB defines the basic principles that govern liability recognition by private sector entities in the United States.[FN 65: The Governmental Accounting Standards Board (GASB) has not published a concept statement on financial statement elements as FASB has done in Concept Statement Number 6 and has not defined "liability" per se. In the current state and local governmental accounting model, a fund liability is "the amount left unpaid at the end of the reporting period that normally would be liquidated with expendable available financial resources. The remainder of the liability should be reported

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in the General Long-Term Debt Account Group (GLTDAG)." National Council on Government Accounting Statement (NCGAS) Number 4, par. 17. (See GASB "Codification of Governmental Accounting and Financial Reporting Standards", section 1500.)] Government corporations follow those standards in their separately issued financial statements. Probably most readers of this Statement are familiar with these principles. Probably most users of federal financial reports are accustomed to seeing other financial reports prepared according to these principles.

143 FASAB's principle for liability recognition differs from FASB's. The difference can be seen as a modification made necessary by the sovereign nature of the federal government. FASAB contemplates a liability standard within the context of a reporting model that provides much greater emphasis on publicly reporting certain stewardship responsibilities than does the reporting model used by private sector organizations. This kind of reporting model is necessary because of the federal government's responsibility for the general welfare of the nation and its resulting willingness to take on obligations.

CONCLUSION ON CONTINGENCIES

144 In the Exposure Draft the Board asked the following question. "When an estimated [contingent] liability is a range of amounts and no amount within the range is a better estimate than any other amount, should either the midpoint or, alternatively, the 'expected value' (as the term is used in statistics) be recognized as a liability instead of the minimum amount?" The majority of respondents preferred the expected value and the second preference was the minimum amount.

145 The Board further considered all of the options. Based on the Board discussions it was noted that it would be difficult to use "expected value" to pinpoint an estimate within a range.

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The expected value method would assign a probability percentage to each of the numbers within the range, but these probabilities would usually be difficult to estimate.

146 After much discussion the majority of the Board preferred the minimum amount because of its established use in other accounting standards. The Board decided that liabilities arising from nonexchange transactions would be recognized for any unpaid amounts due as of the reporting date. This includes amounts payable from the federal entity to pay for benefits, goods, or services[FN 66: Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of disaster relief beneficiaries.] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers that will be financed by

the federal entity but have not yet been reported to the federal entity).

147 In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions a liability would then be recognized at the point the amount is due. Therefore, government-acknowledged events do not meet the recognition criteria necessary to be recognized as a contingent liability. The government is acting in its sovereign capacity when it assumes financial responsibility and makes income transfer payments or provides other nonexchange benefits. The Board does not believe that accounting recognition should anticipate sovereign actions in advance of occurrence.

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CONCLUSION ON PENSIONS, OTHER RETIREMENT BENEFITS AND OTHER POSTEMPLOYMENT BENEFITS

Pensions - Projected Salary Levels

148 A primary objective for federal financial reporting is to measure accurately the full cost of employer entity services to the public. The methods used to account for pensions, ORB, and OPEB in general purpose financial reports should accurately measure the full cost of an employer entity's services. Since federal pension benefits are based on final salaries, whatever method is used for the annual cost and accrued liability of federal pensions must include projected future salaries that reflect an estimate of the compensation levels of the individual employees involved (including future changes attributable to the general price level, seniority, promotion, and other factors). They are part of the obligation that the federal government is incurring.

Accounting for the Pension Plan

Attribution Methods

149 The major federal pension plans use an actuarial cost method for funding purposes known as aggregate entry age normal (AEAN). Various actuarial cost methods exist. All the methods regarded as acceptable methods for advance funding of private pension plans recognize the cost of an employee's pension benefits during the employee's years of service, but the different actuarial methods recognize the cost in different patterns over time. The AEAN method is intended to produce a periodic pension cost that is a level percent of payroll.

150 That is, AEAN is a method under which the present value of projected benefits of each employee is allocated on a level basis (such as a constant percentage of salary) over the service of the employee between entry age and assumed exit

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age. The portion of this present value allocated to each year is called the normal cost. The portion of this present value not provided for at a valuation date by the present value of future normal cost is called the actuarial accrued liability.

151 FASAB considered the method used by the Financial Accounting Standards Board in Statement of Financial Accounting Standards (SFAS) No. 87, "Employer Accounting for Pensions" (the projected unit credit, or PUC), as well as AEAN. FASB concluded that PUC gave a better measure of the employer's obligation for the benefits earned by the employees at a particular point in time. It therefore said that PUC provides a better measure of the value of the benefits that accrue during the year. However, FASAB heard testimony from an OPM actuary that results from these two methods were similar for federal plans. FASAB concluded that AEAN is a sound measure of the accruing expense.

152 FASAB concluded that any method of assigning the value of benefits that are earned over the entire career to particular years of service involves a process of estimation. It is, of course, reasonable to assume that the benefits accrue in some sort of systematic and uniform fashion and not, for example, all at once when the employee becomes eligible. Assuming that the benefits accrue as a uniform percentage of salary each year (as is done with AEAN for pensions) is a reasonable approach. AEAN is particularly useful within an organization when measuring costs over time because it provides that a dollar of salary always equals a fixed percent of pension, regardless of the year involved. Thus, inflation is factored into the calculation automatically.

153 FASAB specified the AEAN for several reasons. First, as stated, AEAN is a reasonable and systematic way of allocating costs evenly over the service lives of employees. Second, the major federal retirement systems [the Military Retirement System (MRS), the Civil Service

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Retirement System (CSRS), and the Federal Employees Retirement System (FERS)] use AEAN, and in two cases (FERS and MRS) charge "full cost" in the budget under a statutory requirement.[FN 67: The CSRS statute calls for procedures that are generally construed as entry age normal. "Full cost," of course, depends on the method selected. For example, prior service cost is amortized in FERS over 30 years pursuant to the funding method; it would be recognized over a shorter period (years of expected future service of the group or 15 years) under SFAS 87. It should be recognized in full immediately under the terms of this standard, but only in financial reports of the agency that administers the pension plan and in the consolidated financial statements of the United States, not in the employer agency's financial statements. Thus, "full cost" in this sentence must be read in a generic way, that is, as a statement of the general intent underlying the law.] Finally, exact comparability with private-sector entities is not relevant. Minor differences in the size of the pension liability and expense calculated pursuant to this Statement and SFAS 87 clearly would not have a material impact on investor's assessment of the credit-worthiness of the U. S. government.

154 Since there are several acceptable attribution methods and several small pension plans in addition to the three major plans, FASAB decided that the use of methods other than AEAN was permitted provided the results were not materially different from those of AEAN. A material difference between the expenses and the liabilities for federal plans based solely on the choice of attribution method would destroy the comparability and impair the usefulness of the information for users other than investors.

155 FASAB recognizes also that other attribution methods might be useful for other purposes. For example, a method that calculates the vested benefits accrued by employees to date, at current salary levels, would be useful as a measure of the accumulated amount the plan would owe if it were

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to terminate. Such calculations would be for special purpose reports not covered by this Statement.

Assumptions

156 There are three objectives for actuarial assumptions. First, FASAB considers it extremely useful to have consistent assumptions among accounting, budgeting, and actuarial statements to the extent it is possible to do so while attaining the objectives of federal financial reporting.

157 Second, assumptions ought to be consistent across federal employee retirement systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of the best available estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.

158 Third, assumptions ought to reflect the underlying economic substance of the transaction. They should reflect the entity's past experience and current expectations regarding cost trends. They should reflect the similarities of and differences between two sets of economic phenomena rather than forcing artificial uniformity.

159 FASAB concluded also that the discount rate should reflect the long-term expected return on plan assets rather than a current market rate on debt of comparable maturity (the discount rate called for by SFAS 87). The long-term expected rate reduces volatility, reflects the actual experience and expectations of the primary federal plans, and is consistent with the assumptions used in the budget. The Governmental Accounting Standards Board uses a similar approach for the discount rate for state and local government

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pensions for similar reasons.

Prior Service Cost

160 Prior service costs (or gains) are the costs (or gains) of retroactive benefits granted (or reduced) in a plan amendment. Under the current budgetary system, prior service costs are funded in the budget through General Fund appropriations over 30 years. The employer entities under MRS and FERS--which are intended to be fully funded--are not charged in their budgets for prior service cost (nor are they credited for gains), but rather the General Fund is charged for these costs. [FN 68: CSRS also receives General Fund appropriations for this purpose, but the appropriations are based on statutory provisions and are less than they would be under a fully funded approach. Because of this, the CSRS funding approach is not being used as an example of budgetary treatment to be contrasted with the accounting treatment.]

161 As stated in the Statement, FASAB believes that prior service costs, interest on the pension (or ORB) liability, and actuarial gains and losses are expenses of the federal government as a whole and are best accounted for by the administrative entity. Some respondents did not agree that employer entities should recognize only the "normal" or "service" cost element. The respondents suggested that the employer entity should recognize all elements of the pension (or ORB) expense: service costs, prior service costs, actuarial gains and losses, and interest on the pension liability. In general, these respondents believe that the full cost of products and services produced by the employer entity includes these elements, and that the full cost thus defined is relevant to various decisions such as comparing the cost of outputs and services with alternative providers.

162 The Board considered these views, but it continues to believe that employer component entities of the U. S. Government should usually recognize only the service cost element of pension

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(and ORB) expense in their general purpose financial reports. (Exceptions will arise in cases such as the Coast Guard, where the employer entity is also the administrative entity for the plan). The Board is aware that its approach may appear to differ from the approaches taken by FASB and GASB in this regard. However, neither of those Boards focused, in their standards on pensions and other retirement benefits, on reporting by component entities of a larger reporting entity comparable to the Government of the United States. All elements of pension (and ORB) expense should be recognized in the consolidated financial statements of the United States Government; however, the Board believes that prior service cost and other non-service cost are not useful for most managerial or policy decisions at the program level. They are sunk costs (or sunk gains) attributable to services rendered in prior years, or otherwise are not under the control of program management. FASAB continues to believe that having non-service elements of cost reported by the administrative entity best reflects the federal environment and organizational structure.

163 The Board recognizes that some analysts might, for some purposes, want to consider an alternative measure of compensation cost, e.g., one that includes interest on the part of the pension (or ORB) liability that relates to current workers, or one that recognizes some non-service costs over the workers' years of expected service. Special analyses and reports will always be necessary for special purposes. General purpose financial reports must, by definition, focus on the most common needs of users of those reports.

164 For similar reasons, FASAB also continues to believe that prior service costs (or gains) should be recognized immediately, without amortization, by the administrative entity, and in federal government-wide financial reports. FASAB sees no benefit to delaying recognition of a cost and a liability or to reducing volatility in the general purpose financial report of the administrative

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entity. FASAB was not persuaded that the benefit (or the cost) derived in future periods from increased (or deceased) pension benefits was sufficiently tangible in the federal context to warrant delayed recognition by means of amortization over future periods. Examples of plausible future benefits or costs would be, increased (decreased) employee productivity or reduced (increased) turnover.

165 FASAB recognizes that, for funding purposes, prior service costs for CSRS, FERS, and MRS are amortized through appropriations over a number of years. Funding decisions, however, should not be determinative for accounting recognition of cost. Deciding when and how to fund an obligation is not an accounting issue.

Actuarial Gains and Losses

166 Actuarial gains and losses result from (1) deviations between actual experience and the actuarial assumptions used and (2) changes in actuarial assumptions. Actuarial assumptions are essentially long-range estimates about future events and necessarily vary from actual experience.

167 Actuarial gains and losses and prior service costs (or gains) have similar characteristics. They are both determined after the accounting period in question has concluded, and both relate to the past (either prior service or prior experience). The difference between actuarial gains and losses and prior service costs (or gains) is that the former are the normal result of actuarial estimation and may occur annually, while prior service costs are incurred only when the plan is amended. Also, actuarial gains and losses may tend to even out over time, unlike prior service costs.

168 FASAB concluded that actuarial gains and losses should receive the same treatment as prior service costs (or gains). They should be charged to the administrative entity. The employer

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entities should recognize an expense only for the service cost[FN 69: "Service cost" is defined as the actuarial present value of benefits attributed by the plan's benefits formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost".] of their employees for the period less the amount contributed by the employees, if any. Like prior service costs, the actuarial losses are sunk costs (or sunk gains) attributable to services rendered in prior years and therefore should be excluded from data used for managerial or policy decisions.

169 For the same reasons as were given for prior service costs, actuarial gains and losses should be recognized immediately by the administrative entity. There is no benefit in delaying recognition or reducing volatility in the cost measures and the financial reports of the administrative entity.

Recognition and Measurement

170 The Board's conclusions discussed immediately above are reflected in the accounting treatment of pensions. The employer entity should recognize an annual pension expense as a cost of operations. When the employer entity's contributions are less than its pension expense, the employer entity should recognize an imputed financing source for the expenses paid by other entities. To the extent that it receives contributions from the employer entity, the administrative entity should recognize an intragovernmental revenue.

171 These transactions are intragovernmental. For purposes of federal government-wide consolidated financial reports, the employer's pension expense should be offset against (1) the administrative entity's contributions received from employer entities and (2) the employer entity's imputed financing source, if applicable.

172 The administrative entity should report the pension liability. An increase in the liability

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during the accounting period is an expense to the administrative entity. The liability is increased by the net total of the pension cost components [normal cost, interest on the pension obligation, prior service costs (gains), and actuarial gains (losses)]. Thus, the administrative entity should be providing information not only about the actuarial liability but also about the relationship between the full cost and the revenue from employees, employer entities, interest, and Treasury contributions.

173 Recognizing the pension cost components in the administrative entity and also the normal cost in the employer entities accomplishes two objectives. First, the full cost and actuarial liability are summarized and presented in one place, i.e., in the administrative entity's operating results and Balance Sheet. Second, each employer entity reports its respective normal cost as a cost of providing service. This is essential to report properly the cost of delivering federal government services. These entries are eliminated during consolidation for federal government-wide financial statements and, thus, no double counting occurs.

Other Retirement Benefits

174 FASAB concluded that ORB are similar to pension benefits and should be accounted for in a similar way unless differences in substance dictate otherwise. The predominant other retirement benefit in the federal government is health care benefits for retirees. These are long-term and require actuarial estimation.

175 FASAB recognizes that future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare.

176 Also, some federal retiree health benefits

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are provided directly in federal government hospitals and domiciliary facilities. The liability in these cases also depends on the amount that the Congress will appropriate in the future to pay for the benefits, so the expense and liability are more difficult to measure. Notwithstanding the measurement difficulties, because of the importance of approximating the cost of services rendered at the time the service is rendered, FASAB believes that in most cases, the ORB costs and liabilities should be measured for federal programs. However, as noted in the discussion starting with paragraph 182, VA medical care cost would be recognized in the period medical care service is rendered.

ACCOUNTING FOR THE OTHER RETIREMENT BENEFITS PLAN

Attribution Method

177 Unlike the situation regarding federal pension plans, there is no established attribution method for federal retirement medical care. Although there are current proposals to do so, the costs are not currently being funded.

178 For retirement health care, FASAB found no compelling reason to prefer an approach other than the aggregate entry age normal used for pensions. The employer's service cost however, should be calculated differently for health care than for pensions. For the pensions, costs are calculated as a percent of payroll, but retirement health care benefits are paid for each individual retiree regardless of prior salary. Cost, therefore, should be calculated on a per person basis because that accurately represents how the cost is incurred.

Assumptions

179 Although the general assumptions employed for ORB should be the same as those for pensions, the health care cost trend assumption is unique. The standard gives general guidance regarding the use

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of "Medicare projections or other authoritative sources" for the trend assumption in order to achieve consistency and set broad guidelines for the estimates. The health care cost assumption should reflect these sources adjusted for any factors unique to the organization.

Other Postemployment Benefits

180 OPEB represent operating expenses of the federal employer entity. Some might argue that OPEB, like pensions and ORB, should be accrued as employees perform services, as a cost of operations, because (1) they believe the event is occurring as the employees perform service, (2) future OPEB payments are probable, and (3) they can be measured. FASAB was not persuaded that there was an adequate nexus between these cost and the employee's daily, ongoing service; or that these costs were sufficiently probable at that point to warrant accrual.

181 FASAB believes that an accrual based on the occurrence of an actual event, such as a job-related injury or a decision to reduce the entity's workforce generally, is a reasonable approach. Such an event makes the future outflow of resources probable and measurable, may involve long-term accruals in some cases, and provides an accurate measure of expense in a way that is the least burdensome to the reporting entities. [FN 70: The federal workers' compensation and unemployment insurance programs are different from the programs applicable to nonfederal workers. The benefits for federal employees under these programs are financed by direct reimbursement from employer entities. Usually the reimbursement period for workers' and unemployment compensation is short-term, but under certain conditions, workers' compensation may extend for many years.]

VA MEDICAL CARE COST

182 Although it might appear that medical benefits provided by the Department of Veterans Affairs should be treated like other retirement or

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medical benefits, there are significant differences between the two. Most often retiree medical benefits are provided through a health insurance provider, which receives premium payments from the former employer. But, with VA medical benefits, the former employer (the government) provides the medical services through VA facilities to veterans on an "as needed" and an "as available" basis versus payment of health insurance premiums for each veteran.

183 Eligibility for VA hospital care and nursing-home care is divided into mandatory and discretionary categories. VA must provide hospital care to veterans with service-connected disabilities and others in the mandatory category. Hospital care is considered discretionary if the veteran has income above a specified limit and a non-service-connected injury. Veterans in the discretionary category may be required to pay fees to receive VA hospital care. In addition, VA medical care is financed by annual appropriations. The entitlement to receive care does not guarantee any particular level of care. The Congress decides annually how adequately VA medical care will be funded.

184 The Board believes that VA medical benefits, for both mandatory and discretionary programs, are best measured by the annual cost incurred rather than by actuarially determined charges during the veteran's military service. Medical care for veterans does not satisfy the probability or reasonably measurable criteria in this standard at earlier dates, and therefore future medical benefits do not constitute a long-term liability to be recognized in the Balance Sheet. The Board believes VA medical benefit liability and related expenses should be recognized in the period medical care service is rendered. The entity should consider, however, what disclosures would be appropriate for these costs under the contingency standard.

CONCLUSION ON INSURANCE AND GUARANTEES

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185 The Board considered two possible bases for recognizing the liability of federal insurance programs. One would recognize as a liability the unpaid expected present value (PV) cost of insured events that had occurred. The second would recognize as a liability the unpaid expected PV cost of risks that had been assumed (i.e., the unpaid expected PV cost inherent in insurance extended or in force). This second approach would be similar to that taken by the Congress in budgeting for direct loans and loan guarantees and by FASAB in accounting for these transactions. (See Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees").

186 Several Board members believe that this second approach has merit from a conceptual standpoint. However, the Board has concerns about the measurability of the risk assumed, particularly in the context of pension guarantees. There may also be some question as to the exact nature or categorization of some assumed risks in the absence of written contracts. The Board concluded that it would continue the traditional practice of recognizing the effect of events that had occurred on the face of the financial statements. However, it also decided to require reporting as RSSI the estimated PV cost of the risk assumed for all programs, except social insurance, life insurance, and loan guarantee programs.

187 Accrual accounting for insurance programs attempts to report the expenses of operations for each period and the unpaid liability at the end of the period. Projections of future claims, including renewed, expanded, and new business, also provide important information for policy decisions about what rates should be charged to cover all expected future losses, what additional insurance should be extended, and similar decisions. Management of reporting entities may wish to include such projections in financial reports as other accompanying information, and may do so on a voluntary basis, but the Board is not

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presently making any specific recommendations about this, beyond those required by this Statement and those to be further considered in "Supplementary Stewardship Reporting."

188 During the Exposure Draft stage of the Liability Standard, the Board asked respondents whether the Standard provided sufficient guidance on how the risk assumed amount should be measured. Two of the fifty five respondents asked for additional guidance but did not mention measurement possibilities.

189 At the discussion stages of the final Statement the Board contemplated two possible measurement perspectives for reporting the risk assumed. The Statement requires that all federal insurance programs (except social insurance, life insurance, and loan guarantee programs) report the risk assumed amount as supplementary information. The risk assumed calculation as presented in the Exposure Draft measured the cost of the coverage outstanding during the reporting year. For annual term insurance programs, under this approach the risk assumed amount might not be significantly different from the sum of recognized liabilities and contingent liabilities reported on the Balance Sheet. However, the Board believes that requiring disclosure or supplementary reporting of a risk assumed number that is similar in concept and amount to the liability recognized could be confusing and would not add informational value.

190 In the second perspective, the risk assumed amount would be a broader and longer term measure of the government's potential cost for on-going insurance programs. Under some measures, this second approach to risk assumed could be regarded as an indicator of the "fair" or "full cost" premium that should be charged if taxpayers are not to subsidize the program. This measure would be a probabilistic estimate of the expected cost under certain assumed economic factors. The Board found merits in this calculation, and believes it can provide important additional information beyond that contained in the accrual. Although

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they believe the measure to be important, proponents of this approach acknowledge that the measure may be difficult to measure precisely. Accordingly, they would treat it as RSSI. The Board currently has a project at the Exposure Draft stage, "Supplementary Stewardship Reporting", that will provide further details on the measurement and reporting of "risk assumed" in its final statement.

191 The Board also considered the liability recognition of whole life insurance programs. The federal government has a small number of whole life insurance programs that are administered by federal entities. The most significant programs (mutual enterprise-type whole life insurance) are through the Department of Veteran Affairs (VA).

192 At the time the exposure draft on liabilities was issued, there were no established accounting standards for mutual enterprise-type whole life insurance within the federal government, state and local government, or the private sector. Therefore VA followed the statutory requirements for accounting purposes as well as statutory insurance reporting.

193 In January 1995, the FASB and AICPA issued a standard and a statement of position, respectively, that specified accounting for mutual whole life insurance enterprises. Due to the similarities between the federal programs and the insurance enterprises covered in the FASB and AICPA documents, the Board decided that the private sector standards would be appropriate for the applicable federal programs. Therefore the Board concluded that federal entities with whole life insurance programs would follow the standards as prescribed in the private sector standards (and as these private sector standards are amended) when reporting the liability for future policy benefits, along with the additional disclosures prescribed by this Statement. The Board further concluded that disclosure of the components of the liability was necessary to adequately inform the financial statement users of the projected use and

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any other potential uses of the liability components and associated assets.

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APPENDIX B: LIABILITY RECOGNITION AND MEASUREMENT MATRIX

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********** APPENDIX B: "LIABILITY RECOGNITION AND MEASUREMENT MATRIX APPEARED HERE IN THE HARD COPY TEXT **********

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GLOSSARY

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Actuarial cost methods - A recognized actuarial technique used for establishing the amount and the incidence of employer contributions or accounting charges for pension costs under a pension plan.

Actuarial liability - A liability based on statistical calculations and actuarial assumptions (actuarial assumptions are conditions used to resolve uncertainties in the absence of information concerning future events affecting insurance, pension expenses, etc.). (Adapted from "Webster's Ninth New Collegiate Dictionary" and "Kohler's Dictionary for Accountants" sixth edition, [Cooper & Ijiri])

Actuarial present value - The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions. (Actuarial Standards of Practice No. 4)

Aggregate entry age normal - A system of applying the entry age normal actuarial cost methodology using aggregate population models or groups instead of applying it individual by individual.

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Attribution - The process of assigning pension benefits or costs to periods of employee service. [SFAS 87]

Budget Authority - The authority provided by federal law to incur financial obligations, as follows:

-- Provisions of law that make funds available for obligation and expenditure (other than borrowing authority), including the authority to obligate and expend the proceeds of offsetting receipts and collections.

-- Borrowing authority or authority to borrow and obligate and expend the borrowed funds, including issuance of promissory notes or other monetary credits.

-- Contract authority, or the making of funds available for obligation but not for expenditure. (Statutory authority under which contracts or other obligations may be entered into before an appropriation for the payment of such obligations. The later appropriation provides cash to liquidate such obligations. See OMB Circular A-34.)

-- Offsetting receipts and collections as negative budget authority and the reduction thereof as positive budget authority. (Omnibus Budget Reconciliation Act of 1990 [Pub. L. 101-508], sec. 13211)

Budget authority may be classified by period of availability (1-year, multiple-year, and no-year), by nature of authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections). (SFFAS Number 1, "Accounting for Selected Assets and Liabilities")

Capital leases - Leases that transfer substantially all the benefits and risks of ownership to the lessee.

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Contingency - An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

Discount rate - The interest rate used to adjust for the time value of money.

Dividend fund interest rate - The interest rate determined at policy issuance used to determine the amount of the dividend fund. It is the rate used to credit interest to the dividend fund, and against which experience is measured to determine the amount of the interest portion of dividends paid to individual policyholders. [AICPA SOP 95-1, Glossary, p. 33]

Earmarked taxes -Taxes levied by the federal government to finance a specific federal program.

Entitlement program - A program in which the federal government becomes automatically obligated to provide benefits to members of a specific group who meet the requirements established by law.

Entitlement period - The period (such as, monthly) for which benefits become due.

Entry age normal actuarial method - A method under which the actuarial present value of projected benefits of each employee is allocated on a level basis over the earnings or the service of the employee between entry age and assumed exit age. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion of this present value not provided for at a valuation date by the present value of future normal cost is called the actuarial accrued liability. The assumption is made under this method that every employee entered the plan (entry age) at the time of initial employment or at the earliest eligibility date, if the plan had been in existence, and that contributions have been made from the entry age to

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the date of the actuarial valuation. The term "aggregate entry age normal" refers to an approach whereby costs are determined for the group as a whole rather than for each individual participant separately.

Event - A happening of consequence to an entity. It may be an internal event that occurs within an entity, such as the transforming of raw materials into a product. Or it may be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, theft, vandalism, a tort caused by negligence, or an accident. (Adapted from FASB Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements")

Exchange transaction - A transaction that arises when each party to the transaction sacrifices value and receives value in return.

Executory contract - A contract which has not been performed by all parties to it. (Trascona, Joseph L., "Business Law", William C. Brown C. Publishers, 1981)

Executory costs - Those costs such as insurance, maintenance, and taxes incurred for leased property, whether paid by the lessor or lessee. (SFAS #13)

Expected value - A statistical measurement attribute that is the sum of the products of each potential outcome multiplied by the probability of that potential outcome.

Fixed value securities - Securities that have a known maturity or redemption value at the time of issue.

Government-acknowledged events - Events that are not a liability in themselves, but are those events that are "of financial consequence" to the federal government because it chooses to respond to the event.

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Government-related events - Nontransaction-based events that involve interaction between federal entities and their environment.

Insurance and guarantee programs - Federal government programs that provide protection to individuals or entities against specified risks. Because the federal government frequently commingles aspects of insurance and guarantees within the same program, this Statement treats the terms as a single type of activity. (Also see separate definition of social insurance).

Interest method - Under the interest method of amortization, an amount of interest equal to the carrying amount of the investment times the effective interest rate is calculated for each accounting period. This calculated interest is the effective interest of the investment (referred to as "effective yield" in some literature). The effective interest is compared with the stated interest of the investment. (The stated interest is the interest that is payable to the investor according to the stated interest rate.) The difference between the effective interest and the stated interest is the amount by which the discount or the premium should be amortized (i.e., reduced) for the accounting period. (SFFAS Number 1, "Accounting for Selected Assets and Liabilities").

Liability - For federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.

Measurable - Reasonably estimable.

Net level premium reserve - The excess, if any, of the present value of future guaranteed death endowment benefits over the present value of future net premiums. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contracts. [AICPA SOP 95-1]

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Nonexchange transaction - A transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return.

Normal cost - That portion of the actuarial present value of pension plan benefits and expenses that is allocated to a valuation year by the actuarial cost method. (From Actuarial Standard of Practice No. 4)

Operating lease - An agreement conveying the right to use property for a limited time in exchange for periodic rental payments.

Other postemployment benefits (OPEB) - Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans.

Other retirement benefits (ORB) - Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits. (FASB Statement of Financial Accounting Standard No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions")

Premium deficiency - A condition under which a liability for future policy benefits using current conditions exceeds the liability for future policy benefits using contract conditions. In such cases, the difference should be recognized as a charge to operations in the current period.

Probable - That which can reasonably be expected or believed to be more likely than not on the

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basis of available evidence or logic but which is neither certain nor proven.

Projected unit credit actuarial method - A method under which the projected benefits of each individual included in an actuarial present valuation are allocated by a consistent formula to valuation years. The actuarial present value of benefits allocated to the valuation year is called the normal cost. The actuarial present value of benefits allocated to all periods before a valuation year is called actuarial liability. (Actuarial Standard of Practice No. 4)

Social insurance programs - Income transfer programs financed by compulsory earmarked taxes and also, in certain cases, general revenues of the federal government. (Also see separate definition of insurance and guarantees).

Terminal dividends - Dividends to policyholders calculated and paid upon termination of a contract, such as on death, surrender, or maturity. If the payment of terminal dividends is probable and the amount can be reasonably estimated, the liability should be recognized. AICPA SOP 95-1.

Transaction - A particular kind of external event involving the transfer of something of value concerning two or more entities. The transfer may be a two way or one way flow of resources or of promises to provide resources. (Adapted from FASB Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements")

Variable value securities - Securities that have unknown redemption or maturity values at the time of issue. Values of these securities can vary on the basis of regulation or specific language in the offering.

Whole life policies - Policies that provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of

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the insured.

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Major Contributors
****

This document reflects extensive input from a number of individuals, including those listed below.

Christine Bonham	General Accounting Office
Debra Carey	Department of the Interior
Sheila Conley	Office of Management and Budget
John Crowley	Bureau of Public Debt
Tom Cuny	Congressional Budget Office
Benjamin Gottlieb	Department of Defense
Ron Gresh	Office of Personnel Management
Larry Jacobson	Office of Management and Budget
Bob Kilpatrick	Office of Management and Budget
Allan Lund	Department of the Treasury
JoEllen McCormack	General Accounting Office
Nancy Nichak	Office of Personnel Management
John Reilly	General Accounting Office
Justine Rodriguez	Office of Management and Budget
Debra Sebastian	General Accounting Office
Laura Triggs	General Accounting Office
Mike Virga	Office of Personnel Management

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**********From Inside Back Cover**********

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

Elmer B. Staats, Chairman
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The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board") in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The Board's sponsors, i.e., the officials who established the Board, then decide whether to adopt the recommendations. If they do, the standard is published by the OMB and the GAO and then becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

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FASAB STAFF:
Ronald S. Young, Executive Director
Project Staff:
Robert W. Bramlett
Richard Fontenrose
Monica R. Valentine

MAILING ADDRESS AND TELEPHONE NUMBER
Federal Accounting Standards Advisory Board
750 First Street, NE, Room 1001
Washington, DC 20002
Telephone (202) 512-7350
Fax (202) 512-7366

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Accounting for property, plant, and equipment
Federal Financial Accounting Standards no. 6

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Federal Accounting Standards Advisory Board
(FASAB)

ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards No. 6

JUNE 1996
GPO # 041-001-00462-9 ($6.50)

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[NOTE 1: THE FOOTNOTES INCLUDED IN THIS DOCUMENT ARE OFTEN CRITICAL TO UNDERSTANDING THE STANDARDS. DUE TO THE LIMITATIONS ON TEXT PRESENTATION THE FOOTNOTES ARE PRESENTED AS ENDNOTES. PLEASE BE SURE TO REFER TO THESE ENDNOTES AS YOU REVIEW THE STANDARDS.]

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EXECUTIVE SUMMARY

a This statement contains accounting standards for Federally owned property, plant, and equipment (PP&E); deferred maintenance on PP&E; and cleanup costs. Each standard is summarized below.

PROPERTY, PLANT, AND EQUIPMENT

b The Federal Government's investment in PP&E exceeds $1 trillion [SEE NOTE 1] PP&E used for many different purposes. "PP&E" is defined as follows:

> Tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity.

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c The diversity among Federal PP&E creates a need for meaningful categories of PP&E with different accounting standards for each category. The Board identifies four categories of PP&E. The categories are:

- general PP&E are PP&E used to provide general government services or goods;
- Federal mission PP&E are PP&E exhibiting specific characteristics set by the Board;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land [SEE NOTE 2] (i.e., land other than that included in general PP&E).

d Complete accounting standards for general PP&E are included in this document.

e Federal mission PP&E, heritage assets, and stewardship land are the subject of a project on "Supplementary Stewardship Reporting." An exposure draft (ED) on this topic was issued in August 1995. The Supplementary Stewardship Reporting ED proposes accounting standards for these assets after their acquisition. The accounting standards in this document address (1) classification of PP&E in the categories, (2) accounting for the acquisition cost of PP&E falling into one of these three categories, and (3) implementation of these standards where it affects the basic financial statements. Because Federal mission PP&E, heritage assets, and stewardship land would be subject to supplementary stewardship reporting, they are referred to collectively as stewardship PP&E. This term is used for convenience only since each category has its own definition.

GENERAL PP&E

f The general PP&E category consists of items

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that:

- could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but are used by the Federal entity to produce goods or services, or to support the mission of the entity; or
- are used in business-type activities; [SEE NOTE 3] or
- are used by entities in activities whose costs can be compared to other entities (e.g., Federal hospitals compared with other hospitals).

g General PP&E includes land acquired for or in connection with other general PP&E. [SEE NOTE 4]

h General PP&E shall be reported in the basic financial statements: the balance sheet, [SEE NOTE 5] and the statement of net cost. [SEE NOTE 6] The acquisition cost of general PP&E shall be recognized [SEE NOTE 7] as an asset. Subsequently, except for land which is a nondepreciable asset, that acquisition cost shall be charged to expense through depreciation. [SEE NOTE 8] The depreciation expense shall be accumulated in a contra asset account--accumulated depreciation.

i The standards provide that certain costs of internally-developed software [SEE NOTE 9] can be capitalized and amortized over a period not to exceed five years. The costs to be capitalized are limited to direct costs incurred after technological feasibility has been established.

j In addition, the standard addresses donations, transfers, and retirements of general PP&E as well as disclosure [SEE NOTE 10] requirements.

STEWARDSHIP PP&E

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k The following paragraphs describe Federal mission PP&E, heritage assets, and stewardship land, the categories for which supplementary stewardship reporting is being proposed. These standards are limited to accounting requirements for the basic financial statements--they do not address the information to be reported through supplementary stewardship reporting. The accounting standards provide guidance on:

- identifying stewardship PP&E, and
- elements associated with stewardship PP&E that are to be recognized on the basic financial statements (e.g., information shown on the statement of net costs).

Federal Mission PP&E

l Federal mission PP&E are specific types of PP&E identified by the Board (i.e., weapons systems and space exploration equipment) or exhibiting the characteristics established by the Board. [SEE NOTE 11] The Board specifically identified weapons systems and space exploration equipment as Federal mission PP&E because it does not believe applying depreciation accounting would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believes that these assets are developed, used, and retired in a manner that does not lend itself to a "systematic and rational" assignment of costs to accounting periods (i.e., depreciation accounting) and, ultimately, to outputs.

m The Board did not find any other categories of PP&E that it believed should be explicitly included in the Federal mission category at this time. However, there are other types of PP&E, or PP&E may be developed in the future, that are similar to these two items, so the

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Board has articulated characteristics of Federal mission PP&E. PP&E other than weapons systems and space exploration equipment clearly exhibiting these characteristics should be categorized as Federal mission PP&E. For example, based on comments from respondents and information provided by the Department of Energy, nuclear weapons production facilities do exhibit these characteristics and should be categorized as Federal mission PP&E.

n There are two types of characteristics. The first relates to the use of the PP&E. The second relates to expectations about, and risks associated with, its useful life. To be categorized as Federal mission PP&E, an item should have at least one characteristic from each of the two types of characteristics discussed below.

o Characteristics related to the use of Federal mission PP&E are that the PP&E:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war, or natural disaster; or
- is specifically designed for use in a program for which there is no other program or entity (Federal or non-Federal, governmental or nongovernmental) using similar PP&E with which to compare costs.

p Characteristics related to the useful life are that the PP&E:

- has an indeterminate or unpredictable useful life [SEE NOTE 12] due to the manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or of premature obsolescence.

q Annual expenditures to acquire, replace or improve Federal mission PP&E shall be shown

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as a cost in the period incurred. Separating these costs from other period expenses would facilitate analysis of the operating expense and prevent distortion due to large infrequent expenditures.

Heritage Assets

r Heritage assets include PP&E that have historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. Expenditures to acquire, construct, reconstruct, or improve heritage assets shall be reported as a cost in the period incurred. Separating these costs from other period expenses would facilitate analysis of the operating expense and prevent distortion due to large infrequent expenditures.

Multi-use Heritage Assets

s Not all heritage assets are used solely for heritage purposes--some serve two purposes by providing reminders of our heritage and by being used in day-to-day government operations unrelated to the assets themselves. For example, the government has constructed "monumental" style office space, such as the Old Executive Office Building and the Pentagon. Such assets contribute to the day-to-day operations of programs but the cost of these assets can not be easily assigned to heritage and operating purposes.

t The cost of renovating, improving, or reconstructing operating components of heritage assets used in government operations shall be included in general PP&E. Following initial construction, any renovation, improvement or reconstruction costs to facilitate government operations (e.g., installation of communications wiring or redesign of office space) would be capitalized and depreciated over its expected

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useful life. The cost should not be depreciated over an unrealistically long life.

u Costs of renovating or reconstructing the heritage asset that can not be directly associated with operations shall be considered heritage asset costs. For example, installing a new roof should be considered a heritage asset cost.

Stewardship Land

v The Federal Government has vast holdings of land and puts land to various uses. If land is acquired for or in connection with an item of general PP&E, it shall be categorized as general PP&E. Other land (e.g., land in the public domain and national park or national forest land) shall be excluded from general PP&E and referred to as 4stewardship land.

w The acquisition cost of stewardship land shall be reported as a cost in the period incurred. Separating the cost of land acquisitions from other period expenses would facilitate analysis of the operating expense and prevent distortion due to large infrequent purchases.

DEFERRED MAINTENANCE

x The deferred maintenance standard requires disclosures related to the condition and the estimated cost to remedy deferred maintenance of PP&E. These disclosures are made as a note to a line item on the statement of net costs--no dollar amount shall be recognized on the statement.

y The standards recognize that there are many variables in estimating deferred maintenance amounts. The standards acknowledge that condition rating is a management function

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since different conditions might be considered acceptable by different entities as well as for different items of PP&E held by the same entity. In addition, management may use condition assessment surveys or life cycle cost plans to estimate the amount of deferred maintenance.

z The deferred maintenance standard applies to all PP&E whether reported on the balance sheet or through supplementary stewardship reporting.

CLEANUP COSTS

aa Cleanup costs are the costs associated with hazardous waste removal, containment, or disposal. In some instances, the Federal Government incurs liabilities [SEE NOTE 13] for cleaning up hazardous waste at sites or facilities it operates or has operated. Generally, cleanup cannot be, or is not, done until permanent or temporary closure or shutdown of sites or facilities. The Board has completed recommended accounting standards for liabilities which address liabilities for environmental cleanup resulting from an accident, natural disaster, or other one-time occurrence. Those liability standards do not address inter-period cost allocation when cleanup relates to operations that span many periods.

ab Therefore, the Board chose to provide additional guidance relative to cleanup costs in this standard. The additional standards in this statement provide for the timing of recognition of the liability and related operating expense.

ac For cleanup costs associated with general PP&E, probable [SEE NOTE 14] and measurable cleanup costs shall be allocated to operating periods benefiting from operations of the general PP&E. This

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allocation shall be based on a systematic and rational method. For example, the estimated cost could be allocated to operating periods based on the expected physical capacity of the PP&E and the amount of capacity used each period. In addition, disclosure of the total estimated cost is required.

ad For cleanup costs associated with stewardship PP&E, probable and measurable liabilities shall be recognized when the stewardship PP&E is placed in service. Simultaneous to recognizing the liability, the related expense for cleanup cost shall be recognized.

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TABLE OF CONTENTS

SECTION	PARAGRAPH
EXECUTIVE SUMMARY	a..ad
CHAPTER 1: INTRODUCTION	
PURPOSE	1..7
SCOPE	8
REPORTING OBJECTIVES	9..12
CAPITALIZATION THRESHOLDS	13
APPLICABILITY	14
MATERIALITY	15
EFFECTIVE DATE	16
CHAPTER 2: ACCOUNTING STANDARD - PROPERTY, PLANT, AND EQUIPMENT	
DEFINITIONS	17..20
CATEGORIES, RECOGNITION AND MEASUREMENT, AND DISCLOSURE REQUIREMENTS:	21..22
General PP&E	23..45
Federal Mission PP&E	46..56
Heritage Assets	57..65
Stewardship Land	66..76
CHAPTER 3: ACCOUNTING STANDARD - DEFERRED MAINTENANCE	

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_6.pdf.

DEFINITION 77..78
RECOGNITION 79
DISCLOSURE REQUIREMENTS 80..84

CHAPTER 4: ACCOUNTING STANDARD - CLEANUP COSTS

DEFINITION 85..87
SCOPE 88..93
RECOGNITION AND MEASUREMENT 94..103
IMPLEMENTATION GUIDANCE 104..106
DISCLOSURE REQUIREMENTS 107..111

APPENDIX A: BASIS FOR CONCLUSIONS 112..113

PROPERTY, PLANT, AND EQUIPMENT 114..170
DEFERRED MAINTENANCE 171..181
CLEANUP COSTS 182..199

APPENDIX B: ILLUSTRATIONS OF CATEGORIES
200..201

FEDERAL MISSION PROPERTY, PLANT, AND EQUIPMENT
202..213
HERITAGE ASSETS 214..225
LAND 226..232

APPENDIX C: DEFERRED MAINTENANCE ILLUSTRATION

233

APPENDIX D: CLEANUP COSTS ILLUSTRATION

234..240

APPENDIX E: GLOSSARY

ENDNOTES 1 THROUGH 92

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INTRODUCTION

PURPOSE

1 The purpose of this statement is to provide accounting standards for Federally owned

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property, plant, and equipment (PP&E); deferred maintenance; and cleanup costs. This introduction provides information on:

- the scope of the standards,
- consideration of reporting objectives,
- applicability of the standards,
- capitalization threshold,
- materiality, and
- effective date.

2 Chapters 2, 3, and 4 present the accounting standards for PP&E, deferred maintenance, and cleanup costs respectively.

3 Appendix A presents the Basis for Conclusions. This appendix provides the Board's rationale for the decisions made and responds to the major issues raised in comment letters.

4 Appendix B presents illustrations to aid in categorizing PP&E.

5 Appendix C provides an example of a deferred maintenance disclosure.

6 Appendix D illustrates cleanup cost accounting.

7 Appendix E is a glossary of terms used in this statement.

SCOPE

8 This statement identifies and defines categories of PP&E and addresses recognition and measurement of, and disclosure requirements associated with property, plant, and equipment (as well as land), including accounting for deferred maintenance and cleanup costs. This statement does not address natural resources. However, the Board is undertaking a project to address accounting for natural resources.

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REPORTING OBJECTIVES

9 In drafting accounting standards for PP&E, the Board relied on its Statement of Federal Financial Accounting Concepts Number 1, Objectives of Federal Financial Reporting. Ultimately, all accounting standards taken as a whole will help meet the four reporting objectives expressed in the Objectives statement: budgetary integrity, operating performance, stewardship, and systems and control. The focus of these standards is on the two reporting objectives most relevant to PP&E--operating performance and stewardship. These objectives and how they could be met through PP&E accounting are discussed under the headings (1) operating performance, and (2) stewardship.

OPERATING PERFORMANCE

10 The Board believes that it can contribute to meeting the operating performance objective [SEE NOTE 15] by measuring the cost associated with using property, plant, and equipment and including that cost in entity operating results. The Board first sought to identify PP&E costs that would be appropriate to include in operating expense. Then, from consideration of cost information required, the Board determined what balance sheet information would have to be reported.

11 To meet the operating performance objective, the Board seeks to provide accounting standards that will result in:

- relevant and reliable cost information for decision-making by internal users (e.g., program managers, budget examiners and officials),
- comprehensive, comparable cost information for decision-making and program evaluation

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by Congress and the public, and
- information to help assess the efficiency and effectiveness of asset management (e.g., condition of assets including deferred maintenance).

STEWARDSHIP

12 The Board believes that Federal financial reporting can fulfill the stewardship objective [SEE NOTE 16] if the Board provides standards that will result in reporting information on:

- asset condition;
- changes in the amount and service potential of property, plant, and equipment;
- cost of property, plant, and equipment where applicable; and
- spending for acquisition of property, plant, and equipment versus non-capital spending.

CAPITALIZATION THRESHOLDS

13 The Board believes that capitalization thresholds should be established by Federal entities rather than centrally by the Board. Because Federal entities are diverse in size and in uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds. Once established, this threshold(s) should be consistently followed and disclosed in the financial reports.

APPLICABILITY

14 For guidance on the general applicability of this standard and all other Federal financial accounting standards please refer

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to Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

MATERIALITY

15 The provisions of this statement need not be applied to immaterial items.

EFFECTIVE DATE

16 The Board recommends that the accounting standards presented in this proposed statement become effective for periods beginning after September 30, 1997. Earlier implementation is encouraged. In addition, under early implementation individual provisions of the accounting standards may be implemented before other provisions. For example, provisions for stewardship PP&E may be implemented before provisions for general PP&E.

****

CHAPTER 2 -- ACCOUNTING STANDARD
PROPERTY, PLANT, AND EQUIPMENT

DEFINITIONS

17 Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives [SEE NOTE 17] of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and
- they have been acquired or constructed with the intention of being used, or being available for use by the entity.

18 Property, plant, and equipment also includes:

- assets acquired through capital leases

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(See paragraph 20), including leasehold improvements;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights. [SEE NOTE 18]

19 Property, plant, and equipment excludes items (1) held in anticipation of physical consumption such as operating materials and supplies [SEE NOTE 19] and (2) the Federal entity has a reversionary interest in. [SEE NOTE 20]

20 Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [SEE NOTE 21] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease. [SEE NOTE 22]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [SEE NOTE 23] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [SEE NOTE 24] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

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STANDARDS AND CATEGORIES

21 The following paragraphs provide recognition and measurement principles, and disclosure requirements for each category of PP&E. The categories identified are:

- general PP&E (including land acquired for or in connection with other general PP&E),
- Federal mission PP&E,
- heritage assets, and
- stewardship land (i.e., land not included in general PP&E).

22 In determining which category PP&E should be placed in, it will be necessary to identify the "base unit" [SEE NOTE 25] of PP&E against which the category definitions will be applied. For example, units as large as entire facilities or as small as computers could be categorized. In determining the level at which categorization takes place, an entity should consider the cost of maintaining different accounting methods for property and the usefulness of the information, the diversity in the PP&E to be categorized (e.g., useful lives, value, alternative uses), the programs being served by the PP&E, and future disposition of the PP&E (e.g., transferred to other entities or scrapped). [SEE NOTE 26]

GENERAL PROPERTY, PLANT, AND EQUIPMENT

23 General property, plant, and equipment is any property, plant, and equipment used in providing goods or services. General PP&E typically has one or more of the following characteristics:

- it could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or

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services, or to support the mission of the entity, or
- it is used in business-type activities, [SEE NOTE 27] or
- it is used by entities in activities whose costs can be compared [SEE NOTE 28] to those of other entities performing similar activities (e.g., Federal hospital services in comparison to other hospitals).

24 For entities operating as business-type activities, all PP&E shall be categorized as general PP&E whether or not it meets the definition of any other PP&E categories.

25 Land and land rights acquired for or in connection with other general PP&E [SEE NOTE 29] shall be included in general PP&E. In some instance, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.

Asset Recognition

26 All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other

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outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid. [SEE NOTE 30]

27 Internally-developed [SEE NOTE 31] software may be included in general PP&E (or other asset accounts [SEE NOTE 32]) if its cost is intended primarily to be recovered through charges to users. [SEE NOTE 33] Other internally-developed software costs shall be expensed when incurred.

28 If an entity elects to capitalize internally-developed software costs under the circumstances described in the preceding paragraph, costs that may be capitalized are limited to:

- those clearly identifiable with major new software projects and distinguishable from recurring maintenance-type activities;
- costs incurred after technological feasibility [SEE NOTE 34] has been established; and
- direct costs of developing the software, initial training material, and documentation manuals incurred after technological feasibility has been established (e.g., salaries of programmers, systems analysts, project

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management, and administrative personnel directly involved in the planning, designing, coding, or testing; associated employee benefits, outside consultants fees, and supplies).

The amortization or depreciation of these costs shall not exceed five years.

29 The cost of general PP&E acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [SEE NOTE 35] unless the net present value exceeds the fair value of the asset).

30 The cost of general PP&E acquired through donation, devise, [SEE NOTE 36] or judicial process excluding forfeiture (See paragraph 33) shall be estimated fair value at the time acquired by the government.

31 The cost of general PP&E transferred from other Federal entities shall be the cost recorded by the transferring entity for the PP&E net of accumulated depreciation or amortization. If the receiving entity cannot reasonably ascertain those amounts, the cost of the PP&E shall be its fair value at the time transferred.

32 The cost of general PP&E acquired through exchange [SEE NOTE 37] shall be the fair value of the PP&E surrendered at the time of exchange. [SEE NOTE 38] If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost shall be the fair value of PP&E acquired. If neither fair value is determinable the cost of the PP&E acquired shall be the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. Any difference between the net recorded amount of the PP&E

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surrendered and the cost of the PP&E acquired shall be recognized as a gain or loss. In the event that cash consideration is included in the exchange, the cost of general PP&E acquired shall be increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received.

33 The cost of general PP&E acquired through forfeiture shall be determined in accordance with Statement of Federal Financial Accounting Standards No. 3, Accounting for Inventory and Related Property (SFFAS 3). [SEE NOTE 39] Amounts recorded for forfeited assets based on SFFAS 3 shall be recognized as the cost of general PP&E when placed into official use.

34 PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. [SEE NOTE 40] In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

Expense Recognition

35 Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E [SEE NOTE 41], except land and land rights of unlimited duration. [SEE NOTE 42]

- Estimates of useful life of general PP&E must consider factors such as physical wear and tear and technological change (e.g., obsolescence).
- Various methods can be used to compute periodic depreciation expense so long as

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the method is systematic, rational, and best reflects the use of the PP&E.

- Any changes in estimated useful life or salvage/residual value shall be treated prospectively. The change shall be accounted for in the period of the change and future periods. No adjustments shall be made to previously recorded depreciation or amortization.

36 Depreciation expense shall be accumulated in a contra asset [SEE NOTE 43] account--accumulated depreciation. Amortization expense shall be accumulated in a contra asset account--accumulated amortization.

37 Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E.

38 In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized [SEE NOTE 44] shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

39 General PP&E shall be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess. It shall be recorded in an appropriate asset account at its expected net realizable value. Any difference in the book value of the PP&E and

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its expected net realizable value shall be recognized as a gain or a loss in the period of adjustment. The expected net realizable value shall be adjusted at the end of each accounting period and any further adjustments in value recognized as a gain or a loss. However, no additional depreciation/amortization shall be taken once such assets are removed from general PP&E in anticipation of disposal, retirement, or removal from service.

Implementation Guidance

40 For existing general PP&E, if historical cost information necessary to comply with the above recognition and measurement provisions has not been maintained, estimates are required. Estimates shall be based on:

- cost of similar assets at the time of acquisition, or
- current cost of similar assets discounted for inflation since the time of acquisition (i.e., deflating current costs to costs at the time of acquisition by general price index).

41 Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost [SEE NOTE 45] and depreciation/amortization charged over the remaining life based on that net remaining cost.

42 For general PP&E that would be substantially depreciated/amortized had it been recorded upon acquisition based on these standards, materiality and cost-benefit should be weighed heavily in determining estimates. Consideration should be given to:

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- recording only improvements made during the period beyond the initial expected useful life of general PP&E, and
- making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building by building estimate).

43 In recording existing general PP&E, the difference in amounts added to asset and contra asset accounts shall be credited (or charged) to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. For published financial statements presenting prior year information, no prior year amounts shall be restated.

44 In the period that these standards are implemented, disclosure of the adjustments, by major class [SEE NOTE 46] of PP&E, made to general PP&E and accumulated depreciation/amortization is required.

Disclosure Requirements

45 The following are minimum general PP&E disclosure requirements:

- the cost, associated accumulated depreciation, and book value by major class;
- the estimated useful lives for each major class;
- the method(s) of depreciation for each major class;
- capitalization threshold(s) including any changes in threshold(s) during the period; and
- restrictions on the use or convertability of general PP&E.

FEDERAL MISSION PROPERTY,

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PLANT, AND EQUIPMENT

46 Federal mission PP&E includes certain items used to meet a Federal Government mission in which the specific PP&E used is an integral part of the output of the mission. [SEE NOTE 47] PP&E should be considered Federal mission PP&E if it possesses at least one of each of the two types of characteristics presented below. One type of characteristic relates to the use of Federal mission PP&E and the other relates to its useful life.

47 Characteristics related to the use of the Federal mission PP&E are that it:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war or natural disaster; or
- is specifically designed for use in a program for which there is no other program or entity (Federal or non-Federal) using similar PP&E with which to compare costs.

48 Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life [SEE NOTE 48] due to the unusual manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or premature obsolescence.

WP Federal mission PP&E specifically includes (1) weapons systems PP&E (e.g., fighter/attack aircraft, submarines, and tracked combat vehicles) and (2) space exploration equipment (e.g., space hardware and launch, tracking, and recovery facilities) which will be defined in paragraphs 50 and 52. Federal mission PP&E excludes land.

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50 "Weapons systems" are a combination of one or more weapons [SEE NOTE 49] with all related equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency. [SEE NOTE 50] This standard addresses only the PP&E component of weapons systems. PP&E included in weapons systems are distinguished from general property, plant, and equipment held by defense agencies and defense support agencies in that they are intended to be used directly by the armed forces to carry out combat missions, when necessary, and to train in peacetime.

51 Weapons systems include only those assets owned by defense agencies and defense-support agencies that would otherwise meet the PP&E definition. Items meeting other than the PP&E asset category definitions (such as items of inventory or operating materials and supplies) are excluded from Federal mission PP&E.

52 "Space exploration equipment" includes items that are:

- intended to operate above the atmosphere for space exploration purposes, and
- any specially designed equipment to aid, service, or operate other equipment engaged in the exploration of space.

Recognition and Measurement

53 The periodic cost of acquiring, constructing, improving, reconstructing, or renovating Federal mission PP&E shall be recognized as a cost on the statement of net cost when incurred. The cost shall be disclosed [SEE NOTE 51] as "cost of Federal mission PP&E." The cost shall include all costs incurred to bring the PP&E to its current condition and location (See paragraph

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26 for examples of the costs to be considered).

54 Additional reporting requirements for stewardship reporting will be developed in a separate standard.

Implementation Guidance

55 Federal mission PP&E previously recognized as assets and contra-assets for balance sheet reporting shall be removed. The amounts removed shall be charged to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. The amounts removed from the balance sheet shall be disclosed in a footnote.

56 For published financial statements presenting prior year information, no prior year amounts shall be restated.

HERITAGE ASSETS

57 Heritage assets are property, plant, and equipment that are unique for one or more of the following reasons:

- historical or natural significance;
- cultural, educational or artistic (e.g., aesthetic) importance; or
- significant architectural characteristics.

58 Heritage assets are generally expected to be preserved indefinitely. One example of evidence that a particular asset is heritage in nature is that it is listed on the National Register of Historic Places.

59 Heritage assets may in some cases be used in general government operations (e.g., office buildings such as the main Treasury building). These assets are referred to as

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multi-use heritage assets. The costs to maintain these assets serve two purposes--they preserve the heritage features and permit continued use of the asset for government operations. Costs of renovation, improvement, restoration, or reconstruction that can be directly related to government operations (e.g., modification or improvement of office space, upgrading of electrical or communications equipment/wiring) shall be treated as general PP&E and depreciated over the period of time they are expected to provide service or produce benefits.

60 Cost to renovate, restore, or reconstruct the heritage asset itself shall be excluded from general PP&E (i.e., not capitalized).

Recognition and Measurement

61 The cost of improving, reconstructing, or renovating heritage assets (excluding any costs designated as general PP&E) shall be recognized as a cost in the period incurred. Also, in the event that heritage assets are acquired or constructed, the cost shall be recognized as a cost of the period incurred. These costs shall be disclosed [SEE NOTE 52] as "Cost of Heritage Assets." The cost shall include all costs incurred to bring the PP&E to its current condition and location (See paragraph 26 for examples of the costs to be considered).

- The cost of heritage assets transferred from other Federal entities shall be the book value of the asset recorded on the transferring entity's books. If the receiving entity does not know the book value, the fair value shall be disclosed in notes to the statement of net cost. If fair value is not estimable, information related to the type and quantity of assets transferred shall be disclosed.
- No amounts for heritage assets acquired

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through donation, or devise [SEE NOTE 53] shall be recognized in the cost of heritage assets. [SEE NOTE 54] The assets' fair value, if known and material, shall be disclosed in notes to the statement of net cost in the year received. If fair value is not known or reasonably estimable, information related to the type and quantity of assets received shall be disclosed.

62 Additional reporting requirements will be developed for stewardship report items in a separate standard.

Implementation Guidance

63 Heritage assets previously recognized as assets for balance sheet reporting shall be removed. The amounts removed shall be charged to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. The amounts removed from the balance sheet shall be disclosed in a footnote.

64 If records are not available to determine which costs are associated with heritage assets and which are general PP&E, the entity may estimate the cost of heritage assets by classes of PP&E (e.g., entire facilities rather than a building by building estimate).

65 For published financial statements presenting prior year information, no prior year amounts shall be restated.

STEWARDSHIP LAND

66 Land is defined as the solid part of the surface of the earth.

67 Excluded from the definition of land are

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materials beneath the surface (i.e., depletable resources such as mineral deposits and petroleum), the space above the surface (i.e., renewable resources such as timber), and the outer-continental shelf resources. The materials excluded from the definition of land will be addressed in a separate accounting and reporting standard related to them.

68 Land and land rights owned by the Federal Government and not acquired for or in connection with other general PP&E [SEE NOTE 55] will be referred to as stewardship land and will not be reported on the balance sheet. Examples of land not associated with other items of general PP&E include land used as forests and parks and land used for wildlife and grazing. General PP&E may be built on existing Federal lands. In this case, the cost of the land would often not be identifiable. In these instances, general PP&E shall include only land or land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.

Recognition and Measurement

69 The acquisition cost of stewardship land shall be recognized as a cost in the period incurred. The cost shall be disclosed [SEE NOTE 56] as "cost of stewardship land." The cost shall include all costs incurred to bring the PP&E to its current condition and location (See paragraph 26 for examples of the costs to be considered).

70 In some cases, land may be acquired along with existing structures. The following treatments may apply:

- if the structure is significant in and of itself, the entity shall use its judgment as to whether the acquisition cost shall

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be treated as the cost of stewardship land, heritage asset, or both;

- if the structure is to be used in operations (e.g., as general PP&E) but (1) the value of the structure is insignificant as compared to the value of the land, (2) it has little or no inherent value, and/or (3) it is merely a byproduct of the acquisition of the land, the cost shall be treated as an acquisition of stewardship land in its entirety; or
- only significant structures which have a significant operating use (e.g., a recently constructed hotel or employee housing block) shall be treated as general PP&E by identifying the cost attributable general PP&E and segregating it from the cost of the stewardship land acquired.

71 However, no amounts for stewardship land acquired through donation or devise [SEE NOTE 57] shall be recognized as a cost on the statement of net cost. Its fair value, if known and material, shall be disclosed in notes to the statement of net cost. If fair value is not estimable, information related to the type and quantity of assets received shall be disclosed in the year received.

72 Land may be transferred between Federal entities. In some cases, land included in general PP&E may be transferred to an entity for use as stewardship land. In this instance, the cost of stewardship land transferred from another Federal entity shall be the book value of the land recorded on the transferring entity's books. If the receiving entity does not know the book value, the transfer shall be disclosed in notes if material. In other cases, stewardship land may be transferred between Federal entities. Transfers of stewardship land shall be disclosed in the notes if material.

73 Any costs to prepare stewardship land for its intended use (e. g., razing a building)

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shall be expensed as a part of the cost of stewardship land.

74 Additional reporting requirements will be developed for stewardship report items in a separate standard.

Implementation Guidance

75 Land previously recognized as assets for balance sheet reporting shall be removed. The amounts removed shall be charged to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. The amounts removed from the balance sheet shall be disclosed in a footnote.

76 For published financial statements presenting prior year information, no prior year amounts shall be restated.

The provisions of this statement need not be applied to immaterial items.**********
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CHAPTER 3 -- ACCOUNTING STANDARDS: DEFERRED MAINTENANCE

DEFINITION

77 "Deferred maintenance" is maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period.

78 For purposes of this standard, maintenance is described as the act of keeping fixed assets in acceptable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its

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expected life. [SEE NOTE 58] Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.

RECOGNITION

79 A line item for "deferred maintenance amounts" [SEE NOTE 59] shall be presented on the statement of net cost with a note reference in lieu of a dollar amount. [SEE NOTE 60] No amounts shall be recognized for deferred maintenance.

DISCLOSURE REQUIREMENTS

MEASUREMENT

80 Amounts disclosed for deferred maintenance may be measured using:

- condition assessment surveys, or
- life-cycle cost forecasts. [SEE NOTE 61]

81 Condition assessment surveys are periodic inspections of PP&E to determine their current condition and estimated cost to correct any deficiencies. It is desirable that condition assessment surveys be based on generally accepted methods and standards consistently applied. [SEE NOTE 62]

82 Life-cycle costing is an acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in a forecast of maintenance expense, these forecasts may serve as a basis against which to compare actual maintenance expense and estimate deferred maintenance.

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DISCLOSURES

83 At a minimum, the following information shall be presented for all PP&E (each of the four categories established in the PP&E standard should be included).

- Identification of each major class [SEE NOTE 63] of asset for which maintenance has been deferred.

- Method of measuring deferred maintenance for each major class of PP&E.

- If the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E:
  * description of requirements or standards for acceptable operating condition,
  * any changes in the condition requirements or standards, and
  * asset condition [SEE NOTE 64] and a range estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition.

- If the total life-cycle cost method is used the following should be presented for each major class of PP&E:
  * the original date of the maintenance forecast and an explanation for any changes to the forecast,
  * prior year balance of the cumulative deferred maintenance amount,
  * the dollar amount of maintenance that was defined by the professionals who designed, built or manage the PP&E as required maintenance for the reporting period,
  * the dollar amount of maintenance actually performed during the period,
  * the difference between the forecast and actual maintenance,
  * any adjustments to the scheduled

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amounts deemed necessary by the managers of the PP&E, [SEE NOTE 65] and

* the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance.

OPTIONAL DISCLOSURES

84 Stratification between critical and noncritical amounts of maintenance needed to return each major class of asset to its acceptable operating condition. If management elects to disclose critical and noncritical amounts, the disclosure shall include management's definition of these categories.

The provisions of this statement need not be applied to immaterial items.

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CHAPTER 4 -- ACCOUNTING STANDARDS: CLEANUP COSTS

DEFINITION

85 Cleanup costs are the costs of removing, containing, and/or disposing of (1) hazardous waste (See paragraph 86) from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E.

86 Hazardous waste is a solid, liquid, or gaseous waste, or combination of these wastes, which because of its quantity, concentration, or physical, chemical, or infectious characteristics may cause or significantly contribute to an increase in mortality or an increase in serious irreversible, or incapacitating reversible,

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illness or pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, disposed of, or otherwise managed.

87 Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and postclosure costs.

SCOPE

88 This standard applies only to cleanup costs from Federal operations known to result in hazardous waste which the Federal Government is required by Federal, state and/or local statutes and/or regulations that have been approved as of the balance sheet date, regardless of the effective date, to cleanup (i.e., remove, contain or dispose of). [SEE NOTE 66] These cleanup costs meet the definition of liability provided in Statement of Recommended Accounting Standards no. 5, Accounting for Liabilities of the Federal Government (SRAS no. 5).

89 However, due to the nature of the liability and the timing associated with cleanup costs, additional guidance is provided in this standard on the recognition of cleanup costs over the life of the related PP&E. Guidance is required since cleanup can not occur until the end of the useful life of the PP&E or at regular intervals during that life.

90 This standard is intended to supplement the accounting requirements for liabilities in SRAS no. 5. SRAS no. 5 defines liabilities as a "probable future outflow or other sacrifice of resources as a result of past transactions or events." Further, SRAS no. 5 requires recognition of liabilities that are probable and measurable. Measurable means that an item has a relevant attribute that can be

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quantified in monetary units with sufficient reliability to be reasonably estimable.

91 The recognition and measurement standards provided in this standard are subject to the criteria for recognition of liabilities included in SRAS no. 5. That is, liabilities shall be recognized when three conditions are met:

- a past transaction or event has occurred,
- a future outflow or other sacrifice of resources is probable, [SEE NOTE 67] and
- the future outflow or sacrifice of resources is measurable. [SEE NOTE 68]

92 SRAS no. 5 also provides for disclosure of liabilities that do not meet all of the above criteria; these standards apply to cleanup costs as well.

93 Other cleanup costs, such as those resulting from accidents or where cleanup is an ongoing part of operations, are to be accounted for in accordance with liability standards and are not subject to the recognition guidance provided in this standard. This guidance does not apply to these other types of cleanup since the cleanup effort is not deferred until operation of associated PP&E ceases either permanently or temporarily. [SEE NOTE 69]

RECOGNITION AND MEASUREMENT

ESTIMATION METHODS

94 Cleanup costs, as defined above, shall be estimated when the associated PP&E is placed in service . The estimate shall be referred to as the "estimated total cleanup cost." There are two approaches to recognizing this total--one applies to general PP&E and another to stewardship PP&E.

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95 The estimate shall contemplate:

- the cleanup plan, including
  * level of restoration to be performed,
  * current legal or regulatory requirements, [SEE NOTE 70] and
  * current technology; and

- current cost which is the amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current period.

96 Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

CLEANUP COST FOR GENERAL PP&E

97 A portion of estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E (e.g., expected usable landfill area) whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as the basis for systematic and rational recognition of expense and accumulation of the liability.

98 Recognition of the expense and accumulation of the liability shall begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation.

99 As reestimates (See paragraph 96) are made,

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the cumulative effect of changes in total estimated cleanup costs related to current and past operations shall be recognized as expense and the liability adjusted in the period of the change in estimate.

100 As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

CLEANUP COST FOR STEWARDSHIP PP&E

101 Consistent with the treatment of the acquisition cost of stewardship PP&E (i.e., expensing in the period placed in service), the total estimated cleanup cost shall be recognized as expense in the period that the stewardship asset is placed in service and a liability established.

102 The liability shall be adjusted when the estimated total cleanup costs are reestimated as described in paragraph 96. Adjustments to the liability shall be recognized in expense as "changes in estimated cleanup costs from prior periods."

103 As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

IMPLEMENTATION GUIDANCE

104 Two implementation approaches have been provided for liabilities related to general PP&E in service at the effective date of this standard:

- A liability shall be recognized for the portion of the estimated total cleanup

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cost that is attributable to that portion of the physical capacity used or that portion of the estimated useful life that has passed since the PP&E was placed in service. The remaining cost shall be allocated as provided in paragraphs 97 through 99.

- If costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total cleanup cost as a liability upon implementation. In addition, in periods following the implementation period, any changes in the estimated total cleanup cost shall be expensed when reestimates occur and the liability balance adjusted. The provisions for cost allocation provided in paragraphs 97 through 99 shall not apply under this implementation method.

105 The offsetting charge for any liability recognized upon implementation shall be made to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in any statement of changes in net position that may be required. No amounts shall be recognized as expense in the period of implementation. The amounts involved shall be disclosed and to the extent possible the amount associated with current and prior periods should be noted.

106 For stewardship PP&E that are in service at the effective date of this standard, the liability for cleanup costs shall be recognized and an adjustment made to the Net Position of the entity.The amount of the adjustment shall be shown as a "prior period adjustment" in any statement of changes in net position that may be required. The amounts involved shall be disclosed.

DISCLOSURE REQUIREMENTS

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107 The sources (applicable laws and regulations) of cleanup requirements.

108 The method for assigning estimated total cleanup costs to current operating periods (e.g., physical capacity versus passage of time).

109 For cleanup cost associated with general PP&E, the unrecognized portion of estimated total cleanup costs (e.g., the estimated total cleanup costs less the cumulative amounts charged to expense at the balance sheet date).

110 Material changes in total estimated cleanup costs due to changes in laws, technology, or plans shall be disclosed. In addition, the portion of the change in estimate that relates to prior period operations shall be disclosed.

111 The nature of estimates and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.

The provisions of this statement need not be applied to immaterial items.

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APPENDIX A -- BASIS FOR THE BOARD'S CONCLUSIONS

112 This appendix summarizes significant considerations by the Board in reaching the conclusions in this statement. In the following paragraphs, the Board's considerations in developing these standards as well as positions on specific issues raised in alternative views, comment letters, and during public hearings are explained. The Board relied extensively on input from a task

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force on Capital Expenditures as well as a small working subgroup on Physical Property. These paragraphs include reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

113 This appendix addresses each of the three standards in sequence.

PROPERTY, PLANT, AND EQUIPMENT

BACKGROUND

114 Before addressing specific issues resolved following issuance of the exposure draft, this section provides a broad basis for the main provisions of the standard on investments in PP&E. The Federal Government makes many expenditures that can be characterized as investments or investment-type expenditures. These include expenditures for Federally owned PP&E.

115 Accounting for expenditures for PP&E as well as for the existing stock of PP&E is a significant undertaking because the Federal Government owns substantial amounts of diverse PP&E. Federal PP&E includes approximately 650 million acres of land, buildings containing over 1.5 billion square feet of floor space, many different forms of equipment, and military hardware.

116 These are used for a wide range of purposes; including, among others, operating, defense, conservation, and heritage purposes. Some of these purposes relate to the Federal Government's responsibility to provide for the Nation's common defense and general welfare. Specific types of PP&E are used by the Federal Government to meet this responsibility. Other types of PP&E are held and used for operating purposes that are not

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unlike those of non-federal entities.

117 Some Federal operations are similar to profit-seeking enterprises and can be described as business-type activities. However, these business-type activities account for a small portion of the investment in PP&E. The majority of the investment in PP&E is used to provide government services and goods where user charges are not the primary source of revenues.

118 The Board found that a single accounting method for such diverse Federal PP&E would not meet the objectives established in its Objectives of Federal Financial Reporting.Therefore, the Board identified categories of PP&E and set different accounting methods for each category.

Categories Required

119 The PP&E standards incorporate the following categories:

- general PP&E are PP&E used to provide general government services;
- Federal mission PP&E are PP&E that are an integral part of the output of certain unique Federal Government missions;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land [SEE NOTE 71] is land other than that included in general PP&E.

120 The latter three categories of assets are referred to as stewardship PP&E. The term "stewardship PP&E" is used simply to refer to those categories of PP&E to be reported on a stewardship report.

General PP&E

121 General PP&E are items used to provide

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general government services; including PP&E that:

- could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or services, or to support the mission of the entity, or
- is used in business-type activities, or
- is used by entities whose costs can be compared to other entities (e.g., Federal hospital services in comparison to other hospitals).

122 Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. The Board's concepts statement, Objectives of Federal Financial Reporting, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information.

Stewardship PP&E

123 For stewardship PP&E, [SEE NOTE 72] the predominant reporting objective is stewardship. This is in contrast to general PP&E, for which the Board is concerned with providing information to assess operating performance and, therefore, provided for depreciation accounting. The most relevant information is about the existence of stewardship PP&E and that information can be provided through a new type of reporting--supplementary stewardship reporting.

124 For stewardship PP&E, the Board believes that allocation of historical cost to

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operating expense for each period would not contribute to the measurement of entity operating performance. Prior to issuing its Objectives statement, the Board conducted a user needs study and met with representatives of a wide variety of user groups. Most users specifically indicated that depreciating stewardship PP&E such as weapons systems would not provide meaningful information for assessing the entity's operating performance. The Board believes that its standards should address the needs of users and the Board has found that users do not need information which includes depreciation expense on this category of PP&E.

125 The Board noted in its Objectives statement that the government's responsibility for the nation's common defense and general welfare is unique and that, in some cases, the most relevant measures of performance are nonfinancial. [SEE NOTE 73] Despite the preference for nonfinancial performance measures for stewardship PP&E, the government must demonstrate that it is being an appropriate "steward" for these assets. To meet the stewardship objective, the government must be able to answer basic questions such as:

- What and where are the important assets?
- Is the government effectively managing and safeguarding its assets?

126 Answers to these questions can be provided through supplementary stewardship reporting. The stewardship information provided would not necessarily have the same measurement basis as information shown on the balance sheet. Information could include value, quantity, and capacity depending on the category being reported on. These types of information are not typically found in balance sheet reporting. (Also, see discussion of deferred maintenance starting at paragraph 171, 181 regarding other

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information that users consider relevant.)

127 The Board is addressing supplementary stewardship reporting in another standard. The information to be provided for stewardship PP&E is proposed in detail in that standard. Each of the stewardship PP&E categories are discussed further in the following paragraphs.

Federal Mission PP&E

128 Federal mission PP&E are specific PP&E acquired to provide a unique good or service for which there is not necessarily a periodic output against which to match costs. For example, the existence of and readiness of weapons systems supports national defense regardless of their actual combat use on a period by period basis. Also, space exploration equipment is used in long-term research efforts which may or may not produce an output each period but which nevertheless benefits the nation in the long run.

129 The standard specifically identifies weapons systems and space exploration equipment as Federal mission PP&E as well as providing a list of characteristics of Federal mission PP&E. The Board articulated characteristics of Federal mission PP&E because it recognizes that there are other types of PP&E, or PP&E may be developed in the future, that are similar to these two items. To be categorized as Federal mission PP&E an item shall meet at least one characteristic from each of the following two types of characteristics.

130 Characteristics related to the use of Federal mission PP&E are that it:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war or natural disaster; or

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- is specifically designed for use in a program for which there is no other program or entity (Federal or non-Federal) using similar PP&E with which to compare costs.

131 Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life [SEE NOTE 74] due to the manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or of premature obsolescence.

132 The cost of Federal mission PP&E acquired during the period be shown on the operating statement.

Heritage assets

133 Heritage assets are held for their cultural, architectural, or aesthetic characteristics. Users have identified nonfinancial information as being relevant for these assets. For assessing operating performance, the Board believes that relevant cost information is provided through reporting of periodic maintenance cost since heritage assets are intended to be preserved as national treasures. It is anticipated that they will be maintained in reasonable repair and that there will be no diminution in their usefulness over time.

134 In addition to assets held purely for heritage purposes (e.g., the Washington Monument), the Federal Government uses heritage assets in its day-to-day operations. For example, many Federal office buildings, such as the Old Executive Office Building, have monumental characteristics. The Board considered whether these multi-use heritage assets would be more appropriately categorized as general PP&E.

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135 Despite their heritage characteristics, these assets serve a function that could otherwise be served by assets that do not possess heritage characteristics. Therefore, the standards provide that costs of reconstruction, renovation, or improvements that are directly associated with supporting operations be treated in a manner consistent with general PP&E. The Board based this decision on the need to measure cost for operations and to compare cost between entities.

Stewardship Land

136 The Federal Government owns vast amounts of land and its use of land is diverse. In some instances Federal land is integral to the ownership of general PP&E. For example, the cost of land upon which an office building is sited is integral to the cost of that building. Land acquired for or in connection with general PP&E will be recognized on the balance sheet to provide a more comprehensive measure of the assets devoted to general government operations. However, since land is not a depreciating asset, depreciation expense will not be recognized on land included in general PP&E.

137 Most Federal land is not directly related to general PP&E. For example, the national parks and forests are not used to support general PP&E. The Board concluded that land other than that acquired for or in connection with other general PP&E should not be reported on the balance sheet. This is consistent with the Board's treatment of heritage assets in that much of the government's land is held for the general welfare of the nation and is intended to be preserved and protected.

ISSUES

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138 Following issuance of the ED, the Board specifically considered several issues related to the PP&E standard. These issues are addressed in the sequence that they appear in the standard.

Definitions

139 The Board asked respondents to comment on the appropriateness of the definitions of PP&E, general PP&E, Federal mission PP&E, heritage assets, and stewardship land. Respondents raised issues on the overall definition of PP&E including (1) internally-developed software, (2) land rights, (3) capitalization threshold, and (4) reversionary interests in property. These four issues are discussed below. An issue raised regarding the Federal mission PP&E definition is also addressed below.

Internally-developed Software

140 The ED proposed that internally-developed software be excluded from PP&E -- in effect, that it be expensed when incurred. In making this proposal, the Board pointed to concerns affecting the objectivity/accuracy of any capitalized cost for internally-developed software in general PP&E. [SEE NOTE 75] The Board was concerned that costs could be overcapitalized thus understating expense for the period and that it would be difficult to provide for the removal or write-off of costs related to unsuccessful projects and/or cost overruns. Given these practical concerns and the expectation that costs for software development efforts would not fluctuate dramatically since they related to continuous agency efforts, the Board proposed that these costs be expensed. [SEE NOTE 76]

141 Many respondents supported the Board's view. They noted that, among other problems,

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it would be difficult to distinguish new development efforts from ongoing system maintenance. In fact, some respondents commented that software undergoes continuous improvement and updating.

142 On the other hand, the majority of respondents objected to the exclusion of these costs from PP&E. Many argued that internally-developed software met the overall definition of PP&E and that accounting could accommodate the problems of cost overruns and unsuccessful efforts. Many suggested that costs be held in a work-in-process account and any unsuccessful efforts subsequently written off in the period deemed unsuccessful. In addition, many believed that cost overruns were appropriate to include in the cost of the asset.

143 Ultimately, the Board made two changes to the PP&E definitions -- they removed the statement excluding internally-developed software from PP&E and they added a provision for recognition of internally-developed software as a component of general PP&E under certain circumstances. Since the Board's concern was with the potential for overcapitalization of these costs, they found that it was not necessary to exclude the costs from the PP&E categories for which costs would not be capitalized. Therefore, any internally-developed software costs appropriately classified as an item of stewardship PP&E may be included in those categories.

144 For internally-developed software costs that would be categorized as general PP&E, the Board placed several restrictions on the capitalization of costs. To be capitalized, it must be intended that the costs be recovered through charges to users. In addition, only certain costs may be capitalized after it has been established that the software project is likely to be

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successful. Once capitalized, the costs can not be amortized over a period longer than five years.

145 In addition to internally-developed software, the Board discussed accounting for contractor-developed software. In principle, the Board's consensus was that the same accounting should be provided for contractor-developed software as for internally-developed software. However, the Board believed that this proposal should be exposed for comment prior to establishing a standard to that effect. Therefore, the standards do not provide specific provisions restricting the capitalization of contractor-developed software.

Land Rights

146 The Board received a request to address restrictive easements acquired by a Federal agency. This agency acquires restrictive easements limiting the use of land adjoining the agency's own property. The Board considers these easements a "land right." Land rights are interests and privileges held by an entity in land owned by others.

147 The Board provided for the recognition of land rights as part of PP&E since they are generally associated with other items of PP&E actually owned by the entity. In addition, where land rights are for a limited period of time and are includable in the general PP&E category, the Board provided for depreciation of the cost.

Capitalization Threshold

148 Many respondents requested that the Board provide a capitalization threshold as an element of the PP&E definition. The Board addressed this issue in developing the ED. At that time, the Board carefully considered whether to take a prescriptive approach by

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setting a threshold or to permit entities the latitude to establish a threshold suited to their particular operating environment. The Board believes that Federal entities are sufficiently diverse that one threshold would not be suitable for all entities. For example, Title 2's $5,000 threshold would be immaterial for defense department operations but perhaps not for a smaller entity such as the Small Business Administration.

149 Instead of setting a specific threshold, the Board has adopted a materiality approach--just as is done in private sector accounting. Each entity would establish its own threshold as well as guidance on applying the threshold to bulk purchases. The Board believes that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

Reversionary Interests in PP&E

150 The Board also received a request to address reversionary interests in PP&E. In some instances, the Federal Government provides grants to state and local governments for the acquisition of PP&E. If the state or local government eventually decides that it no longer needs to use the PP&E for the purpose specified in the original grant there is often a provision that the PP&E must revert to Federal ownership. In these cases, the Federal Government maintains a reversionary interest in PP&E. In essence, these are contingent assets and should not be recognized on the balance sheet. The Board elected to specifically exclude these items from PP&E.

Federal Mission PP&E

151 Some respondents indicated that the term "Federal mission PP&E" had broader

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implications than intended by its definition. It was suggested that some may assume any PP&E used to meet an agency's mission would fit this category (e.g., essentially all Federally owned PP&E).

152 The Board agreed that it was possible that a mere reading of the term "Federal mission PP&E" could lead to broader application of the category than permitted under the standard. However, the Board found that there was no brief term that would effectively communicate the nature of the PP&E properly includable in this category. The Board believes that the characteristics provided as well as the illustrations included in Appendix B of this document will clearly establish the appropriate use of this category. In addition, the Board has incorporated in the standard a cautionary footnote regarding loose interpretations drawn from the term "Federal mission PP&E."

Depreciation

153 The exposure draft posed several questions related to depreciation accounting for general PP&E. Briefly, the questions addressed:

usefulness of depreciation expense for the assessment of operating performance,
an alternative view suggesting that depreciation accounting be limited to business-type activities,
usefulness of the allocation of depreciation expense to responsibility segments, and
cost/benefit of allocating depreciation expense to programs

154 Overall, the respondents supported the Board's proposal to require depreciation accounting on all general PP&E. Many indicated that depreciation accounting would

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improve performance measurement by producing comprehensive, comparable cost information. In addition, operating expenses would not be overstated in periods that assets were purchased and understated in other periods.

155 A few respondents supported the alternative view that would limit depreciation accounting to business-type activities. They argued that depreciation was only necessary where expenses were to be matched to revenues. This view is contrary to the operating performance objective and would not support development of cost information to associate with performance measures.

156 The Board did not make any changes to its requirements to apply depreciation accounting to general PP&E.

Multi-use Heritage Assets

157 The ED addressed renovation, reconstruction, improvement, and rebuilding costs for multi-use heritage assets (e.g., monumental style office buildings). Under the ED's proposal, any costs not directly associated with the heritage nature of the asset would be capitalized and depreciated as general PP&E. The ED also provided that abnormally high costs due to the heritage features of the assets (e.g., replacement of a specialized roofing material versus a modern day equivalent) be treated as heritage asset costs.

158 Respondents indicated that it would be very difficult to apply the proposed standards. Difficulties would include segregating the cost associated with preserving the heritage assets and supporting operations as well as identifying abnormal costs. In response to these concerns, the Board modified the treatment of multi-use heritage assets. The standard now provides that only renovation,

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reconstruction, and improvement costs directly attributable to operations be capitalized as general PP&E.

Current Value

159 The ED included an alternative view espousing the use of current value accounting for Federal Government PP&E. This view was not supported by the respondents. The majority of respondents believed that current values would be difficult and costly to obtain, and subject to manipulation. Many indicated that current values were often useful to decision makers and should be provided on an as needed basis rather than incorporated in the basic financial statements.

Federal Mission PP&E

160 Overall, the reaction to the Federal mission PP&E category was favorable. Respondents indicated that they would not have difficulty applying the category descriptions. However, the Board received the following specific requests for major revisions in the Federal mission PP&E category:

- to retain the definition but include Federal mission PP&E on the balance sheet and apply depreciation accounting to these assets, and
- to make use of the category optional (e.g., managers would be free to use the general PP&E category for PP&E that would otherwise qualify as Federal mission PP&E).

Depreciate Federal Mission PP&E

161 The Board did not adopt the first proposal--to apply depreciation accounting to Federal mission PP&E. While there may be management

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uses of this information, no persuasive examples of management uses have been identified. The Board remains convinced that depreciation accounting for these unusual items of PP&E would not provide meaningful information--a view that is supported by the Board's 1992 user needs study. Further, the Board wishes to note that nothing precludes management from developing depreciation information through cost finding means if it desires to do so for particular management purposes.

Make the Federal Mission PP&E Category Permissive

162 It was proposed that classification of PP&E as Federal mission be permissive rather than mandatory. Two reasons were given for this proposal:

- some PP&E is used as both Federal mission and general PP&E (for example, office facilities located at nuclear weapons production plants), and
- entity management should be free to decide that depreciation information on Federal mission PP&E is useful.

163 It was suggested that adopting this proposal would allow agencies to classify property as best suits their needs. The Board discussed this proposal at length. Some Board members were favorably inclined to permit entity managers to exercise judgment regarding the accounting treatment of Federal mission PP&E. However, the majority of the Board members believed that making the category optional would be inappropriate.

164 These members argued that (1) the user needs study supported their belief that historical cost depreciation on these types of items was not useful, (2) it would not be appropriate to give entities the latitude to use different accounting methods for similar

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assets, and (3) it would not be cost-beneficial to permit entities to make item by item judgments on appropriate accounting treatment. The members noted that, in connection with the proposal to require depreciation accounting for Federal mission PP&E (See paragraph 161), they had not been able to identify any management uses of depreciation information on Federal mission PP&E. The Board was concerned that entities may make unsupported, and costly, decisions regarding the election to categorize items as general or Federal mission PP&E. While entities can use cost finding to determine depreciation expense for internal purposes if they so desire, the Board does not believe that depreciation of Federal mission PP&E would be useful for general purpose financial reports.

165 The Board decided that use of the Federal mission PP&E category would remain mandatory for PP&E exhibiting the designated characteristics. The Board did add guidance in the standard regarding the selection of the base unit to be used in categorizing PP&E (See paragraph 22). One respondent had proposed that this guidance be added and stated that it would aid entities in establishing the level of detail necessary to properly categorize PP&E. For example, should PP&E be categorized on a site by site basis or by a smaller unit such as building by building. As with the capitalization threshold, the Board has indicated the factors that should enter into the selection of a base unit but has ultimately left the actual selection up to management.

Other PP&E Meeting the Characteristics

166 The Board posed a question in the ED regarding the classification of nuclear weapons production facilities and military base facilities as Federal mission PP&E. [SEE

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NOTE 77] This question was posed because of a discussion among the Board members as to whether these items would or would not meet the Federal mission PP&E definition.

167 The majority of the respondents indicated that nuclear weapons production facilities meet the current characteristics of Federal mission PP&E--confirming the initial reaction of the Board members. One respondent did indicate that these facilities could be converted to other uses--as had munitions plants following World War II--however, the Board believes that the cost of such a conversion would be so great as to make it improbable in the near term. The Board has not elected to add this as another specifically identified item that qualifies as Federal mission PP&E because it is a good illustration of the purpose and application of the characteristics developed. In addition, the Board prefers not to engage in an exercise of listing all items that qualify since the absence of certain items may lead practitioners to assume that an item was specifically excluded.

168 The majority of respondents indicated that military base facilities would not as a group meet the definition of Federal mission PP&E and that the category should not be expanded to accommodate these assets. Many respondents pointed out that military base facilities have alternative uses and are currently being reviewed for just that purpose. The Board agrees with these views and has not modified the definition to permit inclusion of military base facilities in the category.

Audit of Federal Mission PP&E

169 Several respondents expressed concern regarding the level of audit coverage applicable to Federal mission PP&E. Although the ED did not specifically address

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supplementary stewardship reporting for those categories of PP&E removed from the balance sheet, there was concern that removing these categories would lessen the audit coverage. Respondents noted that military weapons systems and space exploration equipment represented a substantial investment. They were concerned that the changes could lead to poor tracking systems for these items as well as weak internal controls over them. Other respondents pointed out that the key information is the existence and condition of these assets rather than the historical cost of the items. In addition, they suggested that devoting audit resources to verifying historical cost dollar amounts would detract from auditing more important existence and condition information.

170 The Board responded with the following points:

- auditing standards are beyond the scope of the Board's responsibilities,
- Board members representing the General Accounting Office (GAO) and the Office of Management and Budget (OMB) indicated that the audit coverage would be appropriately addressed in their work on Federal audit requirements,
- accounting standards should be established based on information needs not audit concerns, and
- the ED on supplementary stewardship reporting will include a statement to the effect that the Board expects that the responsible parties will produce audit requirements to satisfy concerns of the respondents.

DEFERRED MAINTENANCE

171 The deferred maintenance standard was well received by the majority of respondents. The Board addressed the issue in part due to the

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many state and local governments as well as national groups that concerned over the deteriorating condition of government owned PP&E. A report of the U.S. Advisory Commission on Intergovernmental Relations (ACIR), High Performance Public Works, [SEE NOTE 78] notes that maintenance competes for funding with other government programs and is often underfunded. Contributing to this underfunding is the fact that the consequences of underfunding maintenance are often not immediately reported. The consequences include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations.

172 The ACIR recommended that entities disclose information on:

- the condition of assets,
- the cost of unfunded maintenance,
- the consequences of unfunded maintenance, and
- the uncertainty in estimates of unfunded maintenance.

173 The Capital Expenditures task force also recognized that deferred maintenance was an issue for Federal PP&E and requested that the Board address it. The policies and initiatives related to deferred maintenance at three Federal agencies [SEE NOTE 79] were reviewed and it was found that Federal agencies are developing systems to report on deferred maintenance. Although the systems are different, the goals of the systems are consistent--to provide reliable information on the condition of PP&E and to estimate the cost of correcting deficiencies.

174 Under these accounting standards, deferred maintenance information will be incorporated in the financial reports despite the differences in measurement among the agencies. The Board believes that deferred

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maintenance is a cost--a cost that management, at whatever level, has elected not to fund. However, the Board found that deferred maintenance is not sufficiently measurable to be recognized in the accounting systems.

175 However, to highlight the reality that the cost remains despite being unfunded, the standards provide that deferred maintenance be disclosed by placing a line item on the statement of net cost with a note reference in lieu of a dollar amount on the financial statements. This recommendation is consistent with the findings of the Board's user needs study; that information on the cost of deferred maintenance is important to users. In addition, due to the measurement differences between entities, the disclosure requirements are flexible.

176 The standards provide two alternatives for estimating amounts to be disclosed--condition assessment surveys and life cycle cost analyses. Condition assessment surveys would provide disclosure of the estimated cost to return the PP&E to its desired condition. Life cycle cost analyses would highlight differences between planned maintenance and actual maintenance.

177 Both of these methods will be under the control of entity program managers since deferred maintenance is dependent on the purpose for which PP&E is held and on judgment regarding what condition PP&E should be in to meet that purpose. Entities are permitted flexibility in (1) setting standards for maintenance requirements and (2) establishing cost beneficial methods to estimate the cost of deferred maintenance.

178 The proposed standards require disclosure of information on the condition of PP&E, estimates of the cost of deferred maintenance, and methods used to assess

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deferred maintenance. The standards apply to both PP&E reported on the balance sheet and the stewardship report.

179 In response to the ED, two opposing suggestions were raised--(1) recognize the amounts as a liability, and (2) remove the information from the notes.

RECOGNITION

180 A few respondents, including two appearing at the public hearing, suggested that the Board provide for recognition of the liability associated with deferred maintenance. The Board does not believe that deferred maintenance can or should be recognized as a liability because it is not sufficiently measurable to be recognized. Deferred maintenance reporting is in an evolutionary phase with Federal agencies currently developing a variety of systems to assess deferred maintenance. Measurement can not be described at this time as consistent or comparable. The deferred maintenance standard will remain as drafted. However, if and when government maintenance standards (e.g., minimum acceptable condition and standard repair costs) are set, the Board will revisit the accounting and consider requiring recognition of the liability and the cost.

REMOVE FROM NOTES

181 A few respondents requested that the Board provide for deferred maintenance information through required supplemental information to lessen the audit burden associated with the information. The Board--as was the case with Federal mission PP&E--does not believe that audit coverage should govern the placement of information in the annual reports. Deferred maintenance information is considered important because it ensures that readers are

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informed of the condition of Federally owned PP&E. If there is a need to reduce the audit coverage, the Board believes that GAO and OMB can best address this need.

CLEANUP COST

182 The Board elected to address cleanup costs from long-term Federal operations as one of the costs associated with PP&E. For example, the Federal Government operates nuclear facilities and is required by law to cleanup any hazardous materials upon closing the facilities. This obligation meets the Board's definition of liability. [SEE NOTE 80] However, because the cleanup of these types of facilities would not occur until operations cease, additional guidance is needed to determine when and how to recognize these costs and liabilities.

183 The guidance in this standard builds on the accounting standards developed for liabilities. These standards were published in the Board's statement entitled Accounting for Liabilities of the Federal Government (liabilities standard). The liabilities standard includes:

- the liability definition,
- recognition criteria, and
- disclosure requirements.

184 The liabilities standard is applicable to cleanup costs. For example, if cleanup costs are not both probable and measurable the disclosure requirements in the liabilities standard would apply. The standards in this statement address cleanup cost accounting including:

- allocating cleanup costs to operating periods,
- estimating cleanup costs to be paid far in the future (e.g., using a current cost

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approach), and
- recognizing changes in estimates prior to actual cleanup.

185 Because of the differences in accounting for the costs of general PP&E and stewardship PP&E, the Board developed different methods for allocating cleanup costs to operating periods depending on the category of the related PP&E.

CLEANUP OF GENERAL PP&E

186 The Board concluded that the liability for cleanup costs related to the operation of general PP&E would be recognized in a systematic and rational manner over the periods that the associated general PP&E is in use. This approach is consistent with the requirement to depreciate general PP&E. In addition, the Board requires disclosure of the estimate of total cleanup costs.

CLEANUP OF STEWARDSHIP PP&E

187 For cleanup costs related to stewardship PP&E, the Board concluded that the total estimated liability for cleanup cost would be recognized at the time that the stewardship PP&E is placed in service. This is consistent with the treatment of the acquisition cost of the stewardship PP&E which is recognized as a cost of operations in the period that the PP&E is placed in service.

ESTIMATING CLEANUP COSTS

188 With regard to estimating cleanup cost, the Board concluded that the estimate would be based on the current cost to perform the cleanup. Current cost should be based on existing laws, technology and management plans. An alternative to current cost would

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have been to estimate costs in the future, factoring in expected inflation, and discounting this amount to current dollars. The Board did not believe that this approach offered any greater degree of accuracy in return for the additional effort involved in making the estimate.

189 As with all estimates, the estimates of cleanup costs will change over time. These changes will be due to inflation as well as to changes in laws and technology.

190 For cleanup costs associated with general PP&E, changes in estimates related to current and prior period operations be recognized as an expense in the period of the change. For example, if a facility with a capacity to produce 100 tons of material has produced 60 tons of material, then 60% of the change in estimate should be recognized as expense in the year that the estimate changes.

191 For cleanup costs associated with stewardship PP&E, the total change in estimate be recognized in the period of the change.

CLEANUP COST ISSUES

192 Respondents to the ED were supportive of the Board's efforts to address cleanup costs. However, several suggested that the Board's treatment of the liability associated with general PP&E--recognizing it incrementally over the life of the PP&E--was inconsistent with its definition of a liability. In some cases, respondents argued, the cleanup liability is incurred at the time the PP&E is placed in service. These respondents suggested that the Board provide for full recognition of the liability if an amount is reasonably measurable at that time.

193 The Board did not adopt this suggestion.

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While the Board recognizes that in fact the liability may be incurred at the date that general PP&E is put in service, the actual recognition of the liability is problematic in a double entry accounting system. Generally, the recognition of a liability, a credit account, generates a concurrent recognition of either an expense (e.g., accounts payable for fuel bills is offset by fuel expense) or an asset (e.g., a capital lease liability is offset by an asset--PP&E), both typically debit accounts. In this case, the cleanup cost is not appropriately includable in operating expense of the period that the PP&E is placed in service. This would create a need for a balance sheet debit to offset the liability.

194 The Board does not believe that it would be appropriate to recognize an asset to offset the cleanup liability. Although some argue cleanup cost is a deferred cost of associated PP&E, the Board does not believe that these costs meet the asset definition and finds that recognition of cleanup cost as a component of PP&E would significantly overstate assets.

195 Other respondents expressed the opposite position, suggesting that it is not appropriate to recognize cleanup costs until they are budgeted for. This approach is not only inconsistent with the definition of a liability but would keep users of the financial statements in the dark as to the magnitude of Federal commitments for environmental cleanup.

196 The Board believes that the standards it has developed will contribute to meeting the operating performance and stewardship reporting objectives of Federal financial reporting. The cleanup cost standards have not been modified for either of these recommendations.

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197 One modification that was made relates to implementation of the standard. Implementation is a significant issue given the magnitude of the Government's existing facilities and its obligations for cleanup of those facilities. One Board member requested that the implementation guidance related to cleanup of general PP&E provide an alternative method. It was suggested that provision of a second method would lower the cost of implementing the standard in situations where the related PP&E had been in service for a substantial portion of its estimated useful life.

198 The second method would be to recognize the entire estimated total cleanup cost as a liability upon implementation. In periods following implementation, entities electing this method would recognize any changes in the estimated total cleanup cost as expense for that period in lieu of the pro-rata amount of the estimated total cleanup cost. This method could be applied only by entities not seeking to recover their costs through user charges.

199 The Board adopted this recommendation in light of the large number of Federal facilities that will be affected by this standard and the cost of implementing the standard.

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APPENDIX B -- ILLUSTRATIONS OF CATEGORIES

200 In developing categories for Federal mission PP&E, Heritage Assets and Stewardship Land (See paragraphs 46, 57 and 66), the Board sought input from Federal agencies, the Standard General Ledger Issues Resolution Committee (SGLIRC), and other subgroup members. The Board found that there were many cases where similar assets could fit more than one category.

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201 For example, aircraft and ships are used by law enforcement agencies as well as by the Department of Defense. Under the proposed categories, only those used by the Department of Defense would meet the criteria for Federal mission PP&E. The illustrations provided are intended to clarify the application of the categories to actual assets.

ILLUSTRATION 1:
FEDERAL MISSION PROPERTY, PLANT, AND EQUIPMENT

ILLUSTRATION 1A:
COAST GUARD PP&E

202 The Coast Guard has unique duties as both a peacetime operating agency and one of the military services. Its mission includes:

- public safety,
- law enforcement, and
- service in the event of conflict, national emergency, or natural and man-made disasters.

203 The Coast Guard uses vessels and aircraft in its operations. Vessels include buoy tenders, buoy boats, and lifeboats. This is general PP&E rather than Federal mission PP&E. The cost of PP&E used in providing general government services (e.g., law enforcement) is relevant for assessing operating performance on a period-by-period basis since PP&E is used routinely in providing these services. The Coast Guard's accomplishments are linked to the inputs available to it (e.g., PP&E) and associating the cost of inputs with accomplishments or outputs is useful for assessing operating performance.

ILLUSTRATION 1B:
SPACE EXPLORATION EQUIPMENT

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204 The application of the Federal mission PP&E characteristics to NASA's space shuttles is illustrated in this section. Of the three characteristics related to the use of the PP&E, the shuttle only meets the third--that is, it was specifically developed for use in a program for which there is no other program or entity using similar PP&E with which to compare costs.

205 Of the characteristics related to useful life, the shuttle meets the first--that is, it has an indeterminate or unpredictable useful life. A shuttle was first flown in 1981. Since that first flight, the fleet has completed 68 missions. Several factors would influence estimates of shuttles' useful lives:

- following the Challenger accident, the fleet was grounded for 32 months with some predicting that another similar accident could end the shuttle program,
- current schedules call for seven flights in 1996 but the space station project would require more frequent space shuttle flights in the future, and
- the possible development of a replacement vehicle which may be available by 2010.

206 Given the uncertainties and variables in estimating a useful life, it would be difficult, and not very meaningful, to assign the shuttle's acquisition cost to the shuttle's output--for example, flights. In the event that charges are made to users, NASA may wish to develop depreciation information for internal use only in setting prices. However, there is no broad need for depreciation information related to use of the shuttle.

207 Another example of space exploration equipment involves equipment that is used once and never recovered. The spacecraft Magellan was launched by a space shuttle in

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1989 and is expected to burn up in the atmosphere around Venus. During the flight to Venus, the Magellan's signal was lost and recovered five times. In addition, many technical problems endangered the mission. However, in 1990, the Magellan reached Venus and began transmitting data back to NASA. Research based on this data is expected to continue for years following the life of the spacecraft. In contrast, the Mars Observer space probe disappeared during its approach to Mars and never reappeared.

208 Given the uncertainties involved in space exploration and the timing of any benefits, it is not useful to capitalize and depreciate space exploration equipment.

ILLUSTRATION 1C:
LAW ENFORCEMENT EQUIPMENT

209 A respondent to the ED Accounting for Property, Plant, and Equipment, questioned whether vehicles used in law enforcement activities qualified as Federal mission PP&E. It was noted that vehicles used for law enforcement purposes may have an abbreviated life expectancy. In addition, these vehicles may be modified for law enforcement uses.

210 However, in applying the two types of characteristics to these items of PP&E, one finds that they do not exhibit one characteristic from each category. The characteristics are repeated below for convenience.

211 Characteristics related to the use of the Federal mission PP&E are that it:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war or natural disaster; or
- is specifically designed for use in a program for which there is no other

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program or entity (Federal or non-Federal) using similar PP&E with which to compare costs.

212 Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life [SEE NOTE 81] due to the unusual manner in which it is used, improved, retired, modified, or maintained, and
- is at a very high risk of being destroyed during use or premature obsolescence.

213 Vehicles used in law enforcement programs do not exhibit any of the three characteristics in the first group since (1) the basic vehicle can be used by other entities in other activities, (2) it is used routinely in operations rather than being held in anticipation of use, and (3) other entities, primarily state and local governments, have law enforcement activities and use similar vehicles. With regard to the second group of characteristics, the useful life may be abbreviated due to the manner in which it is used but it should nevertheless be predictable based on past experience with similar use. While it is possible that the vehicles are at somewhat greater risk of being destroyed than other vehicles, it is a matter of judgment whether this qualifies as very high risk. Overall, it is apparent that these items do not possess one characteristic from each group and do not qualify as Federal mission PP&E.

ILLUSTRATION 2:
HERITAGE ASSETS

214 Many assets are clearly heritage assets. For example, the National Park Service manages the Washington Monument, the Lincoln Memorial and the Mall. However, other assets, particularly Federal office buildings, have

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historical, cultural or architectural significance as well as being used for general operations.

215 The Board has found that these multi-use heritage assets should still be categorized as heritage assets. Any costs to maintain the assets themselves should be treated as heritage assets. However, any costs that are operational in nature (e.g., reconfiguring of office space or modernized communications wiring) should be classified as general PP&E. Costs of these types of improvements or renovations would then be capitalized and depreciated--providing useful information for performance measurement.

216 For assets that are used solely for heritage purposes (e.g., the Washington Monument), the Board believes that the cost of operation, maintenance, and other periodic expenses combined with deferred maintenance disclosures, are sufficient to assess operating performance. Allocating the cost of heritage assets to accounting periods through depreciation would not enhance the information available for performance assessment.

217 Following are examples of general PP&E that exhibit characteristics of heritage assets.

ILLUSTRATION 2A:
MAJOR OFFICE BUILDING

218 A Federal agency constructed a central office building in 1950 to house its headquarters personnel. The building was subsequently placed on the historical registry but continued to serve as headquarters' office space.

219 Public tours are available and educational exhibits are provided in the hallways. However, public access is restricted to guided tours. The majority of floor space is devoted to offices, meeting rooms,

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cafeterias, and storage.

220 The building is currently undergoing major renovations. The cost of these renovations should be capitalized and depreciated over their expected useful lives only to the extent that the work is tied to operations rather than to preserving the building. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

ILLUSTRATION 2B:
NEW OFFICE BUILDING

221 A Federal facility previously used for industrial purposes (e.g., production of equipment parts) is being renovated and remodeled to serve as office space. The brick facade is being preserved because of its historic significance. Office space is being constructed inside of the brick facade.

222 The building can be viewed by visitors to the Federal facility, however, access to the office space will be restricted.

223 The original cost of the brick facade should not be included in the cost of the new office building. The cost of new construction should be capitalized and depreciated as part of general PP&E and none should be treated as a heritage asset. Additional information on the heritage nature of the existing brick facade, if material, would be provided through stewardship reporting.

ILLUSTRATION 2C:
LIBRARY OF CONGRESS

224 The Library of Congress is undergoing restoration and renovation. This includes:

- restoring artwork and architectural features,
- installing wiring for workstations, and
- building office space.

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225 Expenditures for restoration of heritage aspects of the buildings should be treated as a period cost for heritage assets. However, expenditures for operational aspects of the renovation should be categorized as general PP&E. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

ILLUSTRATION 3:
LAND

226 The proposed standard provides that land acquired for or in connection with other general PP&E be included in that category. For example, the cost of land on which facilities are located would be included in general PP&E. Other land would be subject to stewardship reporting.

227 The following illustrations cover two potential issues associated with land. First, identifying land associated with general PP&E. Second, identifying land improvements as general PP&E or PP&E subject to stewardship reporting.

ILLUSTRATION 3A:
MILITARY USES OF LAND

228 In general, land used for military bases would be considered general PP&E. However, in some cases, land is used by the military as a site for missile silos, testing grounds or firing ranges. Land used for these purposes meets the definition of stewardship land. The Board believes that period-by-period cost information related to holding land for defense purposes is not relevant to assessing operating performance.

ILLUSTRATION 3B:
ROADS ON PUBLIC LANDS

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229 Public lands have various types of roads to provide access. These types include:

- rough dirt roads created from years of use,
- dirt roads created by non-Federal land users (e.g., oil & gas exploration crews) and then abandoned, and
- roads created by Federal entities to provide access (e.g., gravel & paved roads).

230 Some of these roads are maintained while others merely exist until natural conditions overtake them.

231 Under private sector accounting, permanent improvements to land are included in the cost of land on the balance sheet. Typically, the cost of clearing and establishing the road bed is considered a permanent improvement because, with routine maintenance, it will remain indefinitely. Any pavement or gravel that must be replaced periodically would be considered depreciable PP&E. For a Federal entity, if the road could be categorized as general PP&E this practice would be appropriate since the period-by-period cost of assets is relevant for assessing operating performance.

232 For land subject to stewardship reporting, the cost of establishing the roadbed would be expensed in the year incurred since the land improved by the roadbed is not capitalized on the balance sheet. On the other hand, the paved and gravel roads are general PP&E because they are operational and the period-by-period cost is essential for assessing operating performance. The cost of pavement or gravel would be capitalized and depreciated. Decisions about the quality of the road conditions (e.g., how often roads are repaved) are an element of operating performance and of the cost of providing government services.

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APPENDIX C -- DEFERRED MAINTENANCE ILLUSTRATION

233 This appendix illustrates the footnote disclosures in paragraphs 77-83. The example shown here is for illustrative purposes only. Different entities may developed different asset categories, condition codes and descriptive terminology. The Board intends that this standard provide flexibility while providing relevant information on the condition of Federal assets. The following illustration presents text from a footnote meeting the requirements of the standard.

XYZ Hospital Facility

Note 4. Deferred Maintenance

XYZ operates a hospital facility at one of its remote sites. During the period maintenance expense is recognized as incurred. However, maintenance was insufficient over the past several years and resulted in deferred maintenance.

Information on deferred maintenance is based on an annual inspection of facilities. Standards are provided for evaluating facility condition. These standards include:

- minimum and desirable condition descriptions for facilities
- suggested maintenance schedules
- standard costs for maintenance actions
- standardized condition codes

There have not been material changes in the standards in recent years.

The following chart presents information on deferred maintenance on major categories of PP&E experiencing material amounts of deferred maintenance:

[SEE PRINTED COPY FOR TABLE 1]

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APPENDIX D -- CLEANUP COST ILLUSTRATIONS

234 This appendix illustrates one method of complying with the standards proposed for cleanup costs. The examples shown in this appendix are for illustrative purposes only. There are many types of cleanup that may be accounted for under this proposed standard (e.g., nuclear facilities, landfills, or laboratories). Applying this proposed standard may require consideration of estimated cost components other than those shown here.

235 The computations are based on a formula allocating the estimated total cleanup costs (i.e., the total amount to be spent in the future to accomplish cleanup) to accounting periods. In identifying the amount to be expensed for the period, the formula considers the cumulative amounts:

- of capacity used at the end of the accounting period; and
- recognized as expense in prior accounting periods.

236 The components of the formula are defined below:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period [SEE NOTE 82]
c = total estimated capacity [SEE NOTE 83]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

237 To calculate the appropriate expense amount, the following formula is used:

$$(a \times b/c) - d = e$$

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238 Simply put, the end of period estimated total cleanup cost (a) is multiplied by the percentage of capacity used up at the end of that period (b/c) to arrive at the portion of cleanup cost that has been generated by operations through the end of the period. Theoretically, that amount of expense has been incurred and should be recognized. Amounts recognized as expense in prior periods (d) should be deducted to arrive at the current period expense amount (e). If this is the first period, the deduction for expense recognized in prior periods (d) is zero.

ILLUSTRATION 1:
HAZARDOUS WASTE DISPOSAL SITE

Operating Assumptions

239 The hazardous waste disposal site will begin accepting waste in 1995. The following assumptions apply:

- the site capacity is 100,000 cubic yards of waste
- it is estimated that the site will accept waste for ten years at an average rate of 10,000 cubic yards per year
- after the site is closed the following cleanup efforts are required by state, local and Federal laws:
  * site closure & sealing
  * thirty year monitoring
  * remediation
- 1995 cost estimates are based on current cost for 1995
- 1996 cost estimates are based on 1996 costs adjusted for inflation at a rate of 1.0%
- 1997 cost estimates are based on current costs for 1997 and include new technology and changes in monitoring requirements

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS

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FOR 1995 (Dollars in thousands)

Estimated Total Cleanup Cost [SEE NOTE 84] based on Current Cost in 1995	
1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$ 100
Sealing site	750
Erosion and control facilities	500
2. Monitoring Cost (for a period of 30 years):	
Inspection	3,000
Sampling & Testing	2,250
Maintenance of facilities	300
3. Remediation Cost:	
Projected remediation based on statistical studies	500
TOTAL ESTIMATED CLEANUP COST	$7,400

Calculation of Annual Expense and Accrued Liability Amounts

This proposed standard would require that a portion of the estimated total cleanup costs be recognized as an expense and as a liability each period that the site operates. During 1995, the site accepts 15,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,400 x 15,000/100,000) - 0 = e
$7,400 x .15 = e
$1,110 = e

where:
a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period [SEE NOTE 85]
c = total estimated capacity [SEE NOTE 86]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current

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period

The following journal entry would be required:

Dr. Cleanup expense $1,110
Cr. Cleanup liability $1,110

To recognize estimated cleanup costs.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1996 (Dollars in thousands)

Estimated Total Cleanup Cost based on Current Cost in 1996

1. Site Closure and Sealing Cost:
   Facilities for monitoring operations $ 101
   Sealing site 758
   Erosion and control facilities 505
2. Monitoring Cost (for a period of 30 years):
   Inspection 3,030
   Sampling & Testing 2,273
   Maintenance of facilities 303
3. Remediation Cost:
   Projected remediation based on statistical studies 505
   TOTAL ESTIMATED CLEANUP COST $7,475

Calculation of Annual Expense and Accrued Liability Amounts

During 1996, the estimated total cleanup costs were adjusted for inflation of 1.0% and site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,475 x 25,000/100,000) - $1,110 = e
$7,475 x .25 - $1,110 = e
$759 = e

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where:
a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period [SEE NOTE 87]
c = total estimated capacity [SEE NOTE 88]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense $759
Cr. Cleanup liability $759

To recognize estimated cleanup costs.

In addition, the proposed standard would require that any material changes in the estimate due to changes in laws, technology, or cleanup plans be disclosed. However, there is no indication that material changes occurred.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1997 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1997

1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$ 115
Sealing site	740
Erosion and control facilities	500
2. Monitoring Cost (for 30 years):	
Inspection	2,250
Sampling & Testing	1,300
Maintenance of facilities	300
3. Remediation Cost:	
Projected remediation based on statistical studies	400
TOTAL ESTIMATED CLEANUP COST	$5,605

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Calculation of Annual Expense and Accrued Liability Amounts

During 1997, a new estimate of total cleanup costs was prepared and the site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a X b/c) - d =e
($5,605 x 35,000/100,000) - ($1,110 + 759)
$5,605 x .35 - $1,869 = e
$1,962 - $1,869 = e
$ 93 = e

where:
a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period [SEE NOTE 89]
c = total estimated capacity [SEE NOTE 90]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense $93
Cr. Cleanup liability $93

To recognize estimated cleanup costs.

In addition, the proposed standard would require that material changes in estimated cleanup costs be disclosed and that amounts attributable to prior period operations be disclosed. One means of calculating this amount is to segregate the amount recognized as cleanup expense for the current period between "changes in estimated cleanup cost from prior periods" and "current period cleanup cost." These two amounts would be

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disclosed.

Changes in estimated cleanup costs from prior periods are:

f = (a X b1/c) - d
f = ($5,605 x 25,000/100,000) - ($1,110 + 759)
f = $5,605 x .25 - $1,869
f = $1,401 - $1,869
f = $(468)

where:
a = total cleanup cost estimated as of end of period
b1 = cumulative capacity used at beginning of period [SEE NOTE 91]
c = total estimated capacity [SEE NOTE 92]
d = amount previously recognized as expense at beginning of period
f = changes in estimated cleanup cost from prior periods

Current period cleanup costs are:

g = e - f
g = $ 93 - $(468)
g = $ 561

where:
e = cleanup cost recognized in the current period
f = changes in estimated cleanup cost from prior periods
g = current period cleanup costs

SUMMARY:

FINANCIAL STMT.	1995	1996	1997
Operating expense	$1,110	$ 759	$ 93
Liability	$1,110	$1,869	$1,962

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ILLUSTRATION 2:
NUCLEAR FACILITY QUALIFYING
AS GENERAL PP&E

Operating Assumptions

240 A nuclear facility was placed in operation in 1981. No recognition of cleanup cost was made under past accounting policy. At the end of 1995, the entity adopts the accounting policies presented in this proposed standard.

The following assumptions apply:
the entity has an expected useful life of thirty years
after the site is closed the following cleanup efforts are required by state, local and Federal laws:
- site closure & sealing
- thirty year monitoring
- remediation

1995 cost estimates are based on current cost for 1995

RECOGNITION OF LIABILITY AMOUNTS FOR 1995
(Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1995

1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$1,000
Sealing site	3,000
2. Monitoring Cost (for 30 years:	
Inspection	6,000
Sampling & Testing	3,000
Maintenance of facilities	600
3. Remediation Cost:	
Projected remediation based on statistical studies	2,000
TOTAL ESTIMATED CLEANUP COST	$15,600

Calculation of Liability Amount To be Recognized Upon Implementation

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At the end of 1995, the estimated total cleanup costs was $15,600,000. The following calculations show the amounts that should have been recognized as of the end of 1995 if the proposed standard had been in effect since the facility began operating on October 1, 1980:

(a X b/c) - d = l
($15,600 x 15/30) - $0 = l
$15,600 x .5 - $0 = l
$7,800 = l

where:
a = total cleanup cost estimated as of end of period
b = number of years of operation
c = estimated useful life
d = amount previously recognized as expense-beginning of period
l = liability to be recognized at the end of 1995

Dr. Net Position $7,800
Cr. Cleanup liability
$7,800

To recognize estimated cleanup liability.

No expense is recognized in the year of implementation.

SUMMARY:

FINANCIAL STMT. 1995

Prior Period Adjustment $7,800
Liability $7,800

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APPENDIX E -- GLOSSARY

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Assets - Tangible or intangible items owned by the Federal Government which would have probable economic benefits that can be obtained or controlled by a Federal Government entity.

Book value - The net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of an asset or liability minus an allowance or valuation amount.)

Business type activity - Significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue (See FASAB Exposure Draft, Statement of Recommended Accounting Standards, Revenue and Other Financing Sources).

Capital leases - Leases that transfer substantially all the benefits and risks of ownership to the lessee.

Capitalize - To record and carry forward into one or more future periods any expenditure the benefits or process from which will then be realized. (Kohler's Dictionary for Accountants)

Cleanup costs - The costs of removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E.

Condition assessment surveys - Periodic inspections of PP&E to determine their current condition and estimated cost to correct any deficiencies.

Cost object (also referred to as cost objective) - An activity, output, or item whose cost is to be measured. In a broad sense, a cost object can be an organizational division, a function, task, product, service, or a customer.

Deferred maintenance - Maintenance that was not performed when it should have been or was

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scheduled to be and which, therefore, is put off or delayed for a future period.

Depreciation accounting - The systematic and rational allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.

Direct Cost - The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities. A cost that is specifically identified with a single cost objective.

Disclosure - Reporting information in notes regarded as an integral part of the basic financial statements.

Discount rate - The interest rate used to adjust for the time value of money. (SFAS #87)

Donated capital - The amount of nonreciprocal transfers of assets or services from State, local, and foreign governments; individuals; or others not considered parties related to the Government. (Project on Standardization of Basic Financial Information Requirements of Central Agencies, JFMIP, October 1991)

Economic life - The period during which a fixed asset is capable of yielding services of value to its owner. (See "useful life".)

Expense - Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period. (Adapted from Kohler's Dictionary and FASB Concepts Statement No. 6)

Executory cost - Those costs such as insurance, maintenance, and taxes incurred for leased

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property, whether paid by the lessor or lessee. (FASB, SFAS #13)

Good - A tangible product produced to provide to a customer.

Hazardous waste - A solid, liquid, or gaseous waste, or combination of these wastes, which because of its quantity, concentration, or physical, chemical, or infectious characteristics may cause or significantly contribute to an increase in mortality or an increase in serious irreversible, or incapacitating reversible, illness or pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, disposed of, or otherwise managed.

Historical cost - Initially, the amount of cash (or its equivalent) paid to acquire an asset; subsequent to acquisition, the historical amount may be adjusted for amortization. (Kohler's Dictionary for Accountants)

Indirect cost - A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.

Interest - The service charge for the use of money or capital, paid at agreed intervals by the user, commonly expressed as an annual percentage of outstanding principal. (Kohler's Dictionary for Accountants)

Liability - For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.

Life-cycle costing - An acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets.

Maintenance - The act of keeping fixed assets in useable condition. It includes preventive

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maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.

Market value - The estimated amount that can be realized by disposing of an item through arm's length transactions in the marketplace; the price (usually representative) at which bona fide sales have been consummated for products of like kind, quality, and quantity in a particular market at any moment of time.

Measurable - Can be determined with reasonable certainty or is reasonably estimable.

Operating lease - An agreement conveying the right to use property for a limited time in exchange for periodic rental payments. (Adapted from Financial Accounting: Principles and Issues, 4th Edition, Michael H. Granof and Philip W. Bell, p. 416.)

Opportunity Cost - The value of the alternatives foregone by adopting a particular strategy or employing resources in a specific manner. Also called Alternative Cost or Economic Cost.

Outputs - Any product or service generated from the consumption of resources. It can include information or paper work generated by the completion of tasks of an activity.

Output measure - A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. It shall have two key characteristics: 1) it shall be systematically or periodically captured through accounting or management information system, and 2) there shall be a logical connection between the reported measures and the program's purpose.

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Probable - That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Product - Any discrete, traceable, or measurable good or service provided to a customer. Often goods are referred to as tangible products, and services are referred to as intangible products. A good or service is the product of a process resulting from the consumption of resources.

Recognize - To record an amount in entity accounts and to report that amount in the entity financial statements either individually or in aggregate with other amounts.

Service - An intangible product or task rendered directly to a customer.

Useful Life - The normal operating life in terms of utility to the owner.

Weapon System - A combination of one or more weapons with all related equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency.

Write-off - An action to remove an amount from an entity's assets or financial resources.

Major Contributors

This document reflects extensive input from a number of individuals, including those listed below.

Robert Anderson	Office of Management and Budget
Christine Bonham	General Accounting Office

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Debra Carey	U. S. Department of the Interior
Phil Calder	General Accounting Office
Sheila Conley	Office of Management and Budget
Tom Cuny	Congressional Budget Office
Ken Dressner	General Services Administration
Tim Gonzales	Environmental Protection Agency
Bob Kilpatrick	Office of Management and Budget
Allan Lund	Department of the Treasury
JoEllen McCormack	General Accounting Office
Gordon Peterson	Department of Education
Cathy Presnell	U. S. Army Audit Agency
De Ritchie	Department of Defense
Justine Rodriguez	Office of Management and Budget

FASAB Board Members

Elmer B. Staats, Chairman

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James L. Blum

Donald H. Chapin

Martin Ives

Norwood Jackson

Gerald Murphy

James E. Reid

Cornelius E. Tierney

Alvin Tucker

Ronald S. Young, Executive Director

Project Staff:
Wendy M. Comes
Lucy Lomax
Richard Wascak

Federal Accounting Standards Advisory Board
750 First Street, NE, Room 1001
Washington, DC 20002

Telephone (202) 512-7350
Fax (202) 512-7366

ENDNOTES

NOTE

1 Department of the Treasury, Financial Management Service, Consolidated Financial Statements of the United States Government,

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prototype 1993, p. 23. The prototype statements provide gross historical cost investment amounts for all PP&E recorded by government entities. These amounts have not been audited.

NOTE 2 Land acquired for or in connection with general PP&E would be included in that category. Land not associated with general PP&E would be subject to supplementary stewardship reporting and is referred to throughout this document as stewardship land.

NOTE 3 Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in the Board's exposure draft on Revenue and Other Financing Sources.

NOTE 4 "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

NOTE 5 "Balance sheet" refers to the statement that reports on assets, liabilities, and net position of the entity at the end of the reporting period. This statement is referred to in OMB Bulletin 94-01, Form and Content of Agency Financial Statements, as the Statement of Financial Position.

NOTE 6 "Statement of Net Cost" refers to the statement providing information on the entity's flows of exchange revenues, expenses, gains, and losses. The Board presented this new statement in its Statement

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of Recommended Accounting Concepts No. 2, Entity and Display. In addition, the Board has exposed for comment a standard for reporting net costs and has provided an illustrative statement which might give effect to this standard in the ED on Revenue and Other Financing Sources, July, 1995.

NOTE
7 "Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.

NOTE
8 "Depreciation" is the systematic and rational allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.

NOTE
9 "Internally-developed software" means software developed by personnel employed by the reporting entity. This includes modifications made by entity personnel to purchased or contractor-developed software. Standards for internally-developed software are not to be applied to purchased or contractor developed software. The Board recognizes that contractor-developed software is conceptually similar to internally-developed software and that standards for each should be similar. The Board intends to address the inconsistent treatment of these items at a later date.

NOTE
10 "Disclosure" refers to reporting information in notes regarded as an integral part of the basic financial statements.

NOTE
11 The term "federal mission" refers to

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activities that are typically Federal--such as national defense. In addition, Federal mission PP&E is limited to PP&E that would not typically be used by non-Federal entities. Clearly, any functions performed by a "Federal" entity could be labeled "Federal mission." The definition of this category clarifies the characteristics of PP&E appropriately includable in this category--a much narrower group than inferred by the category's title.

NOTE

12 This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.

NOTE

13 FASAB's Statement of Recommended Accounting Standards No. 5, Accounting for Liabilities of the Federal Government, recommends the following definition for liability: a probable future outflow or other sacrifice of resources as a result of past transactions or events. The standards require recognition, in general purpose Federal financial reports, of probable and measurable liabilities arising from past exchange transactions; government-related injuries or damage; or non-exchange amounts that, according to current law and applicable policy, are due and payable to the ultimate recipient. The standards also provide guidance for disclosures related to liabilities that are not both probable and measurable at the balance sheet date.

NOTE

14 The term "probable" means that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven. For example, cleanup costs would be probable if (1) laws and regulations that have been approved as of the balance sheet date, regardless of the

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effective date of those laws and regulations, require cleanup or (2) compliance agreements (e.g., agreements with state or local authorities relating to the extent and the timing of remedial action) had been entered into by a Federal entity.

NOTE

15 Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

a. the costs of providing specific programs and activities and the composition of, and changes in, these costs.

b. the efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs.

c. the efficiency and effectiveness of the government's management of its assets and liabilities.

NOTE

16 Federal financial reporting should assist users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:

a. whether the government's financial position improved or deteriorated over the period.

b. whether the future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

c. whether government operations have contributed to the nation's current and

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future well-being.

NOTE
17 Useful life is the normal operating life in terms of utility to the owner. (adapted from Kohler's Dictionary for Accountants)

NOTE
18 "Land rights" are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

NOTE
19 Accounting for operating materials and supplies is addressed in Statement of Federal FInancial Accounting Standards No. 3 Accounting for Inventory and Related Property.

NOTE
20 The Federal Government sometimes retains an interest in PP&E acquired with grant money. In the event that the grant recipient no longer uses the PP&E in the activity for which the grant was originally provided the PP&E reverts to the Federal Government.

NOTE
21 Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, Preparation and Submission of Budget Estimates, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to

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risk levels.

NOTE
22 "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.

NOTE
23 "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.

NOTE
24 "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)

NOTE
25 "Base unit" refers to the level of detail considered in categorizing PP&E. Generally, the base unit is the smallest or least expensive item of property to be categorized. The term "base unit" may be used by others to have a different meaning--the meaning intended in this standard is limited to that specified above.

NOTE
26 The concept described here is intended for PP&E categorization purposes only. However, for the purpose of record keeping, greater detail may be necessary to maintain accountability for PP&E so that assets can be safeguarded against loss, theft, misappropriation, etc. Categorizing PP&E with

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less detail considered does not necessarily mean that (1) accounting systems or (2) property records must follow the same level of detail.

NOTE
27 Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in the Board's exposure draft on Revenue and Other Financing Sources.

NOTE
28 The Board is not making a recommendation that cost comparisons actually be made. Nor is it suggesting that costs can be easily compared for a Federal and non-Federal entity. If the activities are somewhat comparable then one should presume that a cost comparison could be made.

NOTE
29 "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

NOTE
30 "Interest costs" refers to any interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E.

NOTE
31 "Internally-developed" means that employees of the entity are actively involved in developing the software. This is distinguished from contractor developed software and purchased software which are subject to the provisions of the PP&E standard.

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NOTE
32 Currently, the US Standard General Ledger includes an account titled Automated Data Processing Software, number 1830, which is not part of the PP&E account series. These standards do not require that software be accounted for as a component of the PP&E accounts. It is permissible to maintain a separate account for software and the accumulated amortization on software.

NOTE
33 In this case, users may be internal or external to the entity.

NOTE
34 Technological feasibility has been established when the entity has completed all planning, designing, coding, and testing activities that are necessary to establish that the software can meet its design specifications.

NOTE
35 See Statement of Recommended Accounting Standards No. 5, Accounting for Liabilities of the Federal Government.

NOTE
36 A will or clause of a will disposing of property.

NOTE
37 This paragraph applies only to exchanges between a Federal entity and a non-Federal entity. Exchanges between Federal entities shall be accounted for as transfers (See paragraph 31).

NOTE
38 If the entity enters into an exchange in which the fair value of the PP&E acquired is less than that of the PP&E surrendered, the PP&E acquired shall be recognized at its cost as described in paragraph 32 and subsequently reduced to its fair value. A loss shall be

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recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value..

NOTE
39 SFFAS 3 requires that forfeited real and personal property be valued at market value less an allowance for any liens or claims from a third party.

NOTE
40 Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery. For PP&E acquired by a contractor on behalf of the entity (e.g., the entity will ultimately hold title to the PP&E), PP&E shall also be recognized upon delivery or constructive delivery whether to the contractor for use in performing contract services or to the entity.

NOTE
41 Software and land rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. "Amortization" is applied to intangible assets in the same manner that depreciation is applied to general PP&E--tangible assets.

NOTE
42 Land rights that are for a specified period of time shall be depreciated or amortized over that time period.

NOTE
43 A contra asset account is an account which partially or wholly offsets an asset account. On financial statements they may be either merged or appear together.

NOTE
44 For example, amounts realized may include cash received for scrap materials or fair

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value of items received in exchange for PP&E removed from service.

NOTE
45 Net remaining cost is the original cost of the asset less any accumulated depreciation/amortization to date.

NOTE
46 "Major classes" of general PP&E shall be determined by the entity. Examples of major classes include buildings and structures, furniture and fixtures, equipment, vehicles, and land.

NOTE
47 The name "Federal Mission PP&E" may cause readers to erroneously assume that this category should include any PP&E supporting a Federal mission. Federal mission PP&E is limited to those items specifically identified herein as well as any other items exhibiting at least one characteristic from each of the two groups listed.

NOTE
48 This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.

NOTE
49 Weapons are instruments of combat used to destroy, injure, defeat or threaten an enemy. (adapted from Dictionary of Weapons and Military Terms)

NOTE
50 Joint Chiefs of Staff, Department of Defense Dictionary of Military and Associated Terms, Joint Publication 1-02, March 23, 1994.

NOTE
51 Disclosure shall be either on the face of the statement of net cost or in footnotes depending on the materiality of the amounts

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and the need to distinguish such amounts from other costs relating to measures of outputs or outcomes of the reporting entity.

NOTE
52 Disclosure shall be either on the face of the statement of net cost or in footnotes depending on the materiality of the amounts and the need to distinguish such amounts from other costs relating to measures of outputs or outcomes of the reporting entity.

NOTE
53 A will or clause of a will disposing of property.

NOTE
54 Theoretically, the amount of donated heritage assets should be included in the statement of net cost. However, the cost of providing this information is not warranted since heritage assets are more difficult to value than items that would typically be included in general PP&E.

NOTE
55 "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

NOTE
56 Disclosure shall be either on the face of the statement of net cost or in footnotes depending on the materiality of the amounts and the need to distinguish such amounts from other costs relating to measures of outputs or outcomes of the reporting entity.

NOTE
57 A will or clause of a will disposing of property.

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NOTE
58 Acceptable services and condition may vary both between entities and among sites within the same entity. Management shall determine what level of service and condition is acceptable.

NOTE
59 This requirement applies to all four categories of PP&E.

NOTE
60 If management determines that there are no material amounts of deferred maintenance, this line item need not appear.

NOTE
61 Other methods may be used which are similar or identical to condition assessment survey or life-cycle costing. These methods would also be acceptable sources of information on deferred maintenance.

NOTE
62 Management shall determine what methods and standards to apply. Once determined, it is desirable but not required that methods and standards be applied consistently from period to period.

NOTE
63 "Major classes" of general PP&E shall be determined by the entity. Examples of major class include, among others, buildings and structures, furniture and fixtures, equipment, vehicles, and land.

NOTE
64 Examples of condition information include, among others, (1) averages of standardized condition rating codes, (2) percentage of assets above, at or below acceptable condition, or (3) narrative information.

NOTE
65 Adjustments may be necessary because the cost

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of maintenance foregone may not be cumulative. For example, if periodic painting is skipped twice it is not necessarily true that the cost would be double the scheduled amount.

NOTE
66 Accounting for environmental liabilities such as cleanup costs is currently undergoing change--due to both improved measurement techniques and increased attention from the accounting community. The Board will monitor these changes and revisit these standards as needed.

NOTE
67 Probable means that the future confirming event or events is more likely than not to occur.

NOTE
68 The unit of analysis for estimating liabilities can vary based on the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, an estimate of the cleanup costs could be made on a facility by facility basis, or an entity by entity basis.

NOTE
69 Cleanup may be deferred for other reasons, such as availability of resources. However, this type of deferral does not affect the recognition of the liability.

NOTE
70 Laws and regulations approved as of the balance sheet date, regardless of the effective date of those laws and regulations, shall be considered.

NOTE
71 Note that land acquired for or in connection with general PP&E would be included in that

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category. All other land would be subject to stewardship reporting and is referred to throughout this document as stewardship land.

NOTE
72 The term "stewardship PP&E" is used to refer collectively to federal mission PP&E, heritage assets, and stewardship land.

NOTE
73 Objectives, paragraph 54.

NOTE
74 This may be evidenced by the ability (1) to retire the PP&E and later return it to service, or (2) to continually upgrade the PP&E to maintain its usefulness. In addition, PP&E that is held for "one-time" use, such as a warhead, has an indeterminate life.

NOTE
75 Internally-developed software may be a component of general PP&E or stewardship PP&E.

NOTE
76 In fact, the majority of private-sector entities do not capitalize the cost of internally-developed software. The Financial Accounting Standards Board has not developed guidance on this issue.

NOTE
77 FASAB Exposure Draft, Accounting for Property, Plant, and Equipment, February 28, 1995, page 19, paragraph 71, Item IC.

NOTE
78 U.S. Advisory Commission on Intergovernmental Relations, High Performance Public Works: A New Federal Infrastructure Investment Strategy for America, November 1993.

NOTE
79 These agencies are the Department of Energy, the Department of the Navy, and the National

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Aeronautics and Space Administration.

NOTE
80 FASAB, Recommended Accounting Standard No. 5, Accounting for Liabilities, September 1995.

NOTE
81 This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.

NOTE
82 If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

NOTE
83 If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

NOTE
84 This estimate includes any costs of any cleanup efforts required during the thirty year cleanup period. While these activities will not occur until the associated PP&E is closed, the costs are estimated at the current cost to conduct similar efforts.

NOTE
85 If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

NOTE
86 If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

NOTE
87 If recognition of the costs is based on the

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passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

NOTE

88 If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

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89 If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

NOTE

90 If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

NOTE

91 If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

NOTE

92 If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

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Federal Accounting Standards Advisory Board

Implementation Guide to Statement of Financing in Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources*: Detailed Information on the Statement of Financing

April 2002

This is the original Revised Implementation Guide to SFFAS 7; it has not been updated for subsequent changes to SFFAS 7. Please check for the most recent SFFAS 7 file in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

This implementation guide presents explanations of concepts and standards intended to help practice and understanding. In April 2000, the American Institute of Certified Public Accountants established the hierarchy of accounting principles for Federal government entities (see Statement of Auditing Standards 69 and 91 and Office of Management and Budget (OMB) Bulletin 01-09, section 1.2) wherein *Implementation Guides* occupy level "D." However, the financial statement formats illustrated in this *Implementation Guide* are not intended to be authoritative. They provide a framework, consistent with and amplifying the OMB's periodic bulletins on the form and content of agency financial statements (see OMB Bulletin 01-09), within which individual entities have the flexibility to provide useful information.

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TABLE OF CONTENTS

Page No.

Introduction **4**

Background on the Statement of Financing **4**

Basic Construction of the Statement of Financing. **7**
Budgetary Resources Used to Finance Activities **8**
Other Resources Used to Finance Activities. **13**
Resources Which Do Not Finance the Net Cost of Operations **14**
Components of Net Cost of Operations Which Do Not Generate or Use Resources in the Reporting Period. **15**
Net Cost of Operations **16**

Explanation of Lines on the Illustrative Statement of Financing in OMB's *Form and Content* **17**
Resources Used to Finance Activities. **20**
Resources Used to Finance Items Not Part of Net Cost of Operations **21**
Components of Net Cost of Operations Not Requiring or Generating Resources **24**
Net Cost of Operations **27**

Additional Illustrative Items **28**
Upward and Downward Credit Program Subsidy Expense Adjustments in the Year of Collection or Payment. **28**
Receipt of Basic Credit Program Subsidy or Payment of Negative Subsidy **29**
Amortization of the Allowance for Subsidy for the Interest Differential Component **30**
Obligations for Items that Decrease Liabilities for Loan Guarantees or Allowances for Subsidy **31**
Scrapping, Transfer-out, or Sale of Fixed Assets **31**
Decrease in Exchange Revenue Receivable from the Public **33**
Accruing and Collecting Non-federal Receivables for Overpayment of Expenses **33**
Defaults Expense **34**
Prior Period Adjustments **34**

Appendices
Appendix A – Statement of Financing from Bulletin 01-09 . . . . . **36**
Appendix B – Statement of Net Cost from Bulletin 01-09 . . . . . **38**
Appendix C – Statement of Changes in Net Position from Bulletin 01-09 . . . . . **39**
Appendix D – Statement of Budgetary Resources from Bulletin 01-09 . . . . . **40**

Bibliography. **42**

This is the original Revised Implementation Guide to SFFAS 7; it has not been updated for subsequent changes to SFFAS 7. Please check for the most recent SFFAS 7 file in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

I. INTRODUCTION

1. This implementation guide provides detailed information about the statement of financing in the Federal Accounting Standards Advisory Board (FASAB–"The Board") Statement on Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (SFFAS 7). It is organized by the following sections:

    - Background of the statement.
    - Basic construction of the statement.
    - Explanation of lines on the illustrative format of the statement provided by the Office of Management and Budget (OMB).
    - Additional illustrative items.

2. This implementation guide supersedes pars. 72-93 and 122-173 of FASAB's *Implementation Guide to Statement of Federal Financial Accounting Standards No. 7,* Accounting for Revenue and Other Financing Sources" (June 1996) (IG7) and *Special FASAB News Article No. 1 on the Statement of Financing* (original, dated August 1998, and revised version, dated March 1999). The guide discusses concepts and the reporting in general and does not provide the pro forma entries of IG7. The United States Standard General Ledger (USSGL) accounts and related pro forma entries and case scenarios are available on the Financial Management Service (FMS) Web site, www.fms.treas.gov/ussgl.

Background of the Statement of Financing

3. Prior to the issuance of SFFAS 7 in April 1996, the principal financial statements required of federal agencies were a balance sheet and a combined statement of operations and changes in net position. The nature and organization of the information in the combined statement of operations and changes in net position was insufficient to provide information on the cost of federal programs and contained numerous vagaries which did not provide readers of the financial statements useful information. The Board dealt with this in Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and* Display, and in SFFAS 7 by providing requirements for primary information grouped by statements of net cost, changes in net position, and custodial activity.[1]

1 Federal Accounting Standards Advisory Board, *Implementation Guide to Statement of Federal Financial Accounting Standards No. 7,* Accounting for Revenue and Other Financing Sources (June 1996), (*Implementation Guide*) pars. 7-10, 14-20.

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4. Because almost no budgetary information was provided in either the balance sheet or other new statements, the Board required in SFFAS 7 primary budgetary information encompassed in a statement of budgetary resources, which paralleled existing information federal agencies provided OMB, but at a higher level of reporting. This filled a major gap in the credibility and usefulness of the primary financial statements.[2]

5. In addition, because substantial budgetary information was being required in the primary financial statements for the first time, and because the obligation-based budgetary information was different in many respects from the proprietary (accrual-based) statements, the Board also prescribed additional primary information to help explain the differences between the obligation-based budgetary and accrual-based proprietary statements.[3] The Board prescribed a "statement of financing" as the vehicle to show the relationship between those two key figures.

6. The requirements of SFFAS 7 were effective beginning for reporting periods after September 30, 1997. The actual format for agency financial statements is prescribed by OMB. In its Bulletin 97-01, *Form and Content of Agency Financial Statements*, which was also effective for those same reporting periods, OMB adopted as an illustration the condensed statement illustrated in SFFAS 7.[4] The nature of the statement can be seen in the organization of that illustration, and is discussed in the next section of this report.

7. Subsequently, in Bulletin 01-09 that replaced Bulletin 97-01 in September 2001, OMB issued a more detailed illustration of the statement of financing along the lines presented in FASAB's *Special Newsletter No. 1 on the Statement of Financing*, which had served as an unofficial illustration and detailed narrative of the statement's construction and approaches to its preparation.[5] The lines in the new OMB illustration are discussed in a subsequent section of this guide.

8. Additionally, the USSGL Board has issued increasingly-comprehensive crosswalks from budgetary and proprietary Standard General Ledger accounts to the statement of financing which, with the other guidance mentioned, has also helped agencies to prepare their statement of financing.[6] The final section of this document covers some additional reporting situations which may be further useful to agencies in preparing the statement of financing.

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2 SFFAS 7, pars. 77-82, and *Implementation Guide*, pars. 68-71.

3 SFFAS 7, pars. 91-95, and *Implementation Guide* pars. 72-75.

4 OMB, Bulletin 97-01, pp. 1-2, 35-37.

5 Luter, J. Thomas, "The Statement of Financing," *FASAB News* (Special Edition 1, August 1, 1998, updated March 1999), pp. 4, 9, and 15, and OMB *Form and Content* (OMB Bulletin 01-09 version), pp. 46-47.

6 Financial Management Service, *U.S. Government Standard General Ledger [SGL]* (July 2001), pp. V-51 through V-66.

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9. Understanding the statement of financing requires a knowledge of not only the federal proprietary accounting for assets, liabilities, net position, and components of net position, but also of the budgetary accounting for resources and the status of those resources as obligated or unobligated. Such knowledge, basic to federal accounting and auditing, including the design and maintenance of computer systems which organize and store data and generate financial reports, is assumed of the readers of this guide.

10. This guide uses the new OMB Bulletin 01-09 illustrations of the statement of financing and other statements to explain the underlying statement of financing concepts. The Federal agencies are working with Bulletin 01-09 and the illustrations therein and a close adherence to them was deemed essential for this guide.

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II. BASIC CONSTRUCTION OF THE STATEMENT OF FINANCING

11. The statement of financing explains the difference between the budgetary net obligations and the proprietary net cost of operations by setting forth the items that reconcile the two amounts.[7] To understand the statement of financing, it is necessary to understand why these two key figures are different. They are different because (1) the net cost of operations may be financed by non-budgetary resources; (2) the budgetary and non-budgetary resources used by an agency may finance activities which are not components of the net cost of operations; and (3) the net cost of operations may contain components which do not use or generate resources in the current period.

12. With this in mind, the statement of financing has three major sections which, when properly detailed, yield the net cost of operations. A skeleton listing of the sections is shown in figure 1, below.

Figure 1:
SECTIONS OF THE STATEMENT OF FINANCING

RESOURCES USED TO FINANCE ACTIVITIES
Budgetary
Other

RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS
Resources used that involve gross obligations or resources not reported in the Federal budget
Those involving recoveries and offsetting collection activity

COMPONENTS OF NET COST OF OPERATIONS WHICH DO NOT GENERATE OR USE RESOURCES IN THE REPORTING PERIOD

Components requiring or generating resources in future periods
Components not requiring or generating resources

NET COST OF OPERATIONS

7 SFFAS 7, par. 92.

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Budgetary Resources Used to Finance Activities

13. The first section of the statement of financing is "resources used to Finance activities." Resources include those provided through the Federal budget and those not accounted for in the budget, which are designated "other" in the table.

14. ***Budgetary resources*** means "net obligated resources," as defined in the context of the statement of budgetary resources. This is a critical definition for the statement of financing. Care must be taken not to confuse this with total resources, e. g., with total appropriations received and available, as the statement of financing is not concerned with total resources, or restrictions on OMB's ability to apportion or the agency's ability to allot total resources. A resource does not finance an activity unless it is obligated, and, hence, the statement of financing includes only obligated resources. Gross obligations – those reported on line 8 of the statement of budgetary resources illustrated in OMB Bulletin 01-09 (see Appendix D) – consist of:

    (1) undelivered orders for goods and services or benefits to be provided, both with and without advances or prepayments, and
    (2) delivered orders for goods and services or the provision of benefits, both paid and still payable.[8]

15. It should be noted that the amount reported on line 8 of the OMB illustration (see Appendix D) is the difference between the beginning and ending balances of undelivered and delivered orders. If, for example, the beginning amount of orders was $100 and the ending amount was $250, the amount reported as new obligations during the period would be the difference, which is $150. Since any component of obligations can either increase or decrease during the year, its arithmetic contribution to the amount of new obligations for the reporting period could be positive or negative, except for delivered orders paid, which cannot be negative.[9]

16. This is illustrated with the following example. Here, and throughout this guide, small numbers are used to simplify illustration and comprehension, and lines may be abbreviated or paraphrased to fit reasonably into available space or to better support topics discussed.

8 See the definitions for "obligated balance" and "obligations" in OMB Circular A-34, *Instructions on Budget Execution* (November. 3, 2000), p. 4, and the account definitions for the 4800 and 4900 series of accounts in *USSGL*, pp. II-52 through II-56.

9 See, e.g., US*SGL,* Section V, crosswalk items for line 6, "obligations incurred," of the Statement of Budgetary Resources, p. V-46.

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Component	Ending Balance	Beginning Balance	Change
Undelivered Orders w/o Advance	$250	$100	+$150
Undelivered Orders w/Advance	50	75	- 25
Delivered Orders Payable	100	150	- 50
Delivered Orders Paid	500	0[10]	+ 500
Total Obligations	$900	$325	+$575

17. The amount reported for gross obligations on line 8 of the statement of budgetary resources would be $575. The importance of knowing the amount of the computation for each individual component, including its arithmetic sign, will become clear in the next section, which discusses the lines for the statement of financing illustrated in OMB Bulletin 01-09.

18. The Board prescribed reconciling gross rather than net obligations with net cost of operations. Net obligations is defined for most agencies as the difference between gross obligations and

    (1) recoveries of prior-year authority not involving cash and
    (2) offsetting collection activity,[11] which is comprised of

    - actual cash collections,
    - budgetary accounts receivable (i.e., receivables recognized as budgetary resources in the Federal budget), and
    - unfilled customer orders (orders received by an agency to provide goods and services to the requesters, both with and without advances, with the caveat that in most cases, orders from the public without advances cannot be accepted).

    Offsetting collection activity may include more than actual cash collections.[12]

19. Recoveries of prior-year obligations not involving cash occur when obligations made in prior years are cancelled in the current year or are filled in an amount less than originally recorded. For example, a purchase order without an advance may be placed for, say, $100 in Year A. In Year B, the goods or services ordered are received, and the bills are $98. In that case, there is a recovery in Year B of the $2 difference. Of course, if the order was canceled in Year B, with no goods or services received, the entire $100 would be reported as a recovery in Year B. Recoveries of prior-year obligations are found in OMB Bulletin 01-09 illustration of the statement of

10 As readers should be aware, the beginning balance of paid delivered orders will always be zero, because the balance of the ledger accounts for this are brought to zero at the end of the year in the adjusting and closing processes. (See US*SGL*, closing entry F214, p. III-159.)

11 This can be seen in OMB Bulletin 01-09 illustration of the statement of financing, lines 1-5, on p. 46.

12 *OMB Circular A-34*, p. 4, and *USSGL* definitions for accounts 4221, 4222, 4225, 4251, and 4252, e.g. (p. II-43).

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budgetary resources on line 4.[13] With respect to recoveries where the availability of the funds for future obligation has expired or been canceled, the recovery is offset by a withdrawal of funds, which eliminates any difference between net obligations and the net cost of operations.[14]

20. Offsetting collection activity is found in that illustration, as well. Actual cash collections are reported in that illustration on line 3(a)1; budgetary accounts receivable are reported on line 3(a)2; and unfilled customer orders are reported on line 3(b). The OMB illustration labels line 3(a)2 as "receivable from Federal sources."[15] This is because that absent legislation to the contrary, receivables from the public do not count as budgetary resources and would not be reported on the statement of budgetary resources.[16]

21. A further caveat should be noted in determining the amount of collecting activity from federal receivables and from unfilled customer orders. The amount reported on the statement of budgetary resources is determined as the *change* in these items from the beginning to the end of the reporting period rather than their balances at the end of the period. The OMB illustration indicates in the line caption that the amount for unfilled customer orders is the change in the dollar amount of those orders, but it does not indicate that for the receivables.[17]

22. "Offsetting" in the term "offsetting collections" means that the resources generated by the collecting activity are added to expenditure accounts[18] and hence "offset" gross obligations. In a sense, the budgetary cost of an agency is its gross obligations less its offsetting collections and distributed offsetting receipts (i.e., the offsetting receipts distributed to that agency).[19]

23. OMB Bulletin 01-09 required one additional item on the statement of financing to be included in determining net obligations that had not previously been used. The term

13 OMB Bulletin 01-09, p. 41.

14 See OMB Circular A-34, *Instruction on Budget Execution*, section 30, for the treatment of recoveries of prior-year obligations for expired accounts.

15 OMB Bulletin 01-09, p.41.

16 Note that OMB Bulletin 01-09 captions the line for receivables on the statement of budgetary resources, line 3.b.1, as "receivable from federal sources." This is consistent with the related presentations in the SF-132, "Apportionment and Reapportionment Schedule, and SF-133, "Report on Budget Execution and Budgetary Resources," and related instructions, in *OMB Circular A-34*, pp. 57, 73, 99, and 117.

17 OMB Bulletin 01-09, p. 41.

18 The budget distinguishes between receipt accounts and expenditure accounts. "Receipts" are collections from the public primarily from the exercise of the Government's sovereign power, e.g., income and payroll taxes. Outlays are disbursed or made from expenditure accounts. See OMB Circular A-11, *Preparing and Submitting Budget Estimates*, section 20 generally, and especially section 20.7.

19 The budget records money collected by Government agencies two different ways. Depending on the nature of the activity generating the collection, they are recorded either as (1) ***receipts***, which are compared in total to net outlays; or (2) ***offsetting collections*** or ***offsetting receipts***, which are deducted from gross outlays to produce net outlays.

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for that item is "offsetting receipts," which sounds the same as offsetting collections but there is a basic difference. Offsetting collections are included in the entity's expenditure accounts and thus are usually available for spending for the purposes of the account without further action by Congress. If the law does not authorize crediting offsetting collections to an expenditure account, the entity must credit them to a receipt account, and they are deemed "offsetting receipts." Offsetting collections are thus deducted from gross budgetary authority and outlays at the expenditure account level. Offsetting receipts are usually deducted at the agency-wide level, i.e., from the gross budget authority and outlays of the agency that conducts the activity generating the receipts, though in a few cases they are deducted at the government-wide level. [20]

24. One example of offsetting receipts is found in federal credit programs under the Credit Reform Act of 1990. Under that Act, negative subsidies and downward re-estimates of subsidy expense for direct loan and loan guarantee programs are deposited by a credit agency to designated miscellaneous receipt accounts (or other designated accounts).[21] These monies are not available to the agency to use in its operations unless specifically authorized by law, but they are associated with the agency in the Federal budget. Hence, they constitute "offsetting receipts," and must be deducted from gross obligations of an agency to determine net obligations.[22]

25. There are a great many other examples of offsetting receipts, but regardless of their source, the key is that they are associated with the collecting agency in the Federal budget. Care must be taken not to confuse them with custodial collections, which are amounts collected for others and associated with those others in the Federal budget. The Internal Revenue Service and Department of Customs make collections of income taxes and customs duties, respectively, and they are deposited into designated accounts of the Treasury, which are unavailable to either for use in its operations. However, these amounts are not associated with the collectors in the Federal budget, and do not reduce the budgetary costs of the collectors. Hence, they are not offsetting receipts and do not enter the computation of net obligations for the collecting entities.[23]

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20 *OMB Circular A-34*, p. 4. Also see *Analytical Perspectives* in the FY 2003 United States budget series of publications, chapter 5, "User Fees and Other Collections," pages 83-94, and chapter 25, "Budget Systems and Concepts," pages 432-34 for additional information on offsetting collections and offsetting receipts. The purpose of subtracting offsetting collections and offsetting receipts from gross outlays rather than adding them to taxes on the receipt side of the budget is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice, rather than through the market.

21 In limited instances, deposits are made to special fund receipt accounts rather than to miscellaneous receipts accounts, which has different requirements for reporting the fund balance with Treasury. However, these requirements do not affect the statement of financing.

22 OMB Circular A-11, *Preparation and Submission of Budget Estimates* (July 2001), pp. 296-297, 304-305; *OMB Circular A-34,* pp. 175, 177-178; and OMB Bulletin 01-09, pp. 39-43, 46-48.

23 FASAB *Standard 7*, pars. 45, 49-63; *Implementation Guide to Standard 7*, pp. 29-31; and OMB Bulletin 01-09, pp. 53-54.

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26. Based on this information, the computation of net obligations can be summarized as shown in figure 2, below.

Figure 2:
COMPUTATION FOR NET OBLIGATIONS[a]

1. Gross obligations (line 8 of the OMB Bulletin 01-09 Illustration of the Statement of Budgetary Resources)

2. Less recoveries of authority (line 4)

3. Less offsetting collections of cash (line 3.a.1)

4. Less the change in budgetary receivables[b] (line 3.a.2)

5. Less the change in unfilled customer orders[b] (line 3.b)

6. = Net obligations before deducting offsetting receipts, or, said another way, Gross obligations less offsetting collections (used in the larger sense of the word to mean "offsetting collecting activity, the combination of lines 2, 3, 4, and 5 of this table)"[c, d]

7. Less offsetting receipts

8. = Net obligations

[a]The computations in this table include both the budgetary and non-budgetary columns of the statement of budgetary resources.

[b]Note that because these lines are "subtraction lines," the arithmetic sign used would be opposite that for the change in the items. If there were an increase, the arithmetic sign would be a minus. If there were a decrease, the arithmetic sign would be a plus.

[c]Note that agencies may not have any offsetting receipts. When that is the case, line 6 is net obligations.

[d]A few agencies also have transfers from trust funds, which is a separate item to be deducted in the computation for line 6 and appears on line 3.d on the statement of budgetary resources. The line is not indicated here because of its limited applicability.

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27. The net obligations amount constitutes the budgetary resources that finance activities in figure 1, and is the budgetary amount that is to be reconciled with the net cost of operations on the statement of financing.

28. A further caveat regarding consolidation may be made here. The statement of financing is a consolidated statement. However, in computing net obligations, combined amounts, as found on the statement of budgetary resources, rather than consolidated amounts are used. Although the Federal budget reports a consolidated amount for net obligations, its method of consolidating is to decrease the *total* obligations, without elimination for inter-entity transactions, by the *total* recoveries and offsetting collection activity, without elimination for inter-entity transactions. The amount of obligations is the same in either case.[24]

29. Assume, for example, that a reporting entity has two sub-components, A and B. Suppose that entity A obligates resources to make a $10 disbursement to B, which records the transaction as an offsetting collection. Combined and consolidated approaches to reporting this are shown below.

	Combined Reporting	**Consolidated Reporting**
Obligated Resources	$10	$-0-
Offsetting Collections	(10)	-0-
Net Obligated Resources	$-0-	$-0-

30. Note that under the combined approach, both the obligation and the offsetting collection are reported, although they are between components of the same entity. Under the consolidated approach, the intra-entity transactions are eliminated. In either case, the net obligations (net obligated resources) are the same. OMB Bulletin 01-09 requires that the combined approach be used for reporting the lines leading to net obligated resources on the statement of financing, which makes the statement traceable to the Federal budget and to agency information sent to OMB that goes into the compilation of the Budget. It also requires that the remainder of the statement be consolidated on a "line-by-line" basis.[25]

Other Resources Used to Finance Activities

31. One of the reasons that the net obligations does not equal the amount of the net cost of operations is that there are resources which are not reported in the Federal budget which may finance the net cost of operations or other activities of the agency. These resources must be included in order to report the total resources from all sources that finance activities.

24 OMB Bulletin 01-09, pp. 6, 39-40.

25 OMB Bulletin 01-09, pp. 6, section 1.8, and 47-50.

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32. The "other" resources are taken from the "other financing sources" section of the statement of changes in net position illustrated in OMB Bulletin 01-09 (see Appendix C). That section is comprised of lines 12 through 15, which are designated for donations and forfeitures of property (line 12), transfers-in and -out of property from one federal agency to another without reimbursement (line 13), financing sources imputed for costs of the reporting entity which are absorbed by others (line 14), and any additional financing sources which are not reported in the Federal budget (line 15). Care should be taken to realize that transfers-out would have an arithmetic sign of minus in the computation of total "other" resources. Similarly, line 15, which is for any additional items not delineated in the illustration, might have some items that would have an arithmetic sign of minus.

33. The combination of the net budgetary resources obligated and the resources not reported in the Federal budget constitute the total resources used to finance activities on the statement of financing.

Resources Used to Finance Items not Part of the Net Cost of Operations

34. Some resources clearly finance the net cost of operations. For example, consider the expense for a guard service. There would be obligated budgetary resources for the amounts due or paid to the guard service and these amounts would have been expensed. Because the obligated resources and the net cost of operations (the expense for the guard service) would be the same, there would be nothing to reconcile on the statement of financing.

35. However, not all resources finance the net cost of operations. While the next main section of this report, explaining the lines illustrated in the OMB Bulletin 01-09 illustration for the statement of financing, lists a number of these items, which are discussed there, two illustrations will be given here.

36. The first illustration is the acquisition of $1,000 of property, which is capitalized as an asset. Property could be acquired either through the obligation of budgetary resources, by donation from the public, or by transfer-in from another federal agency without reimbursement. The source of the financing, whether budgetary or non-budgetary resources, would appear in the first section of the statement of financing as a resource used to finance activities. However, the "activity"–the acquisition of the property–did not result in expense or exchange revenue, which are the components of the net cost of operations. To explain why resources are $1,000, but the net cost of operations is zero, there needs to be a listing in the section "resources which do not finance the net cost of operations" for acquisition of property. When this is entered, the statement of financing then reports resources of $1,000, subtracts resources which do not finance the net cost of operations in the amount of $1,000, and yields the net cost of operations, zero.

37. Similarly, items that may involve offsetting collecting activity do not affect the net cost of operations. Suppose, for example, that the unfilled customer orders increased by $10 during the reporting period. Reviewing figure 2, line 5, this would decrease net

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obligated resources by $10, because the change is subtracted. However, the change does not affect the net cost of operations, because it has no effect at all on the proprietary accounts, unless an advance is received, in which case only the asset Fund Balance with Treasury and the liability Advances from Others is recorded. No exchange revenue is recognized from the acceptance of an order to provide goods and services to the requester. Recognition of revenue would occur only when the orders were filled and resulted in a receivable or a cash collection. Hence, the net budgetary resources obligated would be -$10, and the net cost of operations would be zero. The difference is explained in the section on resources which do not finance the net cost of operations, and would be entered as +$10. When this is entered, the statement of financing reports resources of -$10, removes resources which do not finance the net cost of operations in the amount by adding back the $10, and yields the net cost of operations, zero.

38. If unfilled customer orders had *decreased* by $10 instead, the statement of financing would explain the difference between resources and net cost of operations in the same manner. The net obligated budgetary resources would be +$10 in this case, because since the change in unfilled customer orders is subtracted from gross obligations, the subtraction of the decrease (-$10) results in an arithmetic sign of plus. Net cost of operations is still zero, and the $+10 would be removed in the section on resources which do not finance the net cost of operations. Resources would be +$10; $10 of resources not financing the net cost of operations would be subtracted; and this would yield the net cost of operations, zero.

Components of Net Cost of Operations that Do Not Generate or Use Resources in the Reporting Period

39. Removing from total resources the resources that do not finance the net cost of operations leaves the resources that *do* finance the net cost of operations, but this is still not the amount reported for the net cost of operations. This is because some of the components of net cost do not use or generate resources in the reporting period. These components can be grouped into two general categories: those that will generate or use resources in subsequent reporting periods and those that will not.

40. The first category can be illustrated through the expense recorded for an accrual to increase an agency's liability for annual leave at the end of the year because employees earned more leave than they took. This proprietary transaction increases the expense for annual leave benefits and correspondingly increases the annual leave liability. However, it has no effect on the budgetary accounts, because Congress does not fund annual leave on an accrual basis. It is financed when it is taken and the amounts are paid to the employees who took the leave. Thus, resources are zero, but the net cost of operations includes the amount of the accrued leave.

41. Assuming an accrual of $10, then, resources would be zero, and the net cost of operations would be $10. The difference would be explained by adding $10 in the statement of financing section on components of net costs, which do not use

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resources and indicating that it was for the increase in the annual leave liability for the year. When this is done, resources are zero, components of net costs not using resources are $10, and the two together yield the $10 net cost of operations.

42. The annual leave example was a case in which the expense would be financed in a subsequent period. At such time in succeeding years as employees take the leave that was accrued, they will be paid for it, and budgetary resources will be obligated for that payment. There are other cases, however, where components of net cost of operations will not use or generate resources in the current or future periods.

43. A common example of that is for depreciation on capitalized assets. Suppose that the $1,000 of capitalized property acquired in our previous illustration was to be depreciated for $100 in the current period. In that case, $100 of depreciation expense will be recorded, and the net cost of operations will thus be $100.

44. There is no budgetary effect of a transaction to record depreciation. An agency's budget is concerned with acquiring assets, not in their subsequent use. Hence, while resources will be obligated to acquire capitalized property, no budgetary accounts are affected by its subsequent depreciation. Because of this, the depreciation transaction would result in resources of zero and net cost of operations of $100. The reconciling factor, reported in the section on components of net cost, which do not use resources, would be the depreciation of $100. The zero resources plus the $100 of net cost components not using resources would yield the $100 net cost of operations.

Net Cost of Operations

45. The net cost of operations must be computed by totaling the statement of financing sections on (1) resources, (2) resources which do not finance net cost of operations, and (3) components of net cost of operations which do not generate or use resources in the reporting period. The amount thus derived must equal the amount reported for net cost of operations on the statement of net cost (line 10 of the OMB Bulletin 01-09 illustration for that statement – see Appendix B). That same amount also appears in the net cost of operations on line 17 of the OMB Bulletin 01-09 illustration for the statement of changes in net position.

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IV. EXPLANATION OF LINES ON THE ILLUSTRATIVE STATEMENT OF FINANCING IN OMB BULLETIN 01-09, *FORM AND CONTENT*

46. The preceding narrative discussed the concepts of the structure of the statement of financing. This section expounds on those concepts by explaining how specific lines on the statement of financing illustrated in OMB Bulletin 01-09 are used to disclose the differences between net obligations (net budgetary resources obligated), and net cost of operations.

47. While the illustration in the OMB Bulletin provides the basis for the discussion in this section, the actual format used by an agency need not have exactly the same line items or the same words captioning the line items or the headings. However, it must contain the major sections to set forth the resources, those resources, which do not finance the net cost of operations, and those components of net cost of operations, which do not require or generate resources during the reporting period[26]. The result of combining the sections must be the amount of the net cost of operations, with the statement then explaining to the reader why the net obligations and the net cost of operations are different.

48. The OMB illustration for the statement of financing is reproduced in Figure 3, below (this illustration is also presented in Appendix A).[27] The comparative columns are omitted for purposes of simplifying the display, as they do not add to the theory underlying the statement. Of course, agencies must present comparative information in their statements in accordance with time schedules specified in OMB Bulletin 01-09.[28]

26 OMB Bulletin 01-09, pp. 6, 15.

27 OMB Bulletin 01-09, pp. 46-47.

28 OMB Bulletin 01-09, p. 13.

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Figure 3: Illustrative Statement of Financing from OMB Bulletin 01-09 (Sections 1 and 2)

Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

Resources Used to Finance Activities:	
Budgetary Resources Obligated	
1. Obligations incurred	$ xxx
2. Less: Spending authority from offsetting collections & recoveries	xxx
3. Obligations net of offsetting collections and recoveries	xxx
4. Less: Offsetting receipts	xxx
5. Net obligations	xxx
Other Resources	
6. Donations and forfeitures of property	xxx
7. Transfers in/out without reimbursement (+/-)	xxx
8. Imputed financing from costs absorbed by others	xxx
9. Other (+/-)	xxx
10. Net other resources used to finance activities	xxx
11. *Total resources used to finance activities*	x,xxx
Resources Used to Finance Items not Part of the Net Cost of Operations	
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	xxx
13. Resources that finance expenses recognized in prior periods	xxx
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	
14a. Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	xxx
14b. Other	xxx
15. Resources that finance the acquisition of assets	xxx
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	xxx
17. *Total resources used to finance items not part of the net cost of operations*	xxx
18. *Total resources used to finance the net cost of operations*	x,xxx

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Figure 3: Illustrative Statement of Financing from OMB Bulletin 01-09 (Section 3)

Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 2 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:	
Components Requiring or Generating Resources in Future Periods:	
19. Increase in annual leave liability	xxx
20. Increase in environmental and disposal liability	xxx
21. Upward/Downward re-estimates of credit subsidy expense (+/-)	xxx
22. Increase in exchange revenue receivable from the public	xxx
23. Other (+/-)	xxx
24. Total components of net cost of operations that will require or generate resources in future periods	xxx
Components not Requiring or Generating Resources:	
25. Depreciation and amortization	xxx
26. Revaluation of assets or liabilities (+/-)	xxx
27. Other (+/-)	xxx
28. Total components of net cost of operations that will not require or generate resources	xxx
29. *Total components of net cost of operations that will not require or generate resources in the current period*	x,xxx
30. *Net cost of operations*	$ x,xxx

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Resources Used to Finance Activities
(Lines 1-11)

49. Figure 4, below, contains the OMB illustration for the first section of the statement of financing, resources used to finance activities.

Figure 4:
Resources Used to Fund Activities

Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$	xxx
2. Less: Spending authority from offsetting collections and recoveries		xxx
3. Obligations net of offsetting collections and recoveries		xxx
4. Less: Offsetting receipts		xxx
5. Net obligations		xxx
Other Resources		
6. Donations and forfeitures of property		xxx
7. Transfers in/out without reimbursement (+/-)		xxx
8. Imputed financing from costs absorbed by others		xxx
9. Other (+/-)		xxx
10. Net other resources used to finance activities		xxx
11. *Total resources used to finance activities*	x,xxx	

50. The concepts underlying this section were set forth in paragraphs 11-33 of this guide and will not be repeated here. A listing of the lines of the statement of financing and the lines of the statements of budgetary resources and of changes in net position to which they must correspond are set forth in figure 5. Lines not shown are subtotals of other lines.[29]

Figure 5:
Correspondence Between Financial Statements for Section 1 of the Statement of Financing

Statement of Financing line no. (see App. A)	Statement of Budgetary Resources line no. (see Appendix D)	Statement of Changes in Financial Position line no. (see Appendix C)
1	8	
2	3a + 3b + 3d + 4	
4	16	
6		12
7		13
8		14
9		15

29 OMB Bulletin 01-09, pp. 35, 41-42, 46-47.

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51. As can be seen from the table, no additional work is required to prepare the first section of the statement of financing. Every figure must already be computed for another financial statement.

Resources Used to Finance Items Not Part of the Net Cost of Operations (Lines 12-17)

52. Figure 6 reproduces the second section of the statement of financing, "resources that do not finance the net cost of operations," or, said another way, resources used to finance items *not* part of the net cost of operations.

Figure 6:
Resources Used to Finance Items not Part of the Net Cost of Operations

Resources Used to Finance Items not Part of the Net Cost of Operations	
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	xxx
13. Resources that finance expenses recognized in prior periods	xxx
14. Budgetary offsetting collections and receipts that do not affect net cost of operations	
14a. Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	xxx
14b. Other	xxx
15. Resources that finance the acquisition of assets	xxx
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	xxx
17. *Total resources used to finance items not part of the net cost of operations*	xxx
18. *Total resources used to finance the net cost of operations*	x,xxx

53. **Line 12** is used to explain the difference between the total resources used to finance activities and the net cost of operations because of the change in "budgetary resources obligated for goods and services and benefits ordered but not yet provided," i.e., "undelivered orders." Undelivered orders are part of the gross obligations on line 1. However, they do not affect the net cost of operations. If an undelivered order is not accompanied by an advance, it does not affect the proprietary accounts at all (the mere ordering of goods and services or benefits to be provided is not recognized in the proprietary accounts, which require that the goods and services be received or the benefits be provided, either through accrual of payables or through actual payment, for recognition). If an advance accompanies the order, there *is* a proprietary effect, but not on the net cost of operations, which is the difference between expenses and exchange revenues. The advance which may accompany an undelivered order would be recorded in the proprietary accounts by increasing prepayments, and asset, and decreasing fund balance with Treasury, also an asset. No expenses or exchange revenues result from the transaction.

54. Thus, for a transaction involving the placing of an undelivered order of $100, line 1 would be $100 and line 30, the net cost of operations, would be zero. The reconciling

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factor is the undelivered order, which would be shown as a negative amount on line 12. This would be the reporting for all increases in undelivered orders during the reporting period.

55. As discussed previously in this guide, the computation of obligations involves the change in undelivered orders over the reporting period. If that change were negative (i.e. if undelivered orders decreased over the reporting period), reverse signs would be required. If there was a $100 decrease in undelivered orders, then, based solely on that, line 1 would be -$100 and line 30 would still be $-0-. The reconciling figure would be placed as a positive amount on line 12.

56. **Line 13** is used to explain differences in resources and net cost of operations caused by expenses, which were accrued in previous periods but paid in the current period. Assume, for example, the following information about the annual leave liability, which Congress funds on a cash rather than an accrual basis:

A.	Beginning Balance	$1,000
B.	Leave Earned	200
C.	Leave Taken	250
D.	Ending Balance	$ 950

57. For this example, the budget would have recorded obligations of $250 for the leave taken. However, the annual leave expense would only be $200. Thus, line 1 would show $250, and line 30 would show $200. The difference is accounted for by the decrease in the annual leave balance, which is an example of “resources that finance expenses recognized in prior periods.” Here, the $250 payment financed all of the current year’s accrual, and $50 of accruals in prior years–recorded as expenses in those years. The decrease would be shown as a negative $50 placed on line 13.

58. Note that the $50 is theoretically the difference between data elements B and C in the list, but the arithmetic is such that the same amount can be determined by taking the difference between A and D. When C is greater than B, or, correspondingly, there is a decrease from A and D, the reconciling item is a negative amount placed on line 13. The treatment for situations in which there is an increase in the annual leave liability is not parallel. That situation is discussed in conjunction with line 19. This same reporting rationale would apply to any liability which Congress funds on a cash rather than an accrual basis.

59. **Line 14** either deals with offsetting collections that do not result in reductions of expenses or increases in exchange revenues. **Line 14a** is provided for credit program collections, which increase liabilities for loan guarantees (in a loan guarantee program) or increase the allowance for subsidy (in a direct loan program) placed against credit program assets to reduce them to their present value. The rules for credit program accounting involving direct loans or loan guarantees obligated after September 30, 1991, the implementation of “credit reform,” are such that certain collections which under pre-credit reform rules would be recorded as exchange

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revenue are instead recorded as increases in the loan guarantee liability or allowance for subsidy.[30]

60. Assume that $10 in application fees is collected in a program under credit reform. That collection is recorded in the budgetary accounts as an offsetting collection, and would be included in line 2 of the statement of financing. Note that because line 2 is a subtraction line, the sign for the collection would be negative. Because the credit reform rules would require that the amount be used to increase the loan guarantee liability (in a loan guarantee program) or the allowance for subsidy (in a direct loan program), the net cost of operations would be unaffected. Hence, the statement of financing would show, solely for this transaction, -$10 on line 2 and zero on line 30. The reconciling factor of +$10 would be placed on line 14a. (See table below.)

61. **Line 14b** would be used for all other transactions which are recorded as offsetting collection activity but which do not affect the net cost of operations. One such transaction, involving unfilled customer orders, is relatively common and was discussed in paragraphs 18-20 of this guide. If there was an increase in unfilled customer orders of $10 that would appear as -$10 on line 2 and zero on line 30. The reconciling factor would be a +$10 on line 14b. (If it was material, a separate line should be shown for it rather than placing it on an "other" line. Generally, material items would be so displayed.) If there was a $10 decrease in unfilled customer orders, that would appear as a +$10 on line 2 and zero on line 30. The reconciling factor would be a -$10 placed on line 14b (or a specific line for unfilled customer orders). Remember that because line 2 is a subtraction line, an offsetting collection amount is shown as minus if it increased and plus if it decreased. (See table below.)

62. **Line 15** is used for acquisitions of assets–fixed assets, supplies inventory, merchandise inventory, and so forth. This was discussed on paragraph 36 of this guide. In the case of the $1,000 asset acquired in that example, line 1 would show the $1,000 if budgetary resources were obligated to obtain the asset, line 6 if the public donated the asset, or line 7 if it was transferred in from another federal agency without recourse. Line 30 would be zero, and the reconciling factor would be a -$1,000 reported on line 15. (See table below.)

	Application Fee	Unfilled Customer Orders	Asset Acquisition
Line 1			$ +1,000
Line 2	$ -10	$ -10/ +10	
Line 14a	+10		
Line 14b		+10/ -10	
Line 15			- 1,000
Line 30	$ 0	$ 0/ 0	$ 0

63. **Line 16** is for any other situation not covered in lines 12-15 which is a reconciling

30 SFFAS 2: *Accounting for Direct Loans and Loan Guarantees*, pars. 22-23, 37-38, and SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees* (May 2000), par. 10 and Appendix B.

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item involving a resource which was not used to finance the net cost of operations. **Line 17** is the combination of lines 13-16, and **line 18**, while not in section 2 itself, is the combination of lines 17 and 11, or stated another way, is the difference between section 1 and section 2. Note that line 11 is the total resources used to finance activities; line 17 is the total resources used to finance items which *did not* finance the net cost of operations (i.e. did not result in an expense or an exchange revenue); and thus, line 18, the difference between 11 and 17, is the amount of resources which *did* finance the net cost of operations.

Components of the Net Cost of Operations Not Requiring or Generating Resources (Lines 19-29)

64. Figure 7 contains OMB's lines for the third section of the statement of financing, "components of the net cost of operations that will not require or generate resources in the current period." Remember that these components are expenses that do not require resources in the current period, and exchange revenues that do not generate resources in the current period. As discussed on paragraphs 39-44, these items may be divided into two broad categories, those that will require or generate resources in subsequent periods and those that will not. OMB has illustrated the former with lines 19-24, and the latter with lines 25-28.

Figure 7:
Expenses and Exchange Revenues Which Do Not Require or Use Resources During the Reporting Period

Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:	
Components Requiring or Generating Resources in Future Periods:	
19. Increase in annual leave liability	xxx
20. Increase in environmental and disposal liability	xxx
21. Upward/Downward reestimates of credit subsidy expense (+/-)	xxx
22. Increase in exchange revenue receivable from the public	xxx
23. Other (+/-)	xxx
24. Total components of Net Cost of Operations that will require or generate resources in future periods	xxx
Components not Requiring or Generating Resources:	
25. Depreciation and amortization	xxx
26. Revaluation of assets or liabilities (+/-)	xxx
27. Other (+/-)	xxx
28. Total components of Net Cost of Operations that will not require or generate resources	xxx
29. *Total components of net cost of operations that will not require or generate resources in the current period*	x,xxx

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65. **Line 19** is for expenses related to an increase in the liability. This situation was discussed in paragraphs 40-42, in which the annual leave liability increased by $10. The reporting would involve zero for resources and $10 for the net cost of operations. The reconciling factor would be a positive $10 on line 19. Note that a situation in which the annual leave liability decreases is handled through line 13. **Line 20** is exactly the same thing, except that the difference is caused by the liability for environmental disposal and cleanup rather than by the annual leave liability. Increases in the liability create a reconciling factor on line 20, and decreases on line 13.

66. **Line 21** is related to credit program accounting under the Credit Reform Act of 1990. The Act provides that agencies will get subsidies to cover defaults and other situations for direct loans and loan guarantees obligated after September 30, 1991. The amount of subsidy is re-estimated each year, and if more subsidy is needed than was provided, it is obtained from an appropriation in the next year. If less subsidy is needed than was provided previously, the excess amount must be deposited to a designated special or miscellaneous receipt in the Treasury in the next year. Because accrual accounting recognizes these adjustments in the year to which they are due, but budgetary accounting does not recognize them until the succeeding year, resources and the net cost of operations disconnect.

67. Suppose that in Year A, a credit-program agency estimates that its subsidy, including interest, was $100 too little–that is, an upward subsidy adjustment, or re-estimate, must be made. Because there will be no budgetary recognition until the following year, resources are zero. However, the net cost of operations contains the $100 of additional, accrued subsidy expense. Thus, line 11 would be zero, and line 30 would be $100. The reconciling factor is the subsidy expense, which would be placed as a positive amount on line 21.

68. The treatment for a downward re-estimate is parallel to that for an upward re-estimate. Suppose that instead, the agency had a downward subsidy re-estimate of $100. In that case, there would still be no budgetary effect, but expenses, and the net cost of operations, would have been *decreased* by the $100. Accordingly, line 11 would be zero, and line 30 would be -$100. The reconciling item is the downward re-estimate, and would be shown as -$100 on line 21.

69. There is an opposite effect in the subsequent year (Year B in the example), in which there is no further effect on the net income from collecting or paying the re-estimated amounts, but there is a budgetary effect. The treatment is not parallel, and is discussed in the final section of this guide, which covers the effect of selected additional transactions on the statement of financing.

70. **Line 22** is for increases in receivables for exchange revenue from the public over the reporting period. Absent specific legislation to the contrary, public receivables do not count as budgetary resources until they are collected. Hence, the revenue related to

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accruals of those resources is not reflected in offsetting collection activity at the time they are accrued.[31]

71. Assume that the following data elements are compiled for interest receivable from the public in Year A.

A.	Beginning Balance	$100
B.	Interest Earned	25
C.	Interest Collected	20
D.	Ending Balance	$105

72. The budgetary transactions would include recognizing the $20 of interest collected as an offsetting collection, and hence line 2 of the statement of financing would be -$20 (remember that line 2 is a subtraction line, and hence the sign for the $20 of collections would be minus). The net cost of operations on line 30 would be -$25, however, recognizing the amount of interest earned on an accrual basis. This indicates that there is -$5 in net cost of operations that is not reflected in resources– i.e. that did not generate recognized budgetary resources. The -$5 would be placed on line 22. The reconciling item is the difference between B and C, and the arithmetic is such that it can also be computed by subtracting A from D, noting that the receivable increased.

73. The situation for a decrease in exchange revenue receivable from the public is not parallel. It is discussed in the final section of this guide, which covers the effect of selected additional transactions on the statement of financing.

74. **Line 23** is for all other expenses or exchange revenues that do not require or generate resources in the current period but will do so in a subsequent period. **Line 24** is the subtotal of lines 19-23.

75. **Line 25** is the first under the section “components [of the net cost of operations] not requiring or generating resources” [in the current or future periods]. It is for depreciation and its related component, amortization. Depreciation was discussed in paragraphs 43-44. In the example, total resources – line 11– would be zero, and the net cost of operations, line 30, would be $100. The reconciling factor is the depreciation expense, which would be placed as a positive amount on line 25. Depreciation expense will not use budgetary resources in the current or future periods, because the related resources were used to acquire the equipment – either through obligating budgetary resources or from public donations or transfers-in from other federal agencies without reimbursement.

76. Cost of goods sold and the expense for supplies used are additional examples of items, which fit into the category of this line. They are treated in exactly the same way, as is depreciation, because they relate to an expense for use of assets or the allocation of their cost over time, which does not use resources.

31 See paragraph 20 and OMB Bulletin 01-09, p. 41.

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77. **Line 26** is for situations in which assets or liabilities are revalued, resulting in related expenses (losses) or exchange revenues (gains) that do not generate or use resources. Assume that an agency has $1,000 of capitalized property on its books, and that a physical inventory indicated that only $950 was accounted for. The resulting adjustment of $50 would decrease inventory and increase expenses (loss from theft, natural disaster, shrinkage, etc.). Thus, resources on line 11 would be zero and the net cost of operations on line 30 would be $50. The reconciling factor of $50 would be placed as a positive amount on line 26.

78. The treatment for a situation in which there was *more* property than expected is parallel. Assume that instead of a physical inventory indicating $950, it indicated $1,050 of merchandise on hand. In that case, the resources on line 11 would still be zero, but the net cost of operations on line 30 would be -$50, reflecting the gain. The reconciling factor would be -$50, and would be placed on line 26.

79. **Line 27** is for any expenses or exchange revenues that will not require or generate resources in the current or future periods that are not accounted for on lines 25 or 26, and **line 28** is the subtotal for lines 25 through 27. **Line 29** is the subtotal of lines 24 and 28.

Net Cost of Operations (Line 30)

80. The final line on the OMB Bulletin 01-09 illustration of the statement of financing is **Line 30**, which is the net cost of operations. This is computed by totaling line 29, the total components of net cost of operations that do not require or generate resources in the current period, and line 18, the total resources used to finance the net cost of operations. When these two lines are totaled, the result must be the net cost of operations, which must be the same amount as reported for that figure on line 10 of OMB's illustration for the statement of net cost and line 17 of its illustration of the statement of changes in net position.

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V. ADDITIONAL ILLUSTRATIVE ITEMS

81. This section explains how the statement of financing handles some transactions not covered in the preceding section of this guide. They were not discussed previously because the OMB illustration did not provide specific lines for them or the transactions did not integrate well in the preceding section. The transactions are for:

- Upward and downward credit program subsidy expense adjustments in the year of collection or payment;
- Receipt of basic positive credit program subsidy or payment of negative subsidy;
- Amortization of the allowance for subsidy for the interest differential component of the subsidy;
- Obligations for Items that decrease liabilities for loan guarantees or allowances for subsidy;
- Scrapping, transfer-out, or sale of fixed assets;
- Decrease in exchange revenue receivable from the public;
- Accruing and collecting non-federal receivables for overpayments of expenses;
- Defaults (bad debts) expense; and
- Prior period adjustments.

These transactions were chosen because of questions frequently asked about them, and are not intended to be comprehensive.

Upward and Downward Credit Program Subsidy Expense Adjustments in the Year of Collection or Payment

82. Section IV covered upward and downward adjustments of credit-program subsidy expense in the year the adjustments were accrued. In the following year, when upward adjustments are collected and downward adjustments are paid to the special or miscellaneous receipt account involved, the budget recognizes the collection or payment, but there is no further effect on the net cost of operations, which already accrued the resulting increase or decrease in subsidy expense in the preceding year.

83. Assume that an agency accrued a $50 upward re-estimate of subsidy expense in Year A. In Year B, the agency would have its program account disburse the $50 to its financing account. A discussion of the nature of these accounts is beyond the scope of this guide; both accounts are components of the reporting entity. In Year B, the program account would obligate the $50, and the financing account would collect

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it. Line 1 of the statement of financing illustrated by OMB would be $50, and line 2 would be-$50 for the obligation and collection, respectively, and thus the net obligated resources would be zero. Because the subsidy expense adjustment had already been accrued in the preceding year, the net cost of operations on line 30 would also be zero. Hence, there is no reconciling item required.

84. Assume instead that an agency accrued a $50 downward re-estimate of subsidy expense. In Year B, the agency would pay the money to a miscellaneous receipt account.[32] The financing account, which would make the payment, would record an obligation for the payment, which would appear as $50 on line 1 of the OMB statement of financing. The collection by the miscellaneous receipt account would appear as -$50 on line 4 of the statement as an offsetting receipt. Thus, the net obligated resources would be zero. Because the subsidy expense adjustment had already been accrued in the preceding year, the net cost of operations on line 30 would also be zero. Hence, there is no reconciling item required.

Receipt of Basic Positive Credit Program Subsidy or Payment of Negative Subsidy

85. A credit program financing account receives basic subsidy (as opposed to re-estimated subsidy) from the program account. The program account obligates resources and recognizes subsidy expense in the same amount as the obligation. The financing account records the offsetting collection from the program account, but increases the allowance for subsidy (a contra-asset) or the loan guarantee liability. Assume that a credit program's basic subsidy was $100. To report this, line 1 of the OMB illustration for the statement of financing would show the $100 obligation, and line 2 would show a -$100 for the offsetting collection, resulting in net resources of zero. The subsidy expense of $100 would result in net cost of operations in that amount on line 30.

86. The reconciling item is due to the fact that the collection resulted in an increase in a contra asset or a liability instead of a decrease in an expense or an increase in exchange revenue. The OMB illustration does not provide a specific line for that, and so line 14b, "other budgetary offsetting collections that do not affect net cost of operations," would be used to report the +$100 reconciling item. If the amount were material, the reporting entity would include a separate line in its statement of financing.

87. In summary, the statement of financing would report +$100 on line 1, -$100 on line 2, +$100 on line 14b, and +$100 on line 30.

88. Most federal credit programs receive subsidy, as in the preceding example. This may be called a "positive subsidy." However, in some credit programs the present value of cash inflows is more than the present value of cash outflows, so they have a negative subsidy. When such a program enters into transactions to issue direct

32 Most agencies would pay downward reestimates to a miscellaneous receipt account, but in special circumstances (such as mandatory programs) the downward reestimates could be paid to a program account, a special fund receipt account, or a liquidating account.

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loans or to make loan guarantees, it must borrow the amount of the negative subsidy and deposit it to its designated miscellaneous receipt account (it will repay the borrowing from future cash collections related to the direct loans or loan guarantees).[33] The deposit is made in the same year that the profit–a negative subsidy expense–is recognized.

89. Assume that a federal credit agency has a $100 negative subsidy. The financing account will obligate the $100, and that will appear as +$100 on line 1. The agency will record the collection in the miscellaneous receipt account as an offsetting receipt of -$100 on line 4. Thus, net obligated resources are zero. The net cost of operations on line 30 would be -$100, reflecting negative subsidy expense in that amount.

90. The reconciling item is due to the fact that the obligation resulted in a net financing disbursement by the non-budgetary financing account and a transfer-out of a financing source rather than an expense. The OMB illustration does not provide a specific line for that, and so line 16, “other resources or adjustments to net obligated resources that do not affect net cost of operation” would be used to report the -$100 reconciling item. If the amount were material, a separate line just for that would be included by the agency in its statement of financing.

91. In summary, the statement of financing would report +$100 on line 1, -$100 on line 4, -$100 on line 16, and -$100 on line 30.

Amortization of the Allowance for Subsidy for the Interest Differential Component of the Subsidy

92. A common trait in many direct loan programs is a subsidy component required because the rate of interest charged borrowers is less than what the Treasury must pay to borrow money. The agency is paying a higher interest expense on its own borrowing from Treasury than the rate it is receiving from the borrower, such that the interest expense is higher than the interest income. Because the subsidy is designed to compensate the agency for this difference, an amount equal to the difference between the interest expense and income is amortized from the allowance for subsidy by decreasing the allowance for subsidy and increasing interest income. The budgetary accounts, which have already recognized the obligation and offsetting collection for subsidy expense, are not affected by the transaction.

93. Hence, resources on line 11 of the OMB illustration of the statement of financing are zero, and the net cost of operations on line 30 is the amount of the amortization. The reconciling item would be placed as one of the “depreciation and amortization items” on line 25, as a positive amount. If the amount were $10, then line 11 would be $-0-, line 25 would be +$10, and line 30 would be +$10.

33 Again, most agencies would pay downward reestimates to a miscellaneous receipt account, but in special circumstances (such as mandatory programs) the downward reestimates could be paid to a program account, a special fund receipt account, or a liquidating account.

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94. It is possible, though more unusual, that the amortization is negative, meaning that the borrower is charged a greater rate than the government pays to obtain funds. The treatment for that is parallel to the treatment for positive amortization. Assume that there is negative subsidy amortization of $10 due to the interest differential. In that case, resources on line 11 are still $0, but the net cost of operations on line 30 is -$10 rather than +$10, because, as there has been more interest income from the borrowers than interest expense paid to the Treasury, interest income must be decreased by the amortization, increasing the net cost of operations. The reconciling factor of -$10 is placed on line 25.

Obligations for Items that Decrease Liabilities for Loan Guarantees or Allowances for Subsidy

95. Paragraphs 59 and 60 dealt with situations in which offsetting collections increased liabilities for loan guarantees or allowance for subsidy related to credit program assets. In those cases, budgetary resources were negative, and net costs of operations were zero. The reconciling item was the collection made.

96. A related situation occurs when obligations are placed that decrease liabilities for loan guarantees or allowance for subsidy. Assume, for example, that a $100 default claim is paid to a third-party lender because a guaranteed loan made by the lender defaults. An obligation placed for the $100 payment would appear on line 1. Because the transaction would decrease both the asset Fund Balance with Treasury and the loan guarantee liability, net cost of operations on line 30 would be zero. The Difference is explained by the default payment having been made. OMB Bulletin 01-09 does not have a separate line for this, and thus the reconciling item would appear on -$100 on line 16 in the model, for “other resources not financing the net cost of operations.” If it were material, a separate line with an appropriate caption would be used.

Scrapping, Transfer-out, or Sale of Fixed Assets

97. Sometimes an agency may scrap its fixed assets, transfer them to other agencies without reimbursement, or may sell them either for cost or at a gain or loss. Assume that an agency has a fixed asset with a book value of $100 and that it disposes of it under each of the following scenarios:

    1. Scrapping the asset.

    2. Transferring the asset to another agency without reimbursement

    3. Selling the asset for $100.

    4. Selling the asset for $110.

    5. Selling the asset for $85.

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98. The treatment for each of these situations on the statement of financing is shown below, using key lines on the OMB Bulletin 01-09 illustration for the statement.

Line	**Scenario 1**	**Scenario 2**	**Scenario 3**	**Scenario 4**	**Scenario 5**
RESOURCES					
2. Offsetting Collections			-$100	-$110	-$85
7. Transfers-out		-$100			
11. Total Resources	**$-0-**	**-$100**	**-$100**	**-$110**	**-$85**
RESOURCES NOT FINANCING COSTS					
14b. Other Collections Not Affecting Costs			$100	$100	$85
16. Other Resources Not Financing Costs		$100			
EXPENSES NOT REQUIRING RESOURCES					
26. Revaluation of Assets	$100				$15
30. Net Cost of Operations	**$100**	**$-0-**	**$-0-**	**-$10**	**$15**

99. In scenario 1, there were no resources generated by the transaction. The net cost of operations was increased by the loss on disposal, and the reconciling item is that loss, which, resulting from a revaluation of assets from $100 to $-0-, is reported on line 26. (A separate line item for losses on asset disposals could be inserted if the amount was material.)

100. In scenario 2, the transfer out would have been reported on the statement of changes in net position and would have reduced financing sources that were not reported in the Budget (transfers in would be zero, and transfers-out would be $100, resulting in a net reduction of $100). Accordingly, the reduction would appear on line 7. The net cost of operations was zero, because the transfer-out is not an expense. The reconciling item is placed on line 16, an “other” line, because the OMB illustration does not have a specific line for it. A discrete line item could be added, if the item were material.

101. In scenario 3, the sale resulted in a collection, making the net resources -$100. However, the net cost of operations was zero, because the asset was sold for its book value. Since none of the $100 collection resulted in net cost of operations, the

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reconciling item is on line 14b, an "other" line used because the OMB illustration does not provide a specific line. A specific line would be added if the amount were material.

102. Scenario 4 is similar to scenario 3, except that $10 of the $110 collection resulted in net cost of operations (a gain of $10, which yielded a negative net cost of operations in that amount). The other $100 was a reduction for the asset. Accordingly, the $100 reconciling item is placed on line 14b.

103. Scenario 5 is a bit more complicated, in that there are two reconciling items. The $85 is an offsetting collection, and appears on line 2, while the net cost of operations is $15, the amount of the loss on the sale. None of the $85 contributed exchange revenues to the net cost of operations, and hence a reconciling item in that amount is placed on line 14b. In addition, the $15 loss did not use resources, and hence a reconciling item in that amount is placed on line 26.

Decrease in Exchange Revenue Receivable from the Public

104. The discussion for line 22 in the previous main section of this guide dealt with an increase in exchange revenue receivable from the public over the reporting period. When the receivable decreases, the reporting is not parallel to that for an increase.

105. Assume that the following data elements are compiled for interest receivable from the public in Year A.

A.	Beginning Balance	$100
B.	Interest Earned	20
C.	Interest Collected	25
D.	Ending Balance	$ 95

106. The budgetary accounting will record the $25 of interest paid as an offsetting collection, and the proprietary accounting will result in interest revenue of $20. The collection will be reported as -$25 on line 2, while the net cost of operations on line 30 will be -$20. The difference of $5 is a collection that does not affect the net cost of operations, and would be reported as a reconciling item of +$5 on line 14b. The $5 can be computed as the difference between B and C or as the difference between A and D, noting that the receivable decreased.

Accruing and Collecting Non-federal Receivables for Overpayments of Expenses

107. Sometimes, agencies will accidentally overpay a vendor for expenses, and the amounts must be collected back. A receivable must be recorded in the proprietary accounts for the overpayment, and expenses are decreased accordingly. If the receivable is from the public rather than a federal entity, the budget will not recognize it as a resource until collected.[34] If collection is not made by the end of the year, net obligations will differ from net cost of operations.

34 See paragraph 20.

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108. Assume that a $10 overpayment for expenses was made to a non-federal vendor, and a receivable from the vendor was accrued. As of the end of the year, the receivable had not been collected. In this case, resources on line 11 are zero, because the non-federal receivable cannot be recorded in the budgetary accounts. The net cost of operations on line 30 is -$10, because of the decrease in the expense. The OMB illustration of the statement of financing does not provide a specific line for this, and so line 23, "other components of the net cost of operations not requiring or generating resources" would be used to report the -$10 reconciling item. If it were material, a separate line would need to be created for it.

109. If collection of the $10 was then made in a subsequent year, offsetting collections on line 2 would be -$10, but the net cost of operations would be zero, because the expense had already been reduced in the previous year. Because none of the collection affected net cost of operations, the reconciling item would be on line 14b, "other collections that do not affect net cost of operations." If it were material, a separate line would need to be created for it.

Defaults Expense

110. Agencies may reduce their accounts receivable, or their pre-credit reform loans receivable to net realizable value by accruing defaults (bad debts) expense. They may also accrue an allowance for estimated loan guarantee losses on their pre-credit reform loan guarantees. Such accruals are not recognized in the Budget, because neither resources nor the status of resources is affected by the transaction. However, the amount of the expense is part of the net cost of operations.

111. Assume that an agency accrues $10 of defaults expense at the end of the year. Resources on line 11 are zero, and the net cost of operations on line 30 is $10. The OMB illustration does not have a specific line for the reconciling factor, which would be placed on line 27, "other expenses not requiring resources." If the amount was material, a special line could be inserted in the statement.

Prior Period Adjustments

112. "Prior period adjustments" (PPA) is a phrase with a technical meaning in proprietary accounting.[35] PPAs adjust the opening balance of cumulative results. The term does not have the same technical meaning in budgetary accounting. Thus, there is a difference between a PPA and an adjustment of prior-period obligations. A PPA could be made for any number of things, and may or may not have a budgetary impact; and, if there is a budgetary impact, it may or may not affect the statement of financing.

113. For example, with respect to undelivered orders, an upward adjustment of an

35 See SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amending SFFAS No. 7,* Accounting for Revenue and Other Financing Sources.

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obligation in order to, for example, correct a recording error in a prior fiscal year would be a reconciling item on the current year's statement of financing [obligations increase, cost does not increase]. It would affect obligations but not the current year net cost of operations. Nor would it affect the prior year net cost of operations and, thus, it would not be a PPA in the proprietary system.

114. To illustrate, the following briefly discusses some possible situations involving upward or downward adjustments to receivables and liabilities:

a. *Non-federal receivables.* The budgetary system generally does not recognize non-federal receivables as resources, so an adjustment of a non-federal receivable would not affect net obligations. Hence, there would be nothing to report on the statement of financing, as net obligations and net cost of operations would both be zero.

b. *Federal receivables—upward adjustment.* An upward adjustment of a federal receivable, if not collected during the period, would appear as a negative item on line 2 of the statement of financing, and there would need to be a reconciling item between that and line 30, which would be zero. There is no specific line for that item in the OMB Bulletin 01-09 illustration, and so line 16 would be used. If material, a separate line just for the adjustment should appear. (If the receivable were collected in whole or part, the cash collection would also feed line 2.)

c. *Federal receivables—downward adjustment.* A downward adjustment of a federal receivable, if not collected during the year would appear as a positive item on line 2 of the statement of financing. The same reconciliation as described in "b," above, would need to be made. Any cash collections would also feed line 2.

d. *Unfunded liabilities.* Since by definition, the budget does not recognize obligations for unfunded liabilities, there would be nothing for the statement of financing to report if there was a prior period adjustment up or down, since both net obligations and net cost of operations would be zero.

e. *Funded liabilities—upward adjustment.* If a funded liability were adjusted upward, there would be an obligation placed, which would appear as a positive amount on line 1. Line 30 would be zero, and the reconciling item, the prior period adjustment, would appear on line 16 (a separate line with an appropriate caption would be used if the amount was material).

f. *Funded liabilities—downward adjustment.* Same as "e," except that the amount on line 1 would be negative.

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Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2	20x1
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ xxx	$ xxx
2. Less: Spending authority from offsetting collections and recoveries	xxx	xxx
3. Obligations net of offsetting collections and recoveries	xxx	xxx
4. Less: Offsetting receipts	xxx	xxx
5. Net obligations	xxx	xxx
Other Resources		
6. Donations and forfeitures of property	xxx	xxx
7. Transfers in/out without reimbursement (+/-)	xxx	xxx
8. Imputed financing from costs absorbed by others	xxx	xxx
9. Other (+/-)	xxx	xxx
10. Net other resources used to finance activities	xxx	xxx
11. *Total resources used to finance activities*	x,xxx	x,xxx
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	xxx	xxx
13. Resources that fund expenses recognized in prior periods	xxx	xxx
14. Budgetary offsetting collections and receipts that do not affect net cost of operations		
14a. Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	xxx	xxx
14b. Other	xxx	xxx
15. Resources that finance the acquisition of assets	xxx	xxx
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	xxx	xxx
17. *Total resources used to finance items not part of the net cost of operations*	xxx	xxx
18. *Total resources used to finance the net cost of operations*	x,xxx	x,xxx

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Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 2 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2	20x1
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
19. Increase in annual leave liability	xxx	
xxx		
20. Increase in environmental and disposal liability	xxx	
xxx		
21. Upward/Downward reestimates of credit subsidy expense (+/-)	xxx	xxx
22. Increase in exchange revenue receivable from the public	xxx	
xxx		
23. Other (+/-)	xxx	xxx
24. Total components of Net Cost of Operations that will require or generate resources in future periods	xxx	xxx
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	xxx	
xxx		
26. Revaluation of assets or liabilities (+/-)	xxx	
xxx		
27. Other (+/-)	xxx	xxx
28. Total components of Net Cost of Operations that will not require or generate resources	xxx	xxx
29. *Total components of net cost of operations that will not require or generate resources in the current period*	x,xxx	x,xxx
30. *Net Cost of Operations*	$ x,xxx	$ x,xxx

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Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF NET COST
For the years ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2	20x1
Program Costs:		
Program A:		
1. Intragovernmental gross costs	$ xxx	$ xxx
2. Less: Intragovernmental earned revenue	-xxx	-xxx
3. Intragovernmental net costs	xxx	xxx
4. Gross costs with the public	xxx	xxx
5. Less: Earned revenues from the public	-xxx	-xxx
6. Net costs with the public	xxx	xxx
7. Total net cost	x,xxx	x,xxx
Other Programs:		
Program B:	xxx	xxx
Program C:	xxx	xxx
Program D:	xxx	xxx
Program E:	xxx	xxx
Program F:	xxx	xxx
Other programs:	xxx	xxx
Total Other Program Costs:	x,xxx	x,xxx
8. Cost not assigned to programs	x,xxx	x,xxx
9. Less: Earned revenues not attributed to programs	-xxx	-xxx
10. Net Cost of Operations	$ x,xxx	$ x,xxx

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APPENDIX C: STATEMENT OF CHANGES IN NET POSITION

Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION
For the years ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2 Cumulative Results of Operations	20x2 Unexpended Appropriations	20x1 Cumulative Results of Operations	20x1 Unexpended Appropriations
1. Beginning Balances	$ xxx	$ xxx	$ xxx	$ xxx
2. Prior period adjustments (+/-)	xxx	xxx	xxx	xxx
3. Beginning balances, as adjusted	xxx	xxx	xxx	xxx
Budgetary Financing Sources:				
4. Appropriations received		xxx		xxx
5. Appropriations transferred-in/out (+/-)		xxx		xxx
6. Other adjustments (rescissions, etc) (+/-)	xxx	xxx	xxx	xxx
7. Appropriations used	xxx	-xxx	xxx	-xxx
8. Nonexchange revenue	xxx		xxx	
9. Donations and forfeitures of cash and cash equivalents	xxx		xxx	
10. Transfers-in/out without reimbursement (+/-)	xxx		xxx	
11. Other budgetary financing sources (+/-)	xxx		xxx	
Other Financing Sources:				
12. Donations and forfeitures of property	xxx		xxx	
13. Transfers-in/out without reimbursement (+/-)	xxx		xxx	
14. Imputed financing from costs absorbed by others	xxx		xxx	
15. Other (+/-)	xxx		xxx	
16. Total Financing Sources	xxx	xxx	xxx	xxx
17. Net Cost of Operations (+/-)	xxx		xxx	
18. Ending Balances	$ x,xxx	$ x,xxx	$ x.xxx	$ x,xxx

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APPENDIX D: STATEMENT OF BUDGETARY RESOUCES

Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2	20x2	20x1	20x1
		Non-Budgetary Credit Program		Non-Budgetary Credit Program
	Budgetary	Financing Accounts	Budgetary	Financing
Accounts				
Budgetary Resources:				
1. Budget authority:				
1a. Appropriations received	$ xxx	$ xxx	$ xxx	$ xxx
1b. Borrowing authority	xxx	xxx	xxx	xxx
1c. Contract authority	xxx	xxx	xxx	xxx
1d. Net transfers (+/-)	xxx	xxx	xxx	xxx
1e. Other	xxx	xxx	xxx	xxx
2. Unobligated balance:				
2a. Beginning of period	xxx	xxx	xxx	xxx
2b. Net transfers, actual (+/-)	xxx	xxx	xxx	xxx
2c. Anticipated Transfers balances	xxx	xxx	xxx	xxx
3. Spending authority from offsetting collections:				
3a. Earned				
1. Collected	xxx	xxx	xxx	xxx
2. Receivable from Federal sources	xxx	xxx	xxx	xxx
3b. Change in unfilled customer orders				
1. Advance received	xxx	xxx	xxx	xxx
2. Without advance from Federal sources	xxx	xxx	xxx	xxx
3c. Anticipated for rest of year, without advances	xxx	xxx	xxx	xxx
3d. Transfers from trust funds	xxx	xxx	xxx	xxx
3e. Subtotal	xxx	xxx	xxx	xxx
4. Recoveries of prior year obligations	xxx	xxx	xxx	xxx
5. Temporarily not available pursuant to Public Law	xxx	xxx	xxx	xxx
6. Permanently not available	xxx	xxx	xxx	xxx
7. Total Budgetary Resources	*$ x,xxx*	*$ x,xxs*	*$ x,xxx*	*$ x,xxx*

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Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 2 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/thousands/millions)

	20x2 Budgetary	20x2 Non-Budgetary Credit Program Financing Accounts	20x1 Budgetary	20x1 Non-Budgetary Credit Program Financing Accounts
Status of Budgetary Resources:				
8. Obligations incurred:				
8a. Direct	$ xxx	$ xxx	$ xxx	$ xxx
8b. Reimbursable	xxx	xxx	xxx	xxx
8c. Subtotal	xxx	xxx	xxx	xxx
9. Unobligated balance:				
9a. Apportioned	xxx	xxx	xxx	xxx
9b. Exempt from apportionment	xxx	xxx	xxx	xxx
9c. Other available	xxx	xxx	xxx	xxx
10. Unobligated balance not available	xxx	xxx	xxx	xxx
11. Total Status of Budgetary Resources	*x,xxx*	*x,xxx*	*x,xxx*	*x,xxx*
Relationship of Obligations to Outlays:				
12. Obligated balance, net, beginning of period	xxx	xxx	xxx	xxx
13. Obligated balance transferred, net (+/-)	xxx	xxx	xxx	xxx
14. Obligated balance, net, end of period:				
14a. Accounts receivable	xxx	xxx	xxx	xxx
14b. Unfilled customer orders from Federal sources	xxx	xxx	xxx	xxx
14c. Undelivered orders	xxx	xxx	xxx	xxx
14d. Accounts payable	xxx	xxx	xxx	xxx
15. Outlays:				
15a. Disbursements	xxx	xxx	xxx	xxx
15b. Collections	xxx	xxx	xxx	xxx
15c. Subtotal	xxx	xxx	xxx	xxx
16. Less: Offsetting receipts	xxx	xxx	xxx	xxx
17. Net Outlays	*$ x,xxx*	*$ x,xxx*	*$ x,xxx*	*$ x,xxx*

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Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
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www.fasab.gov

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FASAB

Federal Accounting Standards Advisory Board

U.S. General Accounting Office
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IMPLEMENTATION GUIDE

ACCOUNTING FOR REVENUE AND

OTHER FINANCING SOURCES

June 1996

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This guide presents illustrations and explanations intended to help practice and understanding; it does not constitute authoritative standards for preparers and auditors of financial statements. Authoritative guidance on display (format) of financial reports prepared pursuant to the Chief Financial Officers Act of 1990 (as amended) is provided by the Office of Management and Budget (OMB) in its periodic bulletins on the form and content of agency financial statements. Further guidance on applying Statements of Federal Financial Accounting Standards (SFFAS) and interpretations of those standards may be requested from OMB, Office of Management and Budget, pursuant to OMB Circular 134, *Financial Accounting Principles and Standards* (May 20, 1993). Also, guidance on specific questions that arise in practice concerning the proper account(s) to use to record a given transaction may be sought from the Standard General Ledger Board.

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IMPLEMENTATION GUIDE FOR

ACCOUNTING FOR REVENUE

AND

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IMPLEMENTATION GUIDE TO ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES

TABLE OF CONTENTS

CHAPTER 1: REPORTING ON REVENUE AND OTHER FINANCING SOURCES 1
INTRODUCTION..... 1
OVERVIEW OF NEW FINANCIAL STATEMENTS..... 2
Statement of Net Cost (3); Statement of Custodial Activity (4); Statement of Changes in Net Position (5); Statement of Budgetary Resources (5); Statement of Financing (6)
HOW FINANCIAL STATEMENTS HAVE BEEN CHANGED..... 7
Changes to the Statement of Operations (7); Changes to the Balance Sheet (9); New Statements of Budgetary Resources and Financing (12)
TERMINOLOGY AND THE EVOLVING FEDERAL REPORTING MODEL..... 12
Disclosure (12); Required Supplementary Information (12); Required Supplementary Stewardship Information (13); Other Accompanying Information (13)

CHAPTER 2: NEW FINANCIAL STATEMENTS..... 16
STATEMENT OF NET COST..... 16
Rationale (16); Illustrative Statement of Net Cost (19); Attributing revenue to the costs of earning it (23); Implications for the display of special cases (26)
STATEMENT OF CUSTODIAL ACTIVITY..... 29
Rationale (29); Illustrative Statement of Custodial Activity (30)
STATEMENT OF CHANGES IN NET POSITION..... 31
Illustrative Statement of Changes in Net Position (32); Implications of the term "net results of operations" (32)
STATEMENT OF BUDGETARY RESOURCES..... 33
Rationale (33); Illustrative Statement of Budgetary Resources (34)
STATEMENT OF FINANCING..... 35
Rationale (35); Illustrative Statement of Financing (37); Preparing the Statement of Financing (37); Obligations and nonbudgetary resources (38); Resources that do not fund net cost of operations (39); Costs that do not require resources (40); Financing sources yet to be provided (41)
REPORTING REVENUE..... 42

CHAPTER 3: COMPARISON BETWEEN ACCOUNTING AND BUDGETARY CLASSIFICATIONS OF TRANSACTIONS..... 44
INTRODUCTION..... 44
TRANSACTIONS WITH THE PUBLIC..... 44
General comparison (44); User charges (47)
INTRAGOVERNMENTAL TRANSACTIONS..... 48
CHOICE OF CLASSIFICATION SYSTEM..... 49

This is the original Implementation Guide to SFFAS 7 and was replaced by the Revised Implementation Guide at http://www.fasab.gov/pdffiles/impguid7200204.pdf. Neither guide has been updated for subsequent changes to SFFAS 7; please check for the most recent SFFAS 7 file in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

CHAPTER 4: CASE STUDY AND ILLUSTRATIONS 53
ILLUSTRATIVE CASE TRANSACTIONS, JOURNAL ENTRIES, AND TRIAL BALANCES 59
ILLUSTRATIVE FINANCIAL STATEMENTS PREPARED FOR CASE STUDY ENTITIES 67

CHAPTER 5: ADDITIONAL GUIDANCE FOR PREPARING THE STATEMENT OF FINANCING 81
INTRODUCTION 81
DECREASE IN THE ANNUAL LEAVE LIABILITY 82
ASSETS ACQUIRED BY CAPITAL LEASE 83
TRANSFERS OF ASSETS IN AND OUT WITHOUT REIMBURSEMENT 87
SALE OF CAPITALIZED ASSETS 89
EXCHANGE REVENUE FROM THE PUBLIC 90
SPECIAL TOPICS RELATED TO DISCRETIONARY DIRECT LOAN AND LOAN GUARANTEE PROGRAMS 93
Introduction (93); Reconciliations and the chapter 4 case (94); Subsidy reestimates (96); Pre-credit reform loans (101); Subsidy expense for defaulted guaranteed loans: credit reform (104)

APPENDIX: CIRCULAR A-134 105

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CHAPTER 1: REPORTING ON REVENUE AND OTHER FINANCING SOURCES

INTRODUCTION

1. Statement of Federal Financial Accounting Standards Number 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting (SFFAS No. 7), provides authoritative standards for classifying, recognizing, and measuring inflows of resources to the U.S. Government and its component reporting entities. These standards help provide better information about the cost of the Government's activities, make Federal financial reporting more supportive of the budget and performance measurement, and demonstrate accountability. The standards reflect the concepts adopted in Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting (SFFAC No. 1), and Statement of Federal Financial Accounting Concepts No. 2, Entity and Display (SFFAC No. 2).

2. This document is an implementation guide for SFFAS No. 7. It is not authoritative material. The guide presents illustrations, explanations, and a case study intended to help practice and understanding. Authoritative guidance on form and content (i.e., display) of financial reports prepared pursuant to the Chief Financial Officers Act of 1990 (as amended) is provided by OMB in its periodic bulletins on the form and content of agency financial statements. Further guidance on applying SFFAS No. 7 and interpretations of it and other Federal accounting standards may be requested from the Office of Federal Financial Management, Office of Management and Budget, pursuant to OMB Circular A-134, *Financial Accounting Principles and Standards* (May 20, 1993, or as subsequently amended).[1] Also, guidance on specific questions that arise in practice concerning the proper account(s) to use to record a given transaction may be sought from the Standard General Ledger Board.

[1] A-134 is reproduced in the Appendix to this Implementation Guide.

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3. FASAB prepared this implementation guide pursuant to Paragraph III.I, "Pronouncements," of FASAB's approved rules of procedure. Subparagraph 3 of paragraph III.I reads: "The FASAB may, in its discretion and with or without appointment of task forces, research, notice, public hearings, or public exposure, issue in its name or at its direction other communications of an informational nature related to Federal accounting and financial reporting, including the FASAB's mission, policies, and activities. Such communications may include, among others, discussion memorandums, summary and related documents, research reports, responses to requests and inquiries, and statements of policy dealing with matters of Federal accounting and financial reporting." Most of this Guide is a revision or expansion of parts of the material included in the exposure draft, Accounting for Revenue and Other Financing Sources (July 1995). It has been revised in light of the comments on that exposure draft.

4. This implementation guide is organized largely in terms of the new basic financial statements for component Federal reporting entities. The following new financial statements illustrate the application of the standards in SFFAS No. 7:

- Statement of Net Cost,
- Statement of Custodial Activity,
- Statement of Changes in Net Position,
- Statement of Budgetary Resources, and
- Statement of Financing.

5. Some accounting and disclosure issues peculiar to the consolidated financial statements of the U.S. Government (required by the Government Management Reform Act) have not yet been addressed by the Board. Those consolidated statements may differ from the statements of the component units described in this guide.

OVERVIEW OF NEW FINANCIAL STATEMENTS

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6. The standards in SFFAS No. 7 contemplate that for each component reporting entity, all costs will be shown in a Statement of Net Cost, along with applicable exchange (i.e., earned) revenues. Another statement, the Statement of Changes in Net Position, will report nonexchange revenues and appropriations. Separating costs and exchange revenues from nonexchange revenues and other financing sources is necessary to calculate the net cost incurred by a reporting entity in providing its outputs and its contributions to outcomes.

Statement of Net Cost

7. Under the new accounting standards, exchange revenues will be deducted from gross costs on a Statement of Net Cost to show the net cost of the entity's operating activities. Gross cost consists of all the costs recognized by an entity for a given period under Federal accounting standards. Net cost is the amount for which the entity is responsible and may, with appropriate details or "breakdowns" by suborganizations and programs, be compared with the entity's outputs to evaluate its performance. Gross cost also is relevant to performance measurement and, for some purposes, is more useful than net cost. Net cost is also the amount that, with some exceptions, must ultimately be paid by the taxpayer. The only major exception is for intragovernmental sales of goods and services. The extent to which taxpayers bear the costs of these goods and services depends on whether the goods and services are sold to entities that in turn sell goods and services to the public, or to entities that are financed by taxes. The net cost of operations may also be financed by other nonexchange revenue such as fines and donations.

8. Details or breakdowns within the Statement will also show exchange revenues deducted from the related costs of the transactions that generated these revenues. This will show the extent to which the costs of goods and services sold to the public are recovered by exchange revenues. Exchange revenues will be included in the Statement of Net Cost regardless of whether the entity retains the amounts or transfers them to others.

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Statement of Net Cost
Focuses on: Operating costs (gross costs) and related exchange revenues of the reporting entity Presents information about: All costs less earned revenues in total and by suborganizations and programs Emphasizes: Net cost of operations for comparison with performance measures

Statement of Custodial Activity

9. For reporting entities such as the Internal Revenue Service (IRS) that collect taxes for other entities, such custodial collections and the adjustments to measure revenue will be reported in statements that are separate from those used to report on the collecting entity's own operations. A Statement of Custodial Activity will reflect the collections by type, the adjustments to calculate the revenue, and the disposition of the amounts to the entities entitled to receive them. The collecting entities will not recognize inflows from these custodial activities as their own revenue.[2]

Statement of Custodial Activity
Focuses on: Revenue collections on behalf of other entities Presents information about: Source and disposition of collections and related accruals Emphasizes: Accountability for collections

[2]The IRS and the Customs Service now prepare a Statement of Custodial Activity.

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Statement of Changes in Net Position

10. The Statement of Changes in Net Position provides a summary of all the entity's transactions that affect its net position. The net result of the entity's operations will be calculated by deducting from the net cost of operations the financing for that net cost. The financing is provided by nonexchange revenues, appropriations used, and other financing sources. To arrive at the change in net position during the period, adjustments will be made for any prior period adjustments and changes in unused but available appropriations.

Statement of Changes in Net Position
Focuses on: Financing sources for operations
Presents information about: All flow transactions of the entity
Emphasizes: The components of net results of operations and the change in net position

Statement of Budgetary Resources

11. The other financial statements do not provide information about the flow of budgetary resources on the budgetary basis of accounting. Information on that basis is used to control the obligation of budgetary resources and the outlays to liquidate those obligations. A Statement of Budgetary Resources will show this information and provide a reference point for the accrual-based financial statements. This Statement tracks the execution of the budget from the budgetary resources, to obligations of those budgetary resources, and finally to outlays (usually in cash) to satisfy obligations. Budgetary integrity will be enhanced because this Statement will be subject to audit.

Statement of Budgetary Resources
Focuses on: Budgetary resources provided, the status of these resources, and outlays

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Presents information about:
Budgetary data from budgetary resources, to obligation of funds, to outlays

Emphasizes:
Showing budget execution on a budget basis of accounting

Statement of Financing

12. Finally, a Statement of Financing will explain how the obligations incurred on a budget basis of accounting, together with nonbudgetary resources, finance the net cost of operations of the reporting entity. The Statement of Financing provides a reconciliation or "translation" from the budget to the financial statements. The Statement will help those who work with the budget to understand the financial statements and the cost information they provide.

Statement of Financing

Focuses on:
Reconciling budget obligations with net cost of operations

Presents information about:
Budgetary and nonbudgetary resources and the items which explain the differences between the budget basis and financial statement basis of accounting

Emphasizes:
Making financial information more comparable and useful

HOW FINANCIAL STATEMENTS HAVE BEEN CHANGED

13. Readers who know how Federal agencies have reported in the past may find it helpful to read this section, which illustrates how the new standards have changed reporting by Government component units.

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Changes to the Statement of Operations

14. Past practice combined all costs, revenues, and other financing sources in a single Statement of Operations. Past practice did not recognize appropriations as a financing source when they were used to acquire assets, but it did accrue anticipated appropriations for incurred expenses. These practices often caused the bottom line in the old Statement of Operations to approximate zero.

15. The illustration on page 8 shows that applying the new standards will mean that the old Statement of Operations will be divided into separate statements. Costs and exchange revenues, on the one hand, will be shown in the new Statement of Net Cost, where they will determine the net cost of operations. Nonexchange revenue and other financing, on the other hand, will be shown in the new Statement of Changes in Net Position, where they will be deducted from the net cost of operations to determine the operating results. The operating results will be calculated in such a way that they will no longer often approximate zero as a matter of definition. This is because the appropriation will be recognized as used in the same period that budgetary accounting recognizes an expended appropriation. This will simplify accounting for appropriations. The Statement of Changes in Net Position will also show how the operating results and other adjustments determine the change in net position.

16. The figure on page 8 illustrates the changes described above, but does not show the interaction between the Statement of Custodial Activity and the Statement of Changes in Net Position (i.e., the flow of nonexchange revenues from the collecting entity's Statement of Custodial Activity to the recipient entity's Statement of Changes in Net Position).

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STATEMENT OF OPERATIONS
(Old Format)

< Revenues

Appropriations used>

Less: Expenses>

Difference (often approximately 0)

STATEMENT OF NET COST
(New)

Cost of goods and services sold <

> Less: Exchange (earned) revenues

Net cost of exchange transactions

Other costs <

> Net cost of operations

STATEMENT OF CHANGES IN NET POSITION
(New)

> Net cost of operations

Appropriations used <

> Nonexchange revenues and other financing

Net result of operations

Prior period adjustments

Change in cumulative results of operations

Change in unexpended appropriations

Change in net position

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Changes to the Balance Sheet

17. The old Balance Sheet will be simplified. The flow effects of current capital transactions will be shown in the Statement of Changes in Net Position as illustrated at the bottom of the preceding page, and certain capital balances will be consolidated in the Balance Sheet. Previously, donations and transfers-in of assets without reimbursement were reflected directly in the Balance Sheet as additions to capital (i.e., without being reflected in operations). Also, appropriations used to acquire capital assets were reflected in the Balance Sheet as invested capital. They were not reflected in operations until the assets were depreciated. As a result, the current period effects of these transactions and events were obscured: only accumulated balances (i.e., stocks rather than flows) at the end of the accounting period were shown.

18. New accounting standards will govern accounting for unreimbursed asset transfers between Government entities, for donations, and for appropriations used. These standards will require that flows from the related transactions and events be separately recognized in the Statement of Changes in Net Position. The results of these flows will be combined with the results of other operating flows in one capital account, "cumulative results of operations." This standard and SFFAS No. 1's requirement for separate disclosure of current liabilities that are not covered by budgetary resources eliminate the need for the capital account for future funding requirements. These standards, together with OMB's form and content requirement that the Balance Sheet separately report liabilities that are covered by budgetary resources and those that are not covered, eliminate the need separately to report future funding requirements as a negative item in net position in the Balance Sheet. The only other capital account on the current Balance Sheet, "unexpended appropriations," will remain unchanged. Entities with reason to do so may continue to report this information separately within cumulative results of operations or as a disclosure.

19. Eliminating separate balances showing the accumulated amounts of invested capital, donations, and transfers from other Government entities will omit some information from the Balance Sheet. That information, however, is not

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ordinarily used and, in the case of future financing, is misleading. It is misleading because it only represents amounts that were expensed, not items that were capitalized (such as assets under capital lease). Hence, looking at the unfunded liabilities (rather than the negative capital account for future funding requirements) gives a truer picture of the future budgetary resources needed for assets and expenses recognized in the proprietary financial statements of the reporting period.

20. The figure on the next page shows how the Balance Sheet will be condensed and how flow information in the Statement of Changes in Net Position affects related Balance Sheet elements.

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BALANCE SHEET
(Old Format)

Fund balance with Treasury
Other assets

Liabilities
Capital:
  Unexpended appropriations
< Transferred-in capital
< Donated capital
< Invested capital
< Future funding/financing requirements
  Cumulative results of operation
Net position

BALANCE SHEET
(New)

Fund balance with Treasury
Other assets

Liabilities
Capital
  Unexpended appropriations<
 >Cumulative results of operations <
Net position

STATEMENT OF CHANGES IN NET POSITION
(New)

Net cost of operations
Appropriations used
Nonexchange revenues (including donations)
Transfers (in and out)
Net result of operations
Prior period adjustments
Net change in cumulative results >
Change in unexpended appropriations >
Change in net position

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New Statements of Budgetary Resources and Financing

21. These two new statements provide budgetary information on a budget basis and relate that information to the financial statements by reconciling budget obligations with the net cost of operations. The next illustration shows how these statements relate to each other and how certain elements relate to the Balance Sheet.

STATEMENT OF BUDGETARY RESOURCES
(new)

Budgetary resources
Status of budgetary resources:
< Obligations incurred
Other
Outlays

STATEMENT OF FINANCING
(new)

>Obligations incurred
Less: Spending authority from offsetting collections and adjustments
Other financing sources (nonbudgetary)
Total obligations, as adjusted, and nonbudgetary resources
Reconciling items:
Minus: Resources that do not fund net cost of operations during the period>
>Plus: Costs that do not require current or future resources to be provided
Plus: Financing sources yet to be provided
Net cost of operations

CURRENT YEAR BALANCE SHEET <

< PRIOR YEAR BALANCE SHEET

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TERMINOLOGY AND THE EVOLVING FEDERAL REPORTING MODEL

22. "**Disclosure**" in this document indicates reporting information in notes or narrative regarded as an integral part of the basic financial statements. "**Supplementary**" indicates reporting information in schedules or narrative regarded as "Required Supplementary Information" (RSI) as that term is used by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB) in accounting standards and by the General Accounting Office (GAO) and the American Institute of Certified Public Accountants (AICPA) in auditing standards. Government auditing standards (which incorporate the AICPA's standards by reference) require more limited auditing procedures for RSI than is required for basic information. "**Required Supplementary Stewardship Information**" (RSSI) is a new category unique to Federal Government accounting and auditing standards. It refers to certain information for which FASAB expects the GAO and OMB in collaboration to agree upon appropriate auditing procedures.[3] "**Other Accompanying Information**" (OAI) refers to unaudited information that accompanies the audited financial statements. These terms are intended to indicate the Board's expectations regarding the minimum auditor's responsibility for the information, not its placement in reports.

23. To provide a context for the new standard, the table on page 15 depicts the terms and categories used in accounting and auditing standards to define the auditor's normal degree of association and responsibility in connection with an examination of financial statements. The word "normal" acknowledges that the scope of any given engagement can be modified by the relevant authorities, e.g., by adding agreed-upon procedures to be performed on certain RSI or OAI.

24. Until such time as the GAO and OMB have defined the audit procedures for RSSI and Government Auditing Standards have been modified, the existing categories should be used. Operationally, similar field work results can be

[3]In its Statement of Recommended Accounting Standards, Supplementary Stewardship Reporting, FASAB recommends designating certain information as RSSI, with the expectation that OMB and GAO will in collaboration agree upon audit procedures appropriate to apply to this information.

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achieved under the existing standards by defining information as RSI or OAI as appropriate, with any additional desired agreed upon audit procedures specified by OMB in its instructions regarding audit of these financial statements. As is illustrated in the table on page 15, different reporting standards would apply under the proposed standards.

25. The new standard calls for certain information to accompany the financial statements as other accompanying information. This includes information about the revenue gap, a perspective on the income tax burden, and estimates of revenue forgone as a result of not charging full cost or market price for transactions with the public. The standard also recognizes that reporting entities may wish to present other accompanying information about other subjects, including directed flows of resources and tax expenditures related to programs for which the entities are responsible. This will mean that the auditor will treat this information as other accompanying information that is provided by the statement preparer but not required by a standards setter. Except as otherwise directed by the authority engaging for audit, or as may be subsequently directed by future developments in auditing and/or accounting standards, the auditor is not responsible for auditing this information. The auditor merely notes any material inconsistency between this information and the audited financial statements.

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CATEGORIES OF INFORMATION AND AUDITOR'S NORMAL ROLE IN CURRENT AND NEW STANDARDS

Basic Information	**Accompanying Information**	
Basic Financial Statements and Notes [highest level of audit work]	**Required Supplementary Information** (RSI) [limited audit procedures]	**Other Accompanying Information** (OAI) [not audited]
Fieldwork: The auditor examines the basic information and expresses an opinion whether it is fairly presented in accordance with relevant accounting standards. Each line in the statements, and each number in the statements and notes, is a separate "assertion" to be tested, but the auditor's tests are performed, and the auditor's opinion is expressed, in light of the auditor's judgment about materiality (whether a user's decision would be influenced). The judgment about materiality is influenced by the objectives of the financial statement or report and the uses contemplated for the information in it. **Reporting:** If basic information is missing or materially misstated the auditor expresses an adverse or "qualified" opinion (or, in some cases, disclaims an opinion).	**Fieldwork:** The auditor performs limited procedures specified by professional standards to review the RSI. These procedures are mainly inquiry and limited analytical procedures such as comparing information obtained for consistency with the auditor's knowledge and the evidence collected in connection with the examination of the basic information. **Reporting:** If RSI is missing or materially misstated, the auditor notes this, but may still express an unqualified opinion on the basic financial statements, if warranted.	**Fieldwork:** The auditor reads the other accompanying information to see whether it appears materially inconsistent with the financial statements, but does not audit the information. **Reporting:** The auditor notes any material inconsistency with the financial statements, but may still express an unqualified opinion on the basic financial statements, if warranted.
Required Supplementary Stewardship Information (RSSI): **Fieldwork:** to be defined by the GAO and OMB; varies for each item. **Reporting:** same as for "basic" information--i.e., auditor must qualify or disclaim if RSSI is missing or materially misstated.		

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CHAPTER 2: NEW FINANCIAL STATEMENTS

STATEMENT OF NET COST

Rationale

26. The Statement of Net Cost is designed to explain and analyze the net cost of operations of an entity. The display of the information in this Statement reflects the thinking that underlies the standards in SFFAS No. 7 for distinguishing exchange revenue from nonexchange revenue and other financing sources, for recognizing exchange revenue, for matching exchange revenue with cost, and for assigning exchange revenue to the costs of earning it. The concept of this Statement is also discussed in SFFAC No. 2, ***Entity and Display***.[4]

27. The illustration of the Statement of Net Cost on page 19 expands upon the illustration in SFFAC No. 2, ***Entity and Display***. As explained in the introduction to this guide, the Statement of Net Cost shows separately the components of the net cost of the reporting entity's operations for the period. It consists of a display showing (1) the gross cost of the goods and services provided at a price, (2) the amount of related exchange revenue, (3) the resulting shortfall, or net cost,[5] (4) the gross cost of the goods, services, transfers, and grants not provided at a price (which comprise most of the Government's expenses), (5) the costs that cannot be assigned to specific outputs or programs, and (6) the exchange revenues that cannot be attributed to specific outputs or programs.

28. The costs in items (1), (4), and (5) of paragraph 0 are the gross costs of the reporting entity during the period and comprise all the costs recognized by the entity for a given period according to Federal accounting standards. The costs that cannot be assigned to outputs or programs consist of (a) high level general management and administrative support costs that cannot be directly traced, assigned on a cause-and effect-basis, or reasonably allocated to segments

[4]See pp. 31-34.

[5]The exchange revenue may be more than the gross cost, in which case the net cost is negative, i.e., the difference is a net revenue.

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and their outputs and (b) those "non-production costs" that cannot be assigned to a particular program (non-production costs are costs that, under Federal accounting standards, are linked to events other than the production of goods and services).[6]

29. The total net cost of operations of the reporting entity will be the net cost of all its outputs, whether or not provided at a price, plus the costs (and minus the exchange revenues) that are not assigned to outputs. The elements of the display on the Statement of Net Cost will be related to each other in a way that shows how the net cost of operations is determined for the reporting entity as a whole and its sub-organizations and programs.

30. Suborganizations are generally equivalent to responsibility segments, for which cost accounting is performed to measure and report the costs of the segment's outputs.[7] More than one suborganization may incur costs for a single program, as in cases where other suborganizations provide supporting services or goods without charge to the program. Net program cost equals the net cost of outputs plus any non-production costs that can be assigned to the program but not to its outputs.

31. The following example of a Statement of Net Cost illustrates some of the basic relationships that might be displayed, depending on the nature of the entity.

- Program A produces outputs that are entirely sold to the public.
- Program B produces outputs all of which are also sold, but some to the public and the rest to other Government entities.
- Programs C and D produce outputs that are not sold. Program C provides goods, services, transfers, or grants to the public; program D provides services to both the public and

[6]See SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, especially pp. 37-38 and 42, paragraphs 92 and 104.

[7]See *ibid.*, pp. 31-35. Also see SFFAC No. 2, *Entity and Display*, pp. 25-26, para. 75 and footnote 14.

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other Government entities.

o Program E produces two outputs for the public, of which one is sold and the other is not.

32. The net program cost is calculated separately for each program as gross costs less revenue earned, if any. Some of the programs illustrated in this Statement are carried out within a single suborganization, while others are not. If a program is carried out by more than one sub-organization, the net program cost is calculated both for each of these suborganizations separately and for all suborganizations together that are responsible for that program. All three sub-organizations in the illustration incur some general management and administrative support costs that cannot be assigned to programs and outputs and are thus reported as "costs not assigned to programs."[8] Suborganization C earns an insignificant amount of revenue that cannot be attributed to its outputs or programs and so is reported for the suborganization as a whole.

[8]SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* pp. 37-38, para. 92, defines such costs more fully and requires that they be reported in the entity's financial statements, such as the Statement of Net Cost, as costs not assigned to programs. Also see SFFAC No. 2, Entity and Display, pp. 33-34, para. 94-96.

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Illustrative Statement of Net Cost

	Sub-organization A	Sub-organization B	Sub-organization C	Total
Costs:				
Program A:				
Public	..	$XX	$XX	$XX
Less earned revenues		..	X	..
Net program costs	..	XX	XX	XX
Program B:				
Intragovernmental	$XXX	..	..	XXX
Public	XXX	..	..	XXX
Total	XXX	..	..	XXX
Less earned revenues	XX	..	..	XX
Net program costs	XXX	..	..	XXX
Program C:				
Program costs, public	XXX	XXX	XXX	XXX
Program D:				
Intragovernmental	XXX	XXX	..	XXX
Public	XXX	XXX	..	XXX
Program costs	XXX	XXX	..	XXX
Program E:				
Output 1:				
Public	XX	..	..	XX
Less earned revenues	X	..	..	X
Net cost of output 1	XX	..	..	XX
Output 2:				
Public	XXX	..	..	XXX
Net program costs	XXX	..	..	XXX
Costs not assigned to programs	XX	XX	XX	XX
Less other earned revenues not attributed to programs	..	..	X	X
Net Cost of Operations	$XXX	$XXX	$XXX	$XXX

33. Other variations on the Statement of Net Cost will also be appropriate depending on the types of programs that the reporting entity carries out and OMB's guidance on the form and content of agency financial statements. For example, a program that makes transfer payments to the public might differentiate these payments from its administrative costs because the transfer payments

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are a measure of the benefits provided by the program:

Program F:	
Public:	
Transfer payments	XXX
Administrative costs	X
Program costs	XXX

34. Stewardship investment might also be differentiated: costs incurred for Federally financed physical property that is owned by state and local governments, for certain education and training, and for research and development. These costs have a distinctive importance because they are investments to increase economic growth and provide benefits to the nation over an extended period of time:[9]

Program G:	
Public:	
Costs for stewardship investment	XXX
Administrative costs	X
Other costs	X
Program costs	XXX

35. As another example, a program might incur non-production costs, which are costs linked to events other than the production of goods and services in the period when the costs were recognized. For example, the cost of acquiring weapons systems and other Federal mission property, plant, and equipment (PP&E) is recognized as a cost on the Statement of Net Cost when acquired, rather than through depreciation over the Federal mission property's estimated useful life.[10] Federal cost accounting does not assign non-production costs such as this to the goods and services produced in the period when the cost is recognized. Non-production costs might usefully be differentiated from other costs on the Statement of Net Cost in order to show and analyze separately those costs that were incurred during the reporting period for producing outputs in that period. For this reason, SFFAS No. 6, Accounting for Property, Plant, and

[9]See FASAB's Statement of Recommended Accounting Standards, *Supplementary Stewardship Reporting* (May 1996), pp. 5 and 31-43.

[10]SFFAS No. 6, Accounting for Property, Plant, and Equipment, p. 16, para. 53.

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Equipment, requires that the cost of Federal mission PP&E, heritage assets, and stewardship land be separately disclosed, either on the face of the Statement of Net Cost or in footnotes, depending on the materiality of the amounts and the need to distinguish them from other costs relating to outputs and outcomes. In the case of weapons systems purchases, the distinction might be shown as follows:[11]

Program H:	
Weapons system purchases	XXX
Other costs	XXX
Program costs	XXX

36. If a program produces several large and distinct outputs, regardless of whether it earns any revenue, it may be illuminating to display the costs of each. If such a program has material non-production costs, they may be displayed separately from the production costs of the outputs:

Program I:	
Public:	
Output 1	XX
Output 2	XX
Non-production costs	X
Program costs	XX

[11]For further analysis of accounting for non-production costs, see ***SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government***, especially para. 97, 103, and 104; and related discussion in SFFAS No. 4's Basis for Conclusions, para. 214-215. For the case of Federal mission PP&E, heritage assets, and stewardship land, see SFFAS No. 6, ***Accounting for Property, Plant, and Equipment***, para. 53, 61, and 69.

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37. As illustrated by these diverse possibilities, the Statement of Net Cost will emphasize information about the cost of operations. By this means, it will help achieve the objectives of Federal financial reporting and managerial cost accounting. Managers responsible for programs can often obtain cost information they need from internal cost reports and in other ways. Other users, however, depend partially or wholly on general purpose financial reports for cost information. These users include higher-level management of the entity, high-level Executive Branch officials and their staffs, and the Congress. They may need to refer to general purpose financial reports not only for the information contained in them but also to help them interpret the cost information they receive directly from management and to relate it to other information and events. Budget or program analysts, academic researchers, and members of the specialized news media and interest groups may depend even more on the information provided in an entity's general purpose financial reports. Members of the general news media and the public who wish to consult Government financial reports may rely entirely on general purpose financial reports. Even for program managers, the emphasis on net cost in this Statement and its use by others may contribute to a greater understanding of the concept and routine use of this information.

38. Good information on gross and net cost, determined and analyzed in the manner of this Statement, is essential to the success of the Government Performance and Results Act of 1993 (GPRA)[12] in relating costs to accomplishments. GPRA requires setting performance goals for program activity and establishing performance indicators to measure outputs and outcomes of the program activity. Performance measurement under GPRA is to begin in FY 1999, and pilot projects started in FY 1994. Under OMB's plan to carry out GPRA, performance reports will show the results of what was actually accomplished (outputs and outcomes) with the resources used. The net cost of programs (as well as gross cost) should be a fundamental measure of these resources.

[12]Public Law 103-62.

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39. Preparers should decide the exact classification of suborganizations and programs based on the nature of the entity, the missions and outputs for the entity's GPRA strategic and annual performance plans, the concepts in Entity and Display, Federal accounting standards, and OMB's bulletin prescribing the form and content of agency financial statements. OMB's guidance on the form and content of agency financial statements may require that the gross cost and net cost of operations be calculated by suborganization, program, and output, and reported separately in the Statement of Net Cost (or, if appropriate to reduce the complexity of the display, in footnotes to that Statement). Suborganizations are generally equivalent to responsibility segments as defined by the standards on managerial cost accounting.[13] Under the cost accounting standards, a responsibility segment must be able to assign full costs to the measurable outputs of its programs.[14] If reported on that basis, users of general purpose federal financial reports will be provided with the gross cost of the reporting entity's outputs (and outcomes).

40. When unit costs of outputs (and outcomes) are provided as performance indicators elsewhere in the report containing the financial statements, it may be useful to provide a reference to that information in the financial statements. A cross-reference in the financial statements does not change the level of audit otherwise specified for the performance information.

41. The information provided in the Statement of Net Cost generally will not be as detailed as the information needed by those who are responsible for budgeting and managing the costs of the Government, and by those who for other reasons have a special interest in the performance of a given program. The detailed information should be available through the managerial cost accounting system, cost analyses, and other studies used to provide the information reported in the Statement of Net Cost. However, the Statement of Net Cost

[13]SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* pp. 31-35. Also see SFFAC No. 2, *Entity and Display*, pp. 25-26, para. 75 and footnote 14.

[14]SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, pp. 36-42 and 51-59.

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provides important summary information to top management, the central agencies, Congress, and the public. The Statement of Net Cost also provides a link to the more detailed information that may be used by managers of the reporting entity to explain the results shown in the Statement of Net Cost.

Attributing revenue to the costs of earning it

42. A reporting entity may have several missions carried out by different suborganizations, all of them having component programs and outputs. For each of these, both gross cost and net cost are important in evaluating performance and managing cost. Furthermore, either an entity as a whole or its suborganizations and programs may have significant costs that are not incurred to earn revenue, as well as significant costs that are incurred for that purpose. Therefore, the revenue-earning and nonrevenue-earning components need to be separately evaluated in order to assess the net cost of particular activities. Additionally, various components may earn revenue but cover costs to different degrees.

43. In all these cases, the net cost of the reporting entity as a whole does not show the extent to which earned revenue covers the cost of providing particular outputs. This can only be calculated for the entity's components. Determining the net cost for components is therefore essential to achieve the goals of SFFAS No. 7: to match exchange revenue with the gross cost of outputs and to offset exchange revenue against that related gross cost.

44. Exchange revenue should be attributed to the costs of outputs unless it is not reasonably possible to do so. If that cannot be done, exchange revenue should be attributed to the costs of programs, or, if that also is not reasonably possible, to the costs of suborganizations. Attributing exchange revenue to the components of an entity in this way is more effective for performance evaluation, price setting, and other purposes than attributing it to the reporting entity as a whole.

45. The following principles help determine the degree to which exchange revenue can reasonably be

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attributed to a component of a reporting entity, a suborganization, or a program. Application of these principles requires the exercise of managerial judgment to meet the goal of measuring net cost for the many Government reporting entities with their varied characteristics.

45.1. Exchange revenue may be earned by an entity or program that sells all its goods or services in exchange for revenue. Examples include the Postal Service and the Defense Business Operations Fund. If the entity's gross costs are divided among programs or suborganizations that all sell goods or services, the exchange revenue attributable to these programs or suborganizations should be offset against the respective gross costs. If the entity is not so divided, its exchange revenue should be offset against the gross cost of the entity as a whole.

45.2. Exchange revenue may be attributable to an organization (or a program) as a whole in carrying out a function that is inherently governmental. For example, SEC registration fees may be deemed attributable to the SEC as a whole rather than to a division or line of activity within the SEC that manages the registration process. Such exchange revenue should be offset against the gross cost of the organization as a whole rather than the costs of the line of activity.

45.3. Exchange revenue may be earned by the operations of the entity as a whole in selling goods or services. For example, the National Park Service charges admission fees to parks and incurs expenses for such activities as preserving wildlife, maintaining roads, and providing visitor facilities. The fees are not related to the costs of the visitors as opposed to the costs of maintaining the land as a national heritage. They should be offset against the gross cost of the National Park Service.

45.4. Exchange revenue may be earned by a particular component of a reporting entity, such as a program within a suborganization. Except in the cases specified above, such exchange revenue should be offset against the gross cost of that component to calculate its net cost. The net cost of that component should be added to the net costs of other components to calculate the net cost of

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the reporting entity as a whole.

45.5. Exchange revenue may be earned as a byproduct by some activities within a program or suborganization that are secondary to the main purpose of the program or suborganization. For example, the Geological Survey sells maps to the public as a byproduct of its surveys and other research. Such exchange revenue should be offset against the incremental costs incurred to produce that revenue, based on the assignment of costs according to the managerial cost accounting standards.[15] The other costs of the Geological Survey should be classified in other components of the organization.

45.6. Exchange revenue that is insignificant or cannot be associated with particular outputs may be deducted separately against the cost of the program, suborganization, or reporting entity as a whole.

46. Whether a particular revenue is offset against the cost of the reporting entity as a whole or against the cost of a component also depends on the level of aggregation of the reporting entity. As explained above, the admission fees of the National Park Service can reasonably be attributed to the National Park Service but not to its components. Therefore, in financial statements of the National Park Service, such revenue would most likely be offset against the gross cost of the reporting entity (the National Park Service) as a whole. However, the financial statements of the Department of the Interior might be divided by suborganization and include the National Park Service as one separate component. Because the admission fees would be reasonably attributed to the National Park Service, they would offset the gross cost of the component (the National Park Service) on the Department's Statement of Net Cost rather than the gross cost of the reporting entity (the Department) as a whole.

47. The effect of the level of aggregation could be even more pronounced where the exchange revenue is deducted from the gross costs of a program within a suborganization in the financial statements of the suborganization. In the

[15]For the standard on cost assignment, see ibid., pp. 51-59.

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financial statements of the full organization, the programs of the suborganization might be consolidated and the exchange revenue deducted from the gross cost of the suborganization as a whole.

Implications for the display of special cases

48. **Exchange revenue collected for others**. Many entities that collect exchange revenue keep that revenue for their own use. Revolving funds keep the revenue they earn. By their nature, they are expected to finance at least a significant part of their cost by selling goods and services in a continuing cycle of business-type activity. Other collecting entities may also keep the revenue they earn. Sometimes, however, the exchange revenue is transferred to the General Fund or to other entities in whole or in part. For example, the Southeastern and Southwestern Power Administrations transfer the revenue they collect from the public to the General Fund of the Treasury. Similarly, the Western Area Power Administration, while retaining some of the revenue that it collects, transfers the rest to the General Fund and various special funds designated by law.

49. As a general rule, exchange revenue transferred to others must be offset against the collecting entity's gross cost to determine its net cost of operations. Exchange revenue reduces the net cost of operations incurred by the entity in producing outputs, regardless of whether the entity keeps the exchange revenue for its own use or transfers it to another operating entity or the General Fund. Likewise, exchange revenue reduces the net cost of the entity's operations to the taxpayer regardless of its disposition. Therefore, all exchange revenue related to the cost of operations must be deducted from gross cost in the Statement of Net Cost to determine the net cost of operations for the entity. The display in that Statement has no need to distinguish between exchange revenue retained or transferred to others.

50. Exchange revenue that is transferred to others does not, however, affect the collecting entity's operating results and net position. Therefore, as required by the standards in SFFAS No. 7 for other financing sources, such exchange revenue is

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recognized as a transfer-out in calculating the entity's operating results in its Statement of Changes in Net Position.

51. The only exception to the general rule occurs when the entity recognizes virtually no cost in earning the exchange revenue, as explained in the following section.

52. **Exchange revenue unrelated to recognized cost.** In exceptional cases, an entity may recognize virtually no costs in connection with earning exchange revenue that it collects. A major example for many years has been the Minerals Management Service (MMS) of the Department of the Interior. It manages energy and other mineral resources on the Outer Continental Shelf (OCS) and collects rents, royalties, and bonuses due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands. The rents, royalties, and bonuses are exchange revenues, earned by sales in the market. If the value of natural resources were recognized as an asset by MMS, then depletion could be recognized as a cost according to the units of production method as minerals were extracted.[16] The revenue from rents, royalties, and bonuses could then be matched against MMS's gross cost, including depletion and minor other costs, to determine its net cost of operations.

53. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards the value of natural resources is not recognized as an asset. As a result, this exchange revenue cannot be matched against the economic cost of operations and bears little relationship to the recognized cost of MMS. Therefore, it should not be subtracted from MMS's gross cost in determining its net cost of operations in its Statement of Net Cost. If it were subtracted, the relationship between MMS's net cost of operations and its measures of performance would be distorted. The net cost of operations of the Department of the Interior would likewise be distorted.

[16]Methods of calculating depletion based on the economic cost of extraction, such as represented here, should be distinguished from depletion methods allowed under the Internal Revenue Code.

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54. MMS collects this revenue acting as an agent for the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. Therefore, MMS should account for the exchange revenue as a custodial activity, which is an amount collected for others, in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. Because the revenue collected by MMS is exchange revenue, it should be recognized and measured under the exchange revenue standards when the rents, royalties, and bonuses are due pursuant to the contractual agreements. Custodial activity is reported in the entity's Statement of Custodial Activity.

55. The rents, royalties, and bonuses transferred to Treasury for the General Fund or to other Government reporting entities should be recognized similarly by these recipient entities. The revenue is exchange revenue and should be recognized and measured under the exchange revenue standards. However, although the revenue comes from exchange transactions, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, the revenue should not offset the cost of operations for the U.S. Government as a whole or for these entities and should not be included in their Statements of Net Cost. As in the case of MMS, offsetting cost by this revenue would distort the relationship between the net cost of operations and the measures of the performance of these entities. The exchange revenue should instead be a financing source in determining the operating results and changes in net position in their Statements of Changes in Net Position.

56. The Board is addressing the accounting for natural resources in a separate project. If it concludes that the value of mineral rights should be recognized as an asset and depletion as a cost, it would be appropriate to recognize the exchange revenue from rents, royalties, and bonuses in determining the net cost of operations.

57. Although MMS is the most prominent case of an entity collecting exchange revenue for which it recognizes virtually no cost, there can be other instances. The Federal Communications Commission

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collects exchange revenue from the auction of the radio spectrum. Such revenue should be accounted for in the same way as the revenue collected by MMS.

STATEMENT OF CUSTODIAL ACTIVITY

Rationale

58. Entities that collect nonexchange revenue for the General Fund and other recipient entities do not recognize revenue as a result of collecting these resources. These entities are designated as "collecting entities" by SFFAS No. 7, which requires that the collection and disposition of nonexchange revenue be accounted for as custodial activity. The collection of exchange revenue is not a custodial activity, as a general rule, because exchange revenue should be deducted from gross cost in the Statement of Net Cost for the purpose of determining the net cost of operations. SFFAS No. 7 requires this accounting for exchange revenue regardless of whether the entity retains the exchange revenue for its own use or transfers it to others, except under exceptional circumstances stipulated in the standard and discussed in the previous section.

59. Collecting entities need to report their custodial activities in a way that highlights these important activities but does not obscure the entities' own operating costs. Therefore, significant transactions related to collecting revenue for others will be reported separately from the entity's reports on its own net cost and changes in net position. A statement designed to do that follows:

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Illustrative Statement of Custodial Activity

Sources of Revenue:	
Cash Collections: (by type of tax or duty)	$XX
Refunds and Other Payments	(X)
Net Collections	XX
Accrual Adjustment	X
Total Revenue	XX
Disposition of Revenue:	
Transferred to others: (by recipient)	XX
Increase (decrease) in amounts to be transferred	X
Retained by the Entity	X
Total Disposition of Revenue	XX
Net Custodial Activity	$-0-

60. Collecting entities are to report both cash and accrual information for taxes and duties they collect. Most of the Government's nonexchange revenues are derived from taxes and duties. Components of cash collections, by type of tax or duty, transfers to recipient entities, and the related accrual adjustments should normally be reported as illustrated above. Collections of nonexchange revenue other than taxes and duties may also be reported on a cash basis and adjusted to an accrual basis, but only the accrual basis information is required. The sources and disposition of revenue should net to zero.

61. The increases (or decreases) in the amounts of revenue to be transferred to other entities affect the inter-entity balances between the collecting entities and the entities that receive and recognize the revenue. Amounts may be retained by the collecting entities if they are entitled to the revenue. The collecting entities report such amounts in their Statement of Net Cost as an

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exchange revenue if it is retained as a reimbursement of the costs of collection.

62. Based on the revenue standards in SFFAS No. 7, the net change in revenue-related assets and liabilities of the collecting entities is a component of revenue. The net change is referred to as the accrual adjustment. The accrual adjustment consists of accounts receivable, the allowance for uncollectible amounts, and accounts payable for refunds. Revenue recognized by the recipient entities is composed of the cash transferred to them and the increase or decrease in the amount to be transferred to them as measured by applicable cash collections and the accrual adjustment.

STATEMENT OF CHANGES IN NET POSITION

63. The Statement of Changes in Net Position is designed to show results of operations for the period and other adjustments to net position. The term "net results of operations" describes the excess (or the deficit) of the "net cost of operations" over "financing sources." These terms designate the first three sections in the Statement, as illustrated below. The net result of operations is also the current period's change in the cumulative results of the entity's operations since its inception, except to the extent that there are prior period adjustments. Prior period adjustments include corrections of errors and all changes in accounting principles.[17]

64. The Statement also shows budgetary resources from two accounting perspectives. First is the amount of appropriations used during the period. Together with other financing sources, "appropriations used" is deducted from net cost to show the net result of the entity's operations for the period. From the budgetary standpoint, appropriations include dedicated tax receipts, such as Social Security taxes and Highway Trust Fund excise taxes. From a proprietary standpoint, on the other hand, unexpended appropriations do not include dedicated tax receipts because these

[17]In the private sector, prior period adjustments are limited to corrections of errors and a few types of accounting principle changes. In addition, if comparative statements are presented, statements of prior periods are restated to reflect the retroactive application of the adjustment.

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receipts are accounted for as nonexchange revenue. Therefore, appropriations used would not include dedicated tax receipts, thus avoiding double counting of these amounts as financing sources.[18]

65. The second perspective on budgetary resources is the change in unexpended appropriations during the period. The Balance Sheet reports "unexpended appropriations" at the end of the current period as a separate element of net position. A simple illustration of the Statement of Changes in Net Position appears below. As was illustrated for the Statement of Net Cost, the Statement of Changes in Net Position might also be subdivided by suborganization.

Illustrative Statement of Changes in Net Position

Net Cost of Operations		$(XXX)
Financing Sources (other than exchange revenue):		
Appropriations used	XXX	
Taxes (nonexchange revenue)	X	
Donations (nonexchange revenue)		X
Imputed financing	X	
Transfers-in	X	
Transfers-out	(X)	
Net Results of Operations	X	
Prior Period Adjustments		X
Net Change in Cumulative Results of Operations	X	
Increase (Decrease) in Unexpended Appropriations	X	
Change in Net Position	X	
Net Position-Beginning of Period	XX	
Net Position-End of Period		$ XX

[18]For trust funds financed entirely by dedicated revenue and other dedicated financing sources, there are no "appropriations used."

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Implications of the term "net results of operations"

66. Some of those who commented on FASAB's exposure draft Accounting for Revenue and Other Financing Sources expressed concern that some readers might infer the amount of "net results of operations" was a significant performance measure, even though this will not be the case for most Federal reporting entities. Some users might draw such an inference because, in the private sector, the term "net results of operations" is synonymous with net income and net income is the "bottom line" performance measure. The Statement of Operations used by Federal reporting entities prior to implementation of SFFAS No. 7 focused on a similar bottom line, net results of operations. This was the effect of showing the flow of all operating activities on a single statement. For most Federal entities, however, no single bottom line can accurately measure performance, and "net results of operations" normally provides little information on either the costs or the benefits of an entity's operations. Therefore, the Statement of Changes in Net Position is not a performance-related Statement, and using the term "net results of operations" in this context does not imply that it is a measure of performance.

67. The Board notes that, when OMB revises its form and content guidance, OMB may wish to consider whether any change is needed in the captions for lines on the Statement of Changes in Net Position that are now labelled "Net Results of Operations" and "Net Change in Cumulative Results of Operations."

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STATEMENT OF BUDGETARY RESOURCES

Rationale

68. The Statement of Budgetary Resources and the related disclosures provide information about how budgetary resources were made available as well as their status at the end of the period. This information is based on budgetary accounting rules. Because it is a basic financial statement, it also makes budget execution subject to audit at the level of the reporting entity. Some people are concerned about the accuracy of budget execution data at the budget account level. SFFAS No. 7 calls for that information to be presented for major budget accounts as RSI, which normally is subject only to limited review by auditors. When appropriate, this information could be made subject to more extensive agreed-upon audit procedures or attestation by OMB (through its bulletin on audits of Federal financial statements) or by Inspectors General or others who arrange for audits. Finally, the Statement of Budgetary Resources reports the "obligations incurred," which is also reported in the Statement of Financing and is the reference point for the reconciliation to the accrual-basis financial statements. An illustration of this statement follows:

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Illustrative Statement of Budgetary Resources

Budgetary resources:	
Budget authority (line 1)	$XXX
Unobligated balances-beginning of period (line 2A)	X
Spending authority from offsetting collections (line 3)	X
Adjustments (lines 4-6)	X
Total, budgetary resources	$XXX
Status of budgetary resources:	
Obligations incurred (line 8))	$XXX
Unobligated balances-end of period (line 9)	X
Unobligated balances-not available (line 10)	X
Total, status of budgetary resources (line 11)	$XXX
Outlays:	
Obligations incurred(line 8)	$XXX
Less: spending authority from offsetting collections and adjustments (lines 3A,B,D,&4A)	X
Obligated balance, net-begin. of period (line 12)	X
Obligated balance transferred, net (line 13)	X
Less: obligated balance, net-end of period (line 14)	X
Total, outlays (line 15)	$XXX

69. The terminology and definitions used in the Statement of Budgetary Resources are taken from the budget. OMB Circular A-34, Instructions on Budget Execution, dated December 26, 1995, defines the terms shown in this Statement. The above budgetary resources illustration differs from SFFAC No. 2, Entity and Display, to conform to the December 1995 revision of A-34. The revised SF-133 line item numbers are shown on the above illustration. If OMB concepts and definitions are revised in the future, the classification and recognition of the appropriate amounts should change accordingly. The U.S. Government Standard General Ledger (SGL) provides a crosswalk from the SGL accounts to reports on budget execution prepared for OMB. Those budget execution reports contain the information needed to prepare this Statement.

70. Disclosures are required if the information shown differs from that which is included in the "actual" column of the President's Budget. For

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example, this disclosure would be needed in cases where the reporting entity in the financial statements is different than the reporting entity in the Budget.

71. Some users may be confused by budgetary terms being used in general purpose financial reports. As with all financial statements, footnotes are needed to make them understandable, especially when the financial statements use terms specific to a field of knowledge not necessarily known to a general user of the statements.

STATEMENT OF FINANCING

Rationale

72. A primary objective of the Board is that readers of the financial statements be able to understand the difference between obligations, as reported in the Federal budget and on the Statement of Budgetary Resources, and the net cost of operations reported in the Statement of Net Cost. Guidance prior to SFFAS No. 7 only reconciled expended authority with expenses. SFFAS No. 7 requires the more comprehensive reconciliation between obligations and net cost of operations.

73. "Net cost of operations" is the focal point of the Statement of Financing. The Board perceives information about gross and net cost to be the principal advantage that the financial statements offer both to those concerned with the budget and to those concerned with making performance measurement (as required under GPRA) successful. Therefore, budgetary obligations should be reconciled with net cost. By this comparison, financial reports can help those who make program authorization, modification, and discontinuation decisions.

74. Besides its value in reconciling budgetary and financial accounting, the Statement of Financing supplies information not shown elsewhere in the financial statements. It reports the net change in the amount of obligations for undelivered orders from the beginning to the end of the period, under the caption "Change in Amount of Goods, Services, and Benefits Ordered, but Not Yet Received or Provided." Under the caption "Financing Sources Yet to Be Provided," the Statement reports the

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future budgetary funding requirements for transactions reflected in the net cost of operations for the period. Those amounts can be large, where substantial amounts of unfunded liabilities are recognized.

75. In addition to the information it provides, the Statement of Financing will provide additional assurance about the reliability of the system that produces the accounting and budgetary information. SFFAC No. 2, Entity and Display, does not illustrate the Statement of Financing but it is explained and illustrated in an amendment to SFFAC No. 2 published as part of SFFAS No. 7. An illustration follows:

Illustrative Statement of Financing

Obligations and Nonbudgetary Resources:	
Obligations incurred	$XXX
Less: Spending authority from offsetting collections and adjustments	X
Donations not in the budget	X
Financing imputed for cost subsidies	X
Transfers-in (out)	X
Exchange revenue not in the budget	(X)
Other	X
Obligations, as adjusted, and Nonbudgetary Resources	$XXX
Resources That Do Not Fund Net Cost of Operations:	
Change in amount of goods, services, and benefits ordered but not yet received or provided	(X)
Costs capitalized on the Balance Sheet	(X)
Financing sources that fund costs of prior periods	(X)
Other	(X)
Costs That Do Not Require Resources:	
Depreciation and amortization	X
Revaluations of assets and liabilities	X
Other	X
Financing Sources Yet to be Provided	X
Net Cost of Operations	$XXX

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Preparing the Statement of Financing

76. This comprehensive reconciliation can be accomplished by presenting the following information:

Net resources: obligations, as adjusted, and nonbudgetary resources

Resources not used to fund net cost of operations

Costs that do not require resources

Financing sources yet to be provided

These sets of information can be combined to yield the net cost of operations and, thereby, explain the differences between obligations and net cost of operations as shown above. The information is discussed in more detail below and is illustrated for specific transactions in chapters 4 and 5.

Obligations and nonbudgetary resources

77. The obligations and nonbudgetary resources section reports the computation of "Obligations Incurred" and its related budgetary adjustments. It also shows the items that provide financing but that are not recognized in the entity's budget.

78. Obligations include orders for goods and services which have not yet been filled (referred to as "undelivered orders,") and the value of goods and services received from orders which have been filled (referred to as "expended authority"). Budgetary adjustments to obligations are required (1) to subtract spending authority from offsetting collections (i.e., earned reimbursements, increases (decreases) in unfilled customer orders for work to be performed by the Federal reporting entity, and transfers from trust funds) and (2) to subtract recoveries of prior year obligations.

79. The sum of obligations and the adjustments to it represents the value of net budgetary resources obligated which could finance the net cost of operations. Additional financing sources could also finance net cost of operations. These would include such items as assets transferred in or out without reimbursement, most donations other than cash, and financing sources imputed for cost

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subsidies. They must be added to the amount of obligations because they are nonbudgetary resources and, therefore, are not included in obligations.

80. Also, there may be exchange revenues which are nonbudgetary, e.g., an increase in accounts receivable from the public. (Intra-governmental accounts receivable are normally considered a budgetary resource, whereas accounts receivable from the public are not.) Any non-budgetary exchange revenues must be subtracted from obligations. This is because they were subtracted in the computation for net cost of operations, but were not included in the computation for obligations, as adjusted. Thus, an increase in accounts receivable from the public would be subtracted in the computation for net resources; a decrease would be added. Note that the amount of collections from the public is budgetary resources; hence the adjustment required is only for the change in revenues accrued as a receivable from the public.

81. The result of the above paragraphs 0-0 would be the net resources available to fund net cost of operations. This would be arrayed as shown below:

Obligations Incurred

Less Adjustments

Plus Nonbudgetary Resources Other than Exchange Revenue

Less Nonbudgetary Exchange Revenues

Equals Obligations, as Adjusted, and Nonbudgetary Resources

Resources that do not fund net cost of operations

82. Resources that do not fund net cost of operations for a reporting period commonly arise from three sources. One source is the change in goods, services, and benefits ordered but not yet received or provided. Another source is any good or service capitalized on the Balance Sheet. The third source is any item treated as a financing source yet to be provided in a prior period that is being recognized as a budgetary resource in the current period.

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83. The change in goods, services, and benefits ordered but not yet received or provided is the net change in undelivered orders from the beginning of the period to the end. The entity had to incur an obligation to place an order for goods or services, but accrual accounting does not recognize the transaction until the ordered goods, services, and benefits are actually received or provided. To reconcile obligations with the net cost of operations, net increases in undelivered orders should be subtracted from the net obligations and nonbudgetary resources; net decreases should be added. The entity's obligation to incur future costs is important information in and of itself, and therefore the total amount outstanding at the end of the reporting period is to be disclosed.

84. Goods and services received and capitalized as assets on the Balance Sheet should be subtracted from obligations and nonbudgetary resources. They require obligations but do not affect net cost. General property, plant, and equipment (PP&E) is the most obvious example. Other examples include loans made by liquidating funds under the Federal Credit Reform Act of 1990 (P.L. 101-508) and purchases of inventory.

85. An entity may receive budgetary resources in the current period that were previously reported as "financing sources yet to be provided," such as appropriations for credit subsidy reestimates recognized as expenses of the previous period, or for decreases in the liability for annual leave. Such amounts must be subtracted from obligations and nonbudgetary resources, because the current period budgetary financing funds costs (either expenses or capitalized items) that were recognized in previous periods.

Costs that do not require resources

86. Although there may be many expenses of this type, two of the most common are: (1) allocation of assets to expense, and (2) expenses related to revaluation of assets.

87. Cost is recognized in the Statement of Net Cost when cost of assets is allocated to expense. Depreciation of capitalized PP&E is an example of such allocation. Often the budgetary financing sources for the assets will have been recognized

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during a prior period, when the capitalized items were acquired. Because the Statement of Financing is to report net cost of operations, the cost of assets allocated to expense must be added to obligations and nonbudgetary resources.

88. Changes during the accounting period in the valuation of assets (initially acquired by budgetary resources) may be made through accounting provisions or revaluations. When made, they are included in net cost of operations. Examples include:

- revaluation of PP&E due to obsolescence or damage, and
- revaluation of inventory for expected losses due to excess or unserviceable quantities, realization value lower than carrying value, etc.

89. It may not always be feasible to report separately the acquisition of certain assets, adjustments to them, and sales of them. For example, as a practical matter, a net decrease in inventory because of a combination of revaluations and sales that exceeded purchases may need to be aggregated in one amount under the caption, "Costs That Do Not Require Resources." This type of netting, though sometimes necessary, reduces the informative quality of the Statement of Financing.

Financing sources yet to be provided

90. The section of the Statement of Financing labeled "financing sources yet to be provided" reports the amount of obligations that will be made in future periods for costs recognized in the reporting period. It includes financing for all costs for which the Congress has not yet authorized the financing, or for which the Congress has authorized the financing but the amount has not yet been made available. This amount is added to the obligations and nonbudgetary resources of the reporting period because it represents a cost recognized in the Statement of Net Cost for the reporting period for which the financing sources will have to be provided in future periods. When financing is later made available, it is reported in the Statement of Financing as a subtraction from obligations and nonbudgetary resources in the

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section entitled "resources that do not fund net cost of operations." It is also recognized as "appropriations used" and reported in the Statement of Changes in Net Position.

91. For agencies funded by appropriations, the most common example is the cost of increases in unused annual leave. Cost for this leave is incurred in the reporting period, but it is normally funded through salary and expense appropriations in subsequent years. The amount related to this increase in unused annual leave is reported as a financing source yet to be provided.

92. A further prominent example is the cost of subsidy reestimates for program funds under the Credit Reform Act. For financial reporting, subsidy reestimates are usually made as of the end of a fiscal year, and any increase in subsidy cost is recognized as an expense of that year. However, the reestimate cannot be calculated until after the end of the year, so the funding of that expense is not available until the following year. Thus, although the Congress has provided a permanent indefinite appropriation, it cannot be used until after the end of the fiscal year to which the reestimate applies.

93. In some instances, such as annual leave, funding for previously recognized costs may not be separately identifiable. Therefore, only the period change can be accounted for in the Statement of Financing. An increase in the unfunded liability would be shown as a financing source yet to be provided and a decrease would be shown as resources that do not fund net cost.

REPORTING REVENUE

94. The previous sections explained the different ways in which revenues are reported, depending on whether the revenue is exchange or nonexchange and on whether the collecting entity keeps the revenue or transfers it to others. The revenue may be reported on the Statement of Net Cost, the Statement of Custodial Activity, or the Statement of Changes in Net Position.

95. The following chart summarizes which statements to use. Note that exchange revenue, except for a few cases as noted earlier (see paragraphs 0-0), is always reported on the

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Statement of Net Cost and deducted from gross cost in calculating the entity's net cost of operations. If such revenue is transferred to others, it is also reported as a transfer-out in the Statement of Changes in Net Position.

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REVENUE REPORTING SUMMARY

DISPOSITION OF REVENUE	EXCHANGE REVENUE[19]	NONEXCHANGE REVENUE
Collecting entity keeps all	Statement of Net Cost	Statement of Changes in Net Position
Collecting entity transfers all to others	Full amount reported on Statement of Net Cost and also reported as a transfer-out on the Statement of Changes in Net Position	Full amounts collected and accrued, and their disposition, reported on Statement of Custodial Activity
Collecting entity keeps some and transfers some to others	Full amount reported on Statement of Net Cost and the amount transferred out reported on the Statement of Changes in Net Position	Full amounts collected and accrued, and their disposition (including amounts retained), reported on the Statement of Custodial Activity. Amounts retained also reported on Statement of Changes in Net Position unless they reimburse the collection function; then they are reported on the Statement of Net Cost as exchange revenue.

[19]See para. 0 - 0 for discussion of exceptional cases where exchange revenue is unrelated to recognized cost.

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CHAPTER 3: COMPARISON BETWEEN ACCOUNTING AND BUDGETARY CLASSIFICATIONS OF TRANSACTIONS

INTRODUCTION

96. This chapter compares the classification of transactions for financial accounting in SFFAS No. 7 with the classification of transactions used in the budget. The classification systems are very similar for transactions with the public, though significantly different in some respects for intragovernmental transactions. This chapter also compares the merits of having separate and common classification systems.

TRANSACTIONS WITH THE PUBLIC

97. **General comparison.** The distinction between nonexchange and exchange revenue is similar but not identical to the distinction in the budget between governmental receipts and offsetting collections from the public.[20] Governmental receipts are shown as the "receipts" in the budget and compared with outlays to calculate the deficit; whereas offsetting collections are subtracted from gross disbursements to determine the "outlays."[21] Nonexchange revenue generally corresponds to governmental receipts, and exchange revenue generally corresponds to offsetting collections. As a result, the

[20]The foundation of budget concepts for the distinction between governmental receipts and offsetting collections is the Report of the President's Commission on Budget Concepts (Washington, D.C.: U.S. Government Printing Office, October 1967), pp. 64-72.

[21]Offsetting collections are divided between two major categories: "offsetting collections credited to expenditure accounts," which are deducted in calculating the net outlays of the expenditure accounts in the budget to which they are credited; and "offsetting receipts," which are deposited in receipt accounts and in most cases are deducted in calculating net outlays at the agency level. (In a few cases, they are deducted in calculating government-wide net outlays.) In either case, they are an offset to total budget outlays. The difference between them, which is determined by law, is not germane to the issues in this chapter.

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budgetary classification and the accounting classification in SFFAS No. 7 are compatible with a few exceptions: gains and losses, budgetary inflows not recognized as revenue (such as exchanges of assets at book value), and inflows of resources recognized in financial accounting but not in the budget (such as non-cash donations). Also, there are a few instances where a particular inflow that is classified as a governmental receipt in the budget is classified as an exchange revenue in the financial accounting and hence subtracted from gross cost in the Statement of Net Cost.

98. The distinction in budgetary concepts between governmental receipts and offsetting collections is based on the difference in the method of allocating resources: collective decision making for governmental receipts and the market for offsetting collections. Governmental receipts are those collections derived from the exercise of the Government's sovereign powers, particularly its sovereign power to compel payment through taxation; whereas offsetting collections from the public are derived from business-type activities. The purpose of this system of classification is to measure the size of the Government, its agencies, and its functions in terms of the amount of resources allocated through collective political choice rather than through the principle that the provision of service requires the payment of a price. Under this classification system, the budget totals--total outlays and total receipts--measure what the U.S. Government does collectively in its role as a government, which is its predominant role, rather than what it does in its secondary role as a business.

99. Since nonexchange transactions, such as income tax receipts, would rarely occur except as a result of the Government's sovereign power, they are all governmental receipts in the budget. Exchange transactions are more varied. Exchange transactions with the public, such as the sale of maps and electricity, generally do not depend on sovereign power, so most are offsetting collections in the budget. However, there are three types of exceptions.

o Federal employee contributions to

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retirement plans are exchange transactions because they are part of a broader exchange transaction--selling labor services in return for compensation--in which each party receives and sacrifices something of value. They are governmental receipts in the budget, however, because the budget classification deems them to be akin to compulsory social insurance taxes.

- Some transactions with the public that arise from the Government's sovereign power to regulate, such as passport fees and the SEC registration fee, are classified as exchange transactions for financial reporting. The entity's operations produce the revenue in conjunction with the expense; identifiable beneficiaries pay fees for the special services provided, or identifiable non-Federal entities pay fees to compensate the Government for the costs that were incurred in regulating them for the benefit of the general public; and the fees in general are closely related to the cost of providing service or regulation. Nevertheless, since the collections depend on the Government's sovereign power rather than being the result of voluntary transactions, these regulatory user fees are governmental receipts under budget concepts.

- Exchange transactions may produce a cash inflow all of which is included in the offsetting collections of the budget but only part of which is recognized in the financial accounting statements as an inflow of resources. Some exchange transactions produce gains or losses for the difference between cash inflow and book value instead of producing revenue for the whole amount of the cash inflow (such as the sale of property, plant, and equipment that has been capitalized). The entire amount of the cash collected is an offsetting collection in the budget, but only the gain or loss is recognized in the Statement of Net Cost. Other exchange transactions, such as the repayment of pre-1992 direct loans and other receivables at book value, are not included in revenue or other financing

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sources at all, although (except for post-1991 direct loans) the entire amount of cash collected is an offsetting collection in the budget.[22]

100. **User charges.**[23] The term "user charge" designates payments that are based to a degree on related benefits or damages. Many are exchange transactions in the accounting classification of SFFAS No. 7 and are offsetting collections in the budget. Some, the regulatory user charges discussed above, are exchange transactions in the classification of SFFAS No. 7 but in concept are governmental receipts in the budget.

101. Still other user charges are benefit taxes or taxes related to the cause of some damage. Benefit taxes are levied on bases that are related to the use of publicly provided goods and services or the public provision of other benefits, such as the gasoline excise tax, which is largely dedicated to the highway trust fund. Taxes may also be levied on bases related to the cause of some damage and dedicated to pay for that damage, such as the tax on domestically mined coal, which is dedicated to the black lung disability trust fund. Because these are taxes, which depend on the Government's sovereign power to compel payment, they are governmental receipts in the budget. Because the relationship between the tax and the benefit received by an identifiable recipient is so indirect and disproportionate, these taxes are nonexchange transactions in the financial accounting.

102. The budget classification of user charges and other transactions is not clear-cut in every case. The nature of transactions may be mixed and contain elements of both voluntary exchange and sovereign power. For example,

[22]These repayments, however, may lead to an increase or decrease in expense if they are the occasion for reestimating the subsidy cost of post-1991 direct loans or for adjusting the allowance for uncollectible amounts of other receivables.

[23]User charges are discussed in a CBO study that has a broader scope than indicated by its title. See The Growth of Federal User Charges (August 1993). The data in that study have been updated in CBO Memorandum, The Growth of Federal User Charges: An Update (October 1995).

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individuals under Medicare may choose to pay premiums for Supplemental Medical Insurance (SMI). At the same time, however, the Government, through its sovereign powers, pays for about three-quarters of the cost of SMI, which is such a strong incentive that almost all eligible persons participate. As a result, the premiums might reasonably be classified as either governmental receipts or offsetting collections. They were classified as governmental receipts when the program began but for some years have been classified as offsetting collections.

103. Furthermore, the budget classification of various user charges does not follow the conceptual principles in every instance. Statutory requirements and other public policies have increasingly classified regulatory user charges as offsetting collections in recent years even though they arise from the exercise of the Government's sovereign power.[24] The budget classification of receipts now has a formal category of "offsetting governmental receipts" that includes a number of transactions that are deemed to arise from sovereign power but are classified as offsetting receipts; and the budget identifies as "governmental" those offsetting collections credited to expenditure accounts that arise from sovereign power.[25]

[24]CBO, The Growth of Federal User Charges (August 1993), pp. 35-36.

[25]Governmental offsetting collections credited to an expenditure account are identified as such and shown on a separate line in the account's program and financing schedule.

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INTRAGOVERNMENTAL TRANSACTIONS

104. The relationship between budgetary and financial accounting transactions is not nearly as close for intragovernmental transactions as it is for transactions with the public. All intragovernmental collections recorded in the budget are offsetting collections. This is necessary in order that the receipt and outlay totals of the budget reflect only transactions with the public. However, as explained in Appendix B of SFFAS No. 7, some of these offsetting collections are exchange revenues in the new financial accounting, a few are nonexchange revenues, while a number of others are classified as other financing sources. Furthermore, the financial accounting recognizes some inflows of resources that are not transactions in the budget.

105. Intragovernmental exchange transactions consist of all payments for goods and services provided, such as the sale of services by DBOF (Defense Business Operations Fund) to another entity within the Department of Defense. Intragovernmental nonexchange transactions are those transactions where the inflow of resources is akin to a corresponding nonexchange transaction with the public (such as an employer entity's contributions to Social Security and Medicare for its employees) or derives directly from past nonexchange transactions with the public (such as interest paid to trust funds on their investments in Treasury securities that they purchased from previous tax receipts).

106. Other intragovernmental financing sources are more varied. They include many inflows of resources that are not recorded as transactions in the budget. The most important of these is appropriations, which are recognized as an other financing source to the entity when used but are not recorded in the calculation of budget outlays and receipts. The budget records appropriations, of course, but appropriations provide the authority to enter into obligations that will result in outlays rather than being offsets in calculating the amount of outlays. Recording appropriations as offsetting collections would make outlays approximately zero when appropriations were subtracted from

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the outlays for which they provided the authority. Further examples of other financing sources are the transfer of capitalized assets without reimbursement, and imputed financing when the full cost of goods or services is recognized but is not charged to the entity that receives them. The other intragovernmental financing sources all have the same basic characteristic: they are not produced by the operations of the entity that receives the inflow and therefore should not be deducted from its gross cost in determining its net cost of operations.

CHOICE OF CLASSIFICATION SYSTEM

107. Because financial and budgetary accounting are related, it may be asked whether financial accounting should follow the budgetary classification of transactions. For intra-governmental transactions, the differences are so large and fundamental between budgetary accounting and the principles in SFFAS No. 7 that the two classifications could not reasonably be made the same.

- The accounting principles of SFFAS No. 7 require that exchange revenue be recognized separately from nonexchange revenue and other financing sources and offset against gross cost in order to calculate net cost. Nonexchange revenue and other financing sources do not affect net cost but do contribute to net position. The budget classification of intragovernmental offsetting collections does not make this distinction and must offset all intragovernmental transactions against gross outlays in order for the budget totals to measure transactions with the public.

- The inflows of resources classified by financial accounting as other financing sources--such as appropriations--could not be classified as offsetting collections in the budget without making the related budget outlays approximately zero as a matter of definition. However, they are necessary in financial accounting to determine the change in net position.

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108. For transactions with the public, on the other hand, the differences between the principles of SFFAS No. 7 and the budgetary classification are relatively small. There are about $5 billion of employee contributions to Federal retirement systems that are classified as exchange transactions for financial accounting but are governmental receipts in the budget, and there are around $2 billion of regulatory user fees that are classified in the same way. There are also sales of property, plant, and equipment, which are recognized in financial accounting only to the extent of a gain or loss but are measured by cash inflow in the budget. These and similar transactions are relatively small compared to the $1,570 billion of governmental receipts plus offsetting collections (from the public) recorded in the budget for 1995.

109. Financial accounting could follow the budget in classifying the type of transaction with the public by matching exchange revenue with offsetting collections and nonexchange revenue with governmental receipts. The arguments are fourfold. First, one classification system is simpler to use and understand than two systems and would avoid confusion. Second, the two classifications generally overlap, as discussed above, so the aggregate loss from misclassification in terms of the financial reporting criteria could not be large. Third, in some cases the transactions for which the two classifications differ are borderline decisions under both classifications, especially in the area of regulatory user charges. And fourth, a separate classification system would need its own method of ensuring compliance.

110. The underlying argument in favor of separate classifications is that different classification systems are needed for different purposes. The primary purpose of the classification system for revenue and other financing sources is to help measure the net cost of an entity's operations. To achieve this result, it is necessary to offset the entity's costs by the revenue that it earns from the provision of goods and services.

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111. The net cost of operations is important information. For all entities, the net cost (and the gross cost) should be compared with outputs and outcomes in assessing the effectiveness with which resources are used to achieve results. For an entity that provides goods and services to the taxpayer, net cost is needed in order to calculate the extent to which the cost of the activity is borne by the taxpayer rather than by identifiable recipients of special benefits or by identifiable parties that are being regulated. This information can help decision makers evaluate the extent to which the entity's exchange activities were justified in terms of the public's willingness to pay. Both the comparison of costs with outputs and outcomes, and the information about the public's willingness to pay, can be used by management, the President, and the Congress in making decisions about the allocation of resources. And for all entities that provide goods and services, whether to the public or to other Federal entities, the net cost of operations is needed in evaluating and establishing the entity's pricing policy. The extent to which expense is covered by user charges can be a critical factor in setting user changes that are efficient and fair.

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112. Although a separate classification system for transactions with the public would make little difference to the aggregate amounts in the consolidated financial statements of the U.S. Government, it would enable these particular goals to be much better met for a number of specific entities and activities: instances where the budget does not offset program outlays by the collections earned by the program's provision of goods and services, or where the budget records an offsetting collection that exceeds the gain/loss or adjustment to expense. Furthermore, as long as the financial accounting standards measure some transactions in terms of the difference between the cash inflow and the book value of the assets that are given up, the dollar amounts of a few types of transactions cannot be the same. The financial accounting standards, moreover, recognize a few transactions with the public that are not recorded in the budget. Nor can the financial accounting classification be compatible in all cases with both budget concepts and budget practice. Finally, the classification of intragovernmental transactions would remain very different, so the two systems would still not be identical.

113. Because the purposes of financial accounting and the budget are different, although related, it is reasonable to expect that the classification systems appropriate for each purpose would also be related but not identical. This would be similar to the relationship between the Federal budget and the Federal sector in the national income and product accounts. Their principal purposes differ, and as a result their classifications have important differences even while being similar in many respects.[26] Accordingly, the

[26]The difference between the classifications in the budget and the national income and product accounts prior to the comprehensive revision of these accounts in January 1996 is discussed in "National Income and Product Accounts," chapter 19 of Analytical Perspectives, Budget of the United States Government, Fiscal Year 1996, pp. 267-70. For a more detailed reconciliation table, see Bureau of Economic Analysis, National Income and Product Accounts of the United States, vol. 2, 1959-88 (Washington: Government Printing Office, 1992), table 3.18B.

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Board decided to recommend that financial accounting use a separate classification system from the budget.

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CHAPTER 4: CASE STUDY AND ILLUSTRATIONS

114. This is a case study to illustrate the application of the new standard on accounting for revenue and other financing sources. The case provides a set of budgetary and proprietary journal entries and related proprietary financial statements for three Federal entities that have transactions with each other and with the public. The entities are:

a. a *collecting entity*, which receives an annual appropriation and collects tax revenues earmarked for a trust fund;

b. a *credit program entity*, which makes loans, provides reimbursable services to the trust fund, and procures services from the public;

c. a *trust fund*, which consolidates the cash and investing activities of Treasury's Financial Management Service with the activities of the program agency administering the trust fund's operations.

115. The case illustrates the following transactions in the appropriate entities:

a. collection, accrual, and transfer of taxes;

b. ordering goods or services to be received or provided;

c. issuance and receipt of appropriations and borrowings from Treasury;

d. interagency borrowing from Treasury;

e. receipt or provision of goods, services, and benefits, including making loans to the public;

f. collection of loan principal and interest;

g. interagency purchase, issuance, and redemption of Treasury securities;

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h. accrual, payment, and receipt of interest on the Treasury securities;

i. imputation of revenue and expense for services provided at less than cost;

j. depreciation of equipment and accrual of annual leave;

k. temporary accrual of financing sources for expenses to be funded from future financing sources;

l. closing entries.

116. Both pre- and post-closing trial balances are shown for the budgetary and proprietary accounts for each entity. From these, the following financial statements are illustrated based on the requirements of the new standard:

a. Statement of Custodial Activity;

b. Statement of Net Cost;

c. Statement of Changes in Net Position;

d. Balance Sheet;

e. Statement of Budgetary Resources; and

f. Statement of Financing.

117. Only the line items necessary to complete the statements are shown. Crosswalks to account balances from which the figures are obtained are presented on the face of the statement for illustrative purposes.

118. There are a number of caveats in using the case.

a. The case entities do not reflect any particular Federal agencies or programs. Although there are counterparts to the illustrated transactions in real Federal agencies and programs, the case entities and their transactions are fictitious. Dollar amounts used in transactions are assumed for purposes of illustration. Particularly, regarding the credit agency, in an actual

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situation the amounts relating to the subsidy and its amortization would be computed using present value methodologies, which are beyond the scope of this implementation guide. Information on present value computations for direct loan and loan guarantee programs is provided in the reference set forth in paragraph 119(h). Additional information is also found in Appendix B, "Technical Explanations and Illustrations," of SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees (August 23, 1993).

b. The transactions are illustrative, but not comprehensive. Federal agencies engage in many transactions in addition to those shown, such as the use and recognition of contract authority and sales of assets, decreases in the liability for annual leave, accrual of exchange revenue from the public, etc. A comprehensive case would mask the benefit of the illustrations by requiring voluminous technical and explanatory information about specific programs and transactions. Similarly, the reports and crosswalks illustrated are condensed and simplified to highlight application of key concepts and requirements of the revenue standard. Authoritative guidance for agency financial statements that are prepared pursuant to the Chief Financial Officers Act (as amended) is contained in OMB's bulletin on form and content. Guidance for budgetary reports is contained in OMB Circulars A-11 and A-34. Agencies may sometimes develop alternative crosswalks which provide the same information.

c. The journal entries and trial balances for the collecting agency and trust fund utilize accounts provided in the U. S. Government Standard General Ledger, and the illustrated reports include crosswalks to those accounts. Account names are often abbreviated to fit within available space. At this writing, the SGL Board is revising the illustrative transactions in the SGL, and journal entries are subject to change.

d. Accounts which would be subaccounts of an SGL account are shown with the master account number. For example, account number 6100,

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"Operating/Program Expenses," is used for the subaccount "Depreciation Expense - Equipment." Subaccount titles and numbers are the purview of agencies.

e. Line items which would be reported based on data elements being captured with accounts are indicated with a "D." For example, account 6100, "Operating Expenses," would require data elements for each expense to indicate whether the expense was exchange- or nonexchange-related.

f. Accounts not presently in the SGL are marked "XXXX" in place of a number, and the issues involved have been referred to the SGL Board for resolution.

g. Crosswalks are those for SGL accounts used in the case only. They do not include the entire SGL chart of accounts.

h. Beginning account balances are assumed to be zero for purposes of illustration.

i. For simplicity, all appropriations are classified as "other," SGL account 4119, rather than as specific types of appropriations. In an actual situation, specific types of appropriations, with different SGL account numbers, would be designated as applicable. Budgetary authority for the collecting and credit agencies is assumed to expire at year-end; authority for the trust fund is assumed to be available for obligation in the succeeding year. Additionally, apportionment of resources is assumed and not illustrated. The status of resources is shown beginning with their allotment by agencies for commitment and obligation. Commitment accounting, which does not add to the value of the case, is not illustrated.

j. In most cases, revenues and expenses are not broken out beyond the designation "exchange" and "nonexchange." This is for illustrative purposes only and is designed to avoid cluttering the statements with specific items

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which do not add to the value of the concepts presented. Note, however, that in an actual situation, revenues and expenses must be broken out by source of revenue and nature of expense as prescribed by OMB's form and content guidance.

k. The trust fund transactions provide for transfers of collections to it in the amount collected. In practice, transfers are made during the year based on estimates, and any amount collected but not yet transferred at year-end is accrued as a receivable and a revenue by the trust fund.

l. In addition to activities for the entities illustrated, the Department of the Treasury would maintain records on the Government's cash position and debt. Related information would be reported in the Consolidated Financial Statements of the U. S. Government.

m. The illustrative Balance Sheets are designed solely to highlight the new, simplified capital structure which would result from application of the revenue standard. Assets and liabilities are not segregated by entity and non-entity to avoid complicating the example with items not related to the revenue standard. Agency Balance Sheets would be prepared in accordance with SFFAS No. 1 and the form and content guidance published by OMB, which prescribes the entity and non-entity designations.

119. More detailed information on Federal accounting can be found in such references as:

a. *Accounting for Basic Operating Appropriations and Reimbursables*, U. S. General Accounting Office (AFMD-PPM-2.1, September 1990)

b. *Accounting for Expired Appropriation Authority Under the Requirements of P.L. 101-110*, U. S. Standard General Ledger Board (October 1991)

c. Illustrative Cases in *Accounting Under the Credit Reform Act of 1990*, U. S. Financial Management Service (cases 2b, 3b, 4, and 5b, with various dates through 1994)

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d. *Budgetary Accounting in the Federal Government*, U. S. Financial Management Service (September 30, 1994)

e. *Treasury Financial Manual*, issued by the U.S. Financial Management Service. (See esp. I TFM 2-4200 and supplements and transmittal letters setting forth and updating the *U. S. Government Standard General Ledger*.)

f. OMB Circulars A-11 (Budget Preparation), A-34 (Budget Execution), and A-127 (Financial Management Systems)

g. OMB Bulletin 94-01, *Form and Content of Agency Financial Statements* (November 1993, or as subsequently amended)

h. Accounting for the Present Value of Direct Loan and Loan Guarantee Programs Under the Federal Credit Reform Act of 1990 (P.L. 101-508), U.S. Financial Management Service (September 16, 1993).

120. The transactions and journal entries for the case begin on the next page.

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ILLUSTRATIVE CASE TRANSACTIONS, JOURNAL ENTRIES, AND TRIAL BALANCES

(In the following illustrations, "N/A" means "not applicable.")

Transactions	Collecting Agency	Credit Agency	Trust Fund
1. The collecting and credit agencies received appropriations, which were fully apportioned and allotted. Warrants were issued.	Budgetary entry 4119 Other Appropriations Realized 1000 4610 Allotments - Realized Resources 1000 Proprietary entry 1010 Fund Balance with Treasury 1000 3100 Appropriated Capital 1000	Budgetary entry 4119 Other Appropriations Realized 1500 4610 Allotments - Realized Resources 1500 Proprietary entry 1010 Fund Balance with Treasury 1500 3100 Appropriated Capital 1500	Budgetary entry None Proprietary entry None
2. The collecting agency collected taxes for the trust fund and deposited them to the Treasury.	Budgetary entry None Proprietary entries 1010 Fund Balance with Treasury 5000 5800 Tax Revenue 5000 - & - 5990 Contra Revenue - Collected for Others 5000 2990 Custodial Liability (D) 5000	N/A	N/A
3. Treasury transferred collections to the Trust Fund. A warrant was issued and the funds were allotted. (The trust fund recognizes this as an appropriation. It is not subject to the apportionment process.)	Budgetary entry None Proprietary entry 2990 Custodial Liability (D) 5000 1010 Fund Balance with Treasury 5000	N/A	Budgetary entry 4119 Other Appropriations Realized 5000 4620 Other Funds Available for Commit/Oblig 5000 Proprietary entry 1010 Fund Balance with Treasury 5000 5800 Tax Revenues 5000
4. Goods, services, and benefits ordered to be received or provided were recorded. Borrowing authority was recorded for loans to be made and was apportioned and allotted.	Budgetary entry 4610 Allotments - Realized Resources 750 4800 Undel Orders 750 Proprietary entry None	Budgetary entry 4142 CY Borr Auth Realized 200 4610 Allotments - Rlzd Resour 700 4800 Undel Orders 900 Proprietary entry None	Budgetary entry 4620 Other Funds Available for Commit/Oblig 4500 4800 Undel Orders 4500 Proprietary entry None
5. The entities received goods and services for use in operations and	Budgetary entry 4800 Undel Orders 750	Budgetary entries 4148 Resour Realzd from BA 200	Budgetary entry 4800 Undel Orders 4200

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Transactions	Collecting Agency	Credit Agency	Trust Fund
provided benefits to participants in programs they operate. These included items accounted for as operating expenses in all three entities; capitalized equipment in the credit agency and trust fund; and loans the credit agency made to credit program participants. To make the loans, the credit agency borrowed money from the Treasury and used funds appropriated for loan subsidies, as provided under the Credit Reform Act of 1990 (P.L. 101-508). The entities paid for some items during the year; the remainder were still payable at year-end.	4900 Expended Authority 750 Proprietary entries 6100 Operating/Program Expense - Nonexch (D) 750 1010 Fund Balance with Treasury 750 - & - 3100 Appropriated Capital 750 5700 Appr Capital Used 750	4145 BA Converted to Cash 200 - & - 4800 Undel Orders 500 4900 Expended Authority 500 Proprietary entries 1010 Fund Balance with Treasury 200 2510 Prin Pay to Treasury 200 - & - 1350 Loans Receivable 250 1750 Equipment 100 6100 Operating/Program Expense - Exch (D) 150 6100 Subsidy Expense-other than re-est. (D) 50 1010 Fund Balance with Treasury 375 1399 Allowance for Subsidy 50 2110 Accounts payable 125 - & - 3100 Appropriated Capital 300 5700 Appr Capital Used 300	4900 Expended Authority 4200 Proprietary entry 1750 Equipment 1000 6100 Operating/Program Expense - Nonexch (D) 3200 1010 Fund Balance with Treasury 3000 2110 Accounts Payable 1200
6. Trust fund monies were invested in Treasury securities.	N/A	N/A	Budgetary entry None Proprietary entry 1610 Securities at Par 800 1010 Fund Balance with Treasury 800
7. Interest on the Treasury securities was collected.	N/A	N/A	Budgetary entry 4119 Other Appro. Realized 10 4620 Other Funds Avail for Commit/Oblig 10 Proprietary entry 1010 Fund Balance with Treasury 10 5300 Interest Revenue 10
8. Collections for loan principal and interest made in transaction #5 were received. The monies were used to pay interest and reduce principal on the borrowing from Treasury.	N/A	Budgetary entries 4262 Act Coll - Loan Principal Collected 40 4263 Act Coll - Loan Interest Collected 10 4147 Payments to Treasury 35* 4900 Expended Authority 15* *The $35 is principal and the $15 is interest on the loan from Treasury Proprietary entries 1010 Fund Balance with Treasury 50 1350 Loans Receivable 40 5300 Interest Inc. - Borrowers (D) 10 - & - 2510 Prin Payable to Treasury 35 6310 Interest Expense-Treasury 15 1010 Fund Balance with	N/A

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Transactions	Collecting Agency	Credit Agency	Trust Fund
		Treasury 50 - & - 3100 Appropriated Capital 15 5700 Appropriated Capital Used 15	
9. The credit agency provided services for, and collected a fee from, the trust fund. (see related transaction 12)	N/A	Budgetary entry 4250 Reimbursements & Other Income Earned 100 4610 Allotments - Rlzd Resour 100 Proprietary entry 1010 Fund Balance with Treasury 100 5200 Service Revenue 100	Budgetary entries 4620 Other Funds Available for Commit/Oblig 100 4900 Expended Authority 100 Proprietary entries 6100 Operating/Program Expenses - Nonexchange (D) 100 1010 Fund Balance with Treasury 100
10. Treasury redeemed a portion of trust fund investments at par plus accrued interest.	N/A	N/A	Budgetary entry 4119 Other Appropriations Realized 11 4620 Other Funds Avail. for Commit/Oblig 11 Proprietary entry 1010 Fund Balance with Treasury 261 1610 Securities 250 5300 Interest Revenue 11
11. The trust fund accrued interest on the remaining Treasury investments.	N/A	N/A	Budgetary entry None Proprietary entry 1340 Interest Receivable 25 5300 Interest Revenue 25
12. The trust fund was informed that the amount charged for services provided by the credit agency was less than the credit agency's cost (see transaction 9). The applicable standard for that cost required the trust fund to recognize an imputed cost for the difference. An imputed financing source was also recognized to offset the imputed cost.	N/A	N/A	Budgetary entry None Proprietary entry XXXX Imputed Expenses 15 5900 Imputed Financing Sources (D) 15
13. Depreciation on equipment was recorded.	N/A	Budgetary entry None Proprietary entry 6100 Depr Exp - Equip (D) 20 1759 Accum Depr - Equip 20	Budgetary entry None Proprietary entry 6100 Depr Exp - Equip (D) 200 1759 Accum Depr - Equip 200
14. The annual leave liability was accrued. Entries to indicate that financing sources are needed are made as a convenience to automated systems	Budgetary entry None Proprietary entries	Budgetary entry None Proprietary entries	Budgetary entry None Proprietary entry

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Transactions	Collecting Agency	Credit Agency	Trust Fund
preparing the Statement of Financing, which requires that figure.	6100 Annual Leave Expense (D) 25 2220 Annual Leave Liab 25 - & - 3501 Future Funding Requir 25 XXXX Fin Sources - Unfunded 25	6100 Annual Leave Expense (D) 30 2220 Annual Leave Liab 30 - & - 3501 Future Funding Requir 30 XXXX Fin Sources - Unfunded 30	6100 Annual Leave Expense (D) 20 2220 Annual Leave Liab 20 [Note: Assumes annual leave is a funded expense for the trust fund. If not, an unfunded Financing Source would have to be recorded, as was done for the Collecting and Credit Agencies.]
15. Tax revenues to be collected were accrued.	Budgetary entry None Proprietary entries 1310 Taxes Receivable (D) 400 5800 Tax Revenues 400 - & - 5990 Contra Revenue for Others 400 2190 Liab for Tax Accrual (D) 400	N/A	N/A
16. A reestimate of the subsidy at year end indicated that $8 additional subsidy and $1 interest on the reestimate should be recorded. After the reestimate the subsidy was amortized and the future financing source for the unfunded subsidy reestimate (which will be received in the following year) was recorded. The entry to indicate that a financing source is needed is made as a convenience to automated systems preparing the Statement of Financing, which requires that figure.	N/A	Budgetary entry None Proprietary entries 6100 Subsidy Exp. Re-est (D) 8 6330 Int Expense - Re-est. (D) 1 1399 Allowance for Subsidy 8 5300 Interest Income - Re-est (D) 1 - & - 1399 Allowance for Subsidy 5 5300 Interest Inc - Subs. (D) 5 - & - 3501 Future Funding Requir 9 XXXX Fin Source - Unfunded 9	N/A
Preclosing Trial Balance	Budgetary 4119 Other Appro Realized 1000 4610 Allotments Rlzd Resour 250 4900 Expended Authority 750 1000 1000 Proprietary XXXX Fin Sources - Unfunded 25 1010 Fund Balance with Treasury 250 1310 Taxes Receivable (D) 400 2190 Liability for Tax Accrual (D) 400 2220 Annual Leave Liab 25 3100 Appropriated Capital 250 3501 Future Funding Requir 25 5700 Appr Capital Used 750 5800 Tax Revenues 5400 5990 Contra Revenue Collected for Others 5400 6100 Annual Leave Expense (D) 25	Budgetary 4119 Other Appr Realized 1500 4142 CY Budget Auth Rlzd 200 4145 BA Converted to Cash 200 4148 Resour Realzd from BA 200 4610 Allotments - Rlzd Resour 900 4250 Reimbursements & Other Income Earned 100 4262 Act Coll - Loan Principal 40 4263 Act Coll - Loan Interest 10 4147 Actual Pmts to Treasury 35 4800 Undelivered Orders 400 4900 Expended Authority 515 2050 2050 Proprietary XXXX Fin Sources - Unfunded 39 1010 Fund Balance with Treasury 1425 1350 Loans Receivable 210 1399 Allowance for Subsidy 53	Budgetary 4119 Other Appro Realized 5021 4620 Other Funds Available for Commit/Oblig 421 4800 Undelivered Orders 300 4900 Expended Authority 4300 5021 5021 Proprietary 1010 Fund Balance with Treasury 1371 1340 Interest Receivable 25 1610 Securities 550 1750 Equipment 1000 1759 Accum Depr - Equip 200 2110 Accounts Payable 1200 2220 Annual Leave Liab 20 5300 Interest Revenue 46 5800 Tax Revenue 5000

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Transactions	Collecting Agency	Credit Agency	Trust Fund
	6100 Operating/Program Expense - NonExch (D) 750 6850 6850	1750 Equipment 100 1759 Accum Depr - Equip 20 2110 Accounts Payable 125 2220 Annual Leave Liab 30 2510 Prin Payable to Treasury 165 3100 Appropriated Capital 1185 3501 Future Funding Requir 39 5200 Service Revenue 100 5300 Interest Revenue 16 5700 Appr Capital Used 315 6100 Annual Leave Expense (D) 30 6100 Subsidy Expense other than re-est. (D) 50 6100 Subsidy Exp.-re-est. 8 6100 Depreciation Expense - Equip (D) 20 6100 Operating/Program Expense - Exchange (D) 150 6310 Interest Expense-Treasury 15 6330 Interest Expense--Re-est. 1 2048 2048	5900 Imputed Financing Sources (D) 15 6100 Depreciation Expense - Equip (D) 200 6100 Annual Leave Expense (D) 20 XXXX Imputed Expenses 15 6100 Operating/Program Expense - Nonexch (D) 3300 6481 6481
Closing Entries: (Note that the closing entry for unfunded financing sources reverses the entry which created the accounts in transaction #14.)	Budgetary entries 4201 Total Actual Resources 1000 4119 Other Appro Realized 1000 - & - 4610 Allotments Rlzd Resour 250 4650 Allotments - Expired Authority 250 - & - 4900 Expended Authority 750 4201 Total Actual Resources 750 Proprietary entries 3310 Cum Result of Oper. 25 5700 Appr Capital Used 750 5800 Tax Revenues 5400 5990 Contra Revenue Collected for Others 5400 6100 Annual Leave Expense (D) 25 6100 Operating/Program Expense - NonExch (D) 750 - & - XXXX Fin Sources - Unfunded 25 3501 Future Funding Requir 25	Budgetary entries 4145 BA Converted to Cash 200 4147 Actual Pmts to Treasury 35 4201 Total Actual Resources 1815 4119 Other Appro Realized 1500 4142 CY Borrow. Auth. Rlzd. 200 4148 Resour Realzd from BA 200 4250 Reimbursement & Other Income Earned 100 4262 Act Coll - Loan Principal 40 4263 Act Coll - Loan Interest 10 - & - 4610 Allotments - Realized Resources 900 4650 Allotments - Expired Authority 900 - & - 4900 Expended Authority 515 4201 Total Actual Resources 515 Proprietary entries 5200 Service Revenue 100 5300 Interest Revenue 16 5700 Appr Capital Used 315 3310 Cumulative Results of Operations 157 6100 Subsidy Expense (D) 58 6100 Annual Leave Expense (D) 30 6100 Depreciation Expense - Equip (D) 20 6100 Operating/Program Expense - Exchange (D) 150	Budgetary entries 4201 Total Actual Resources 5021 4119 Other Appro Realized 5021 - & - 4900 Expended Authority 4300 4201 Total Actual Resources 4300 Proprietary entries 5300 Interest Revenue 46 5800 Tax Revenue 5000 5900 Imputed Financing Sources (D) 15 3310 Cumulative Results of Operations 1526 6100 Depreciation Expense - Equip (D) 200 XXXX Imputed Expenses 15 6100 Annual Leave Expense (D) 20 6100 Operating/Program Expense - Nonexch (D) 3300

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Transactions	Collecting Agency	Credit Agency	Trust Fund
		6310 Int Expense--Treasury 15 6330 Int Expense--Re-est 1 - & - XXXX Financing Sources - Unfunded 39 3501 Future Funding Requir 39	
Post Closing Trial Balance	Budgetary 4201 Total Actual Resources 250 4650 Allotments - Expired Authority 250 250 250 Proprietary 1010 Fund Balance with Treasury 250 1310 Taxes Receivable (D) 400 2220 Annual Leave Liability 25 2990 Custodial Liab. (D) 400 3100 Appropriated Capital 250 3310 Cum Results of Oper. 25 675 675	Budgetary 4201 Total Actual Resources 1300 4650 Allotments - Expired Authority 900 4800 Undelivered Orders 400 1300 1300 Proprietary 1010 Fund Balance with Treasury 1425 1350 Loans Receivable 210 1399 Allowance for Subsidy 53 1750 Equipment 100 1759 Accum Depr - Equip 20 2110 Accounts Payable 125 2220 Annual Leave Liab 30 2510 Prin Payable to Treasury 165 3100 Appropriated Capital 1185 3310 Cumulative Results of Operations 157 1735 1735	Budgetary 4201 Total Actual Resources 721 4620 Other Funds Avail. for Commit/Oblig 421 4800 Undelivered Orders 300 721 721 Proprietary 1010 Fund Balance with Treasury 1371 1340 Interest Receivable 25 1610 Securities 550 1750 Equipment 1000 1759 Accum Depr - Equip 200 2110 Accounts Payable 1200 2220 Annual Leave Liab 20 3310 Cumulative Results of Operations 1526 2946 2946

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121. a. The following pages present financial statements for the three entities involved. The matrix below identifies the statements prepared for each entity.

ILLUSTRATIVE FINANCIAL STATEMENTS PREPARED FOR CASE STUDY ENTITIES

Statement	Collecting Agency	Credit Agency	Trust Fund
Custodial Activity	Figure 1	N/A	N/A
Net Cost	Figure 2	Figure 7	Figure 12
Changes in Net Position	Figure 3	Figure 8	Figure 13
Balance Sheet	Figure 4	Figure 9	Figure 14
Budgetary Resources	Figure 5	Figure 10	Figure 15
Financing	Figure 6	Figure 11	Figure 16

b. The legend for the various statements is as follows:

1. [ ] designates accounts and arithmetic
2. XXXX designates an account not in the SGL
3. B = beginning account balance
4. E = ending account balance
5. No B or E = adjusted (preclosing) account balance
6. Pub = public (outside the Government)
7. Fed = Federal (within the Government)

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Figure 1

Illustrative Collecting Agency
Statement of Custodial Activity
For Year Ended September 30, ____

Sources of Revenue	
Collected [5800 Tax Revenue + 1310 Tax Rec(B)-(E)]	$5,000
Increase in Net Receivables [1310 Tax Rec(E) - (B)]	400
Total Revenues	$5,400
Disposition of Revenue	
Transferred to Others [5990 Rev. Collected for Others- 2190 Liab. for Tax Accrual (E-B)]	$5,000
Increase in Amounts to be Transferred [2190 Liab. for Tax Accrual (E)-(B)]	400
Total Disposition of Revenues	($5,400)
NET CUSTODIAL ACTIVITY	-0-

Figure 2

Illustrative Collecting Agency
Statement of Net Cost
For Year Ended September 30, ____

Costs (not related to earned revenue)	
Annual Leave Expense [6100]	$ 25
Other Expenses [6100]	750
NET COST OF OPERATIONS	$775

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Figure 3

Illustrative Collecting Agency
Statement of Changes in Net Position
For Year Ended September 30, ____

Net Cost of Operations	$775
Financing Sources (Other than Earned Revenues) that Affect Net Position:	
Appropriations Used to acquire goods, services, and benefits [5700]	750
Net Results of Operations	$(25)
Increase in Unexpended Appropriations [3100 (E-B)]	250
Increase in Net Position	$225
Net Position, October 1	0
NET POSITION, SEPTEMBER 30 [MUST = 3100(E) + 3310(E)]	$225

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Figure 4

Illustrative Collecting Agency
Balance Sheet
For Year Ended September 30, ____

Assets	
Fund Balance with Treasury [1010]	$ 250
Taxes Receivable [1310]	400
TOTAL ASSETS	$ 650
Liabilities and Net Position	
Liabilities	
Custodial Liability [2990]	$ 400
Annual Leave Liability [2220]	25
Total Liabilities	$ 425
Net Position	
Unexpended Appropriations [3100]	$ 250
Cumulative Results of Operations [3310]	(25)
Total Net Position	$ 225
TOTAL LIABILITIES AND NET POSITION	$ 650

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Figure 5

Illustrative Collecting Agency
Statement of Budgetary Resources
For Year Ended September 30, ____

Budgetary Resources	
Current Appropriations [4119(B)]	$1,000
Status of Budgetary Resources	
Obligations incurred [4800 (E-B) + 4900]	$ 750
Unobligated balance not available [4650 (E)]	250
Total, status of budgetary resources	$1,000
Outlays	
Obligations incurred [4800 (E-B) + 4900]	$ 750
Add obligated fund balance, net October 1	0
Deduct obligated fund balance, net September 30	0
Total, outlays	$ 750

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Figure 6

Illustrative Collecting Agency
Statement of Financing
For Year Ended September 30, ____

Obligations and Nonbudgetary Resources	
Obligations incurred [4800 (E-B) + 4900]	$750
Other	0
Obligations and Nonbudgetary Resources	750
Financing Sources Yet to be Provided	
[XXXX Future Fin Source or 2220 (E-B)]	25
NET COST OF OPERATIONS	$775

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Figure 7

Illustrative Credit Agency
Statement of Net Cost
For Year Ended September 30, ____

Costs to Produce Exchange Revenue	
Interest Expense [6310 + 6330]	$16
Depreciation Expense [6100]	20
Annual Leave Expense [6100]	30
Subsidy Expense [6100]	58
Other Expense [6100 + XXXX imputed expenses]	150
	$274
Less Earned Revenue	
Intragovernmental [5200 Fed.]	$100
Interest Income [5300]	16
	$(116)
NET COST OF OPERATIONS	$158

Figure 8

Illustrative Credit Agency
Statement of Changes in Net Position
For Year Ended September 30, ____

Net Cost of Operations	$158
Financing Sources (Other than Earned Revenues) that Affect Net Position:	
Appropriations Used [5700]	315
Net Results of Operations	$157
Net Position, October 1, ____	0
NET POSITION, SEPTEMBER 30, ____[must = 3100 (E) + 3310 (E)]	$157

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Figure 9

Illustrative Credit Agency
Balance Sheet
For Year Ended September 30, ____

Assets		
Fund Balance with Treasury [1010]		$1,425
Loans Receivable [1350]	$210	
Less Allowance for Subsidy [1399]	(53)	157
Equipment [1750]	$100	
Less: Accumulated Depreciation [1759]	(20)	80
TOTAL ASSETS		$1,662
Liabilities and Net Position		
Liabilities		
Accounts Payable [2110]		$125
Annual Leave Liability [2220]		30
Prin. Pay. to Treasury [2510]		165
Total Liabilities		$320
Net Position		
Unexpended Appropriations [3100]		$1,185
Cumulative Results of Operations [3310]		157
Total Net Position		$1,342
TOTAL LIABILITIES AND NET POSITION		$1,662

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Figure 10

Illustrative Credit Agency
Statement of Budgetary Resources
For Year Ended September 30, ____

Budgetary Resources	
Current Appropriations [4119]	$1,500
Borrowing Authority [4142]	200
Collection of Loan Principal and Int. [4262 + 4263]	50
Reimbursements for Services [4250]	100
Less Principal Repaid to Treasury [4147]	(35)
Total, budgetary resources	$1,815
Status of Budgetary Resources	
Obligations incurred [4800 (E-B) + 4900]	915
Unobligated balance not available [4650 (E)]	900
Total, status of budgetary resources	$1,815
Outlays	
Obligations incurred[4800 (E-B) + 4900]	$915
Spending authority from offsetting collections and adjustment [4250 + 4262 + 4263]	(150)
Add obligated fund balance, net October 1	0
Deduct obligated fund balance, net September 30 [4800(E) + 2110(E)]	(525)
Total, outlays	$ 240

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Figure 11

Illustrative Credit Agency
Statement of Financing
For Year Ended September 30, ____

Obligations and Nonbudgetary Resources	
Obligations incurred [4800 (E-B) + 4900]	$915
Less spending authority from offsetting collections [4250 + 4262 + 4263]	(150)
Less exchange revenue not in the budget:	
Interest Income--Subsidy [5300 Int. Inc.--Subsidy (D)]	(5)
Interest Income--Reestimate [5300 Int. Inc.--Re-est. (D)]	(1)
Obligations and Nonbudgetary resources	$759
Resources That Do Not Fund Net Cost of Operations	
Changes in Goods, Services, and Benefits Ordered But Not Yet Received or Provided [4800 (E-B)]	(400)
Costs Capitalized on the Balance Sheet [1750 Equipment (E-B) + 4800 Obligations for Loans Made (D) - 4262 Collections of Loan Principal - 6100 Subsidy Expense other than for reestimates (D)]	(260)
Costs That Do Not Require Resources	
Depreciation [6100 Depr]	20
Financing Sources Yet to be Provided	
[XXXX Future Fin Sources or 2220 (E-B) + 6100 Subsidy Reestimates]	39
NET COST OF OPERATIONS	$158

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Figure 12

Illustrative Trust Fund
Statement of Net Cost
For Year Ended September 30, ____

Costs Not Related to Producing Exchange Revenue	
Depreciation [6100]	$ 200
Annual Leave [6100]	20
Imputed [XXXX]	15
Other [6100]	3,300
NET COST OF OPERATIONS	$3,535

Figure 13

Illustrative Trust Fund
Statement of Changes in Net Position
For Year Ended September 30, ____

Net Cost of Operations		$3,535
Financing Sources (Other than Earned Revenues) that Affect Net Position		
Tax Revenues [5800]	$5,000	
Interest Revenue from Treasury [5300 (D)]	46	
Imputed Financing Sources [5900 (D)]	15	
		5,061
Net Results of Operations		$1,526
Net Position, October 1, _____		0
NET POSITION, SEPTEMBER 30, ____		$1,526

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Figure 14

Illustrative Trust Fund
Balance Sheet
For Year Ended September 30, ____

Assets		
Fund Balance with Treasury [1010]		$1,371
Interest Receivable [1340]		25
Securities [1610]	$800	
Less Unamortized Discount [1611]	(250)	550
Equipment [1750]	$1,000	
Less: Accumulated Depreciation [1759]	(200)	800
TOTAL ASSETS		$2,746
Liabilities and Net Position		
Liabilities		
Accounts Payable [2110]		$1,200
Annual Leave Liability [2220]		20
Total Liabilities		$1,220
Net Position		
Cumulative Results of Operations [3310]		1,526
TOTAL LIABILITIES AND NET POSITION		$2,746

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Figure 15

Illustrative Trust Fund
Statement of Budgetary Resources
For Year Ended September 30, ____

Budgetary Resources	
Appropriations of Tax Collections [5800]	$5,000
Appropriations of Interest Collected [5300 - 1340 (E)]	21
Total, budgetary resources	$5,021
Status of Budgetary Resources	
Obligations incurred [4800 (E-B) + 4900]	$4,600
Unobligated balance available for obligation [4260]	421
Total, status of budgetary resources	$5,021
Outlays	
Obligations incurred [4800 (E-B) + 4900]	$4,600
Add obligated fund balance, net October 1 [4800 (B) + 2110 (B)]	0
Deduct obligated fund balance, net September 30 [4800 (E) + 2110 (E)]	1,500
Total, outlays	$3,100

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Figure 16

Illustrative Trust Fund
Statement of Financing
For Year Ended September 30, ____

Obligations and Nonbudgetary Resources	
Obligations incurred[4800 (E-B) + 4900]	$4,600
Imputed financing sources [5900 imputed]	15
Obligations, as Adjusted, and Nonbudgetary Resources	$4,615
Resources That Do Not Fund Net Cost of Operations	
Change in Goods, Services, and Benefits Ordered But Not Yet Received or Provided [4800 (E-B)]	(300)
Costs Capitalized on the Balance Sheet [1750 Equipment (E-B)]	(1,000)
Costs That Do Not Require Resources	
Depreciation [6100 Depr]	200
Annual Leave Expense [6100 Annual lv]	20
NET COST OF OPERATIONS	$3,535

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CHAPTER 5: ADDITIONAL GUIDANCE FOR PREPARING THE STATEMENT OF FINANCING

INTRODUCTION

122. Chapter 4 illustrated the results of numerous typical transactions for the financial statements in SFFAC No. 2, Entity and Display, as amended by SFFAS No. 7 to include the Statement of Financing. It was not feasible to include every possible transaction or to illustrate every possible circumstance.

123. Most of the financial statements in Entity and Display are based on concepts for the same financial statements that existed previously. Even the Statement of Budgetary Resources was based on the SF-133, "Report on Budget Execution," required of agencies by OMB. However, the Statement of Financing, introduced in SFFAS No. 7, is relatively new. While reconciliations between expended authority and expenses have been required before, there has not been a requirement to reconcile gross obligations with net cost of operations.

124. Because of the newness of the Statement, this chapter provides additional information about the Statement of Financing by showing how certain additional transactions should be reported. They include:

a. a decrease in the annual leave liability from the beginning to the end of the year;

b. acquisition of assets under capital leases;

c. transfer of assets in and out without reimbursement;

d. sale of property, plant, and equipment at a gain, loss, or neither;

e. accrual of revenue which is not recognized as a budgetary resource;

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f. special topics related to discretionary direct loan and loan guarantee programs.

125. Whereas chapter 4 presented journal entries and trial balances for the results of the transactions covered, this chapter deals with individual transactions only. Journal entries and trial balances leading to the transaction are not included. The U.S. Government Standard General Ledger illustrates transactions for agencies and includes crosswalks to reports, and the Standard General Ledger Board provides a forum for discussing issues related to recording and reporting.

126. For each of the five transaction types, this chapter describes the transactions and illustrates reporting on the Statement of Financing. The transactions are not intended to be comprehensive, but rather are particular issues raised during a pilot test of the Statement of Financing and in other comments from agencies. As with chapter 4, small dollar amounts are used for simplicity. Also, as with chapter 4, this chapter presents condensed, simplified financial statements designed to illustrate only the basic concepts and information presented. The illustrations are non-authoritative and shall not be viewed as criteria against which to audit. Authoritative guidance for display of financial statements prepared pursuant to the CFO Act (as amended) is provided by OMB in its bulletin on form and content.

DECREASE IN THE ANNUAL LEAVE LIABILITY

127. Chapter 4 illustrated reporting an increase in the unfunded liability for annual leave. This has been the situation most agencies have encountered as their staffs or budgets have grown. However, as the Government has recently begun downsizing, agencies are beginning to encounter situations in which the annual leave liability decreases rather than increases.

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128. For appropriated entities, when the annual leave liability *increases*, it is shown on the Statement of Financing as a reconciling item under the caption “financing sources yet to be provided.” This is because the budget does not recognize an increase in annual leave as an obligation, but financial accounting recognizes it as an expense. Obligations are recorded in the year the leave is paid. Hence, as shown in chapter 4, any increase in an unfunded annual leave liability creates a situation in which obligations are less than net cost of operations, and the difference is reconciled by adding the increase in annual leave as financing sources yet to be provided.

129. When the annual leave liability *decreases*, the expense for annual leave decreases accordingly, and the net cost of operations is less as a result. Reporting is not symmetrical to that for increases in the annual leave liability. Assume, for example, the following situation:

Annual Leave Liability, October 1	$ 40
Annual Leave Accrued for the Year	600
Annual Leave Paid During the Year	(605)
Annual Leave Liability, September 30	$ 35

130. In this instance, obligations of $605 would have been recorded for the leave paid. However, net cost of operations would be increased by only $600 for annual leave, the expense of leave accrued. The $5 decrease in the annual leave liability is a reconciling item which must be subtracted from obligations to yield net cost of operations. Because that $5 of the $605 in obligations did not fund the net cost of operations, which was only $600, it is subtracted under the caption "resources that do not fund net cost of operations."

131. An abbreviated Statement of Financing for the situation is shown below. Note that, based solely on the transaction described above, obligations are $605 and net cost of operations is $600.

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Obligations Incurred	$605
Resources That Do Not Fund Net Cost of Operations	
Decrease in Annual Leave Liability	(5)
Net Cost of Operations	$600

ASSETS ACQUIRED BY CAPITAL LEASE

132. The Government may enter into an agreement to lease the use of assets in such a way that the benefits and risks of ownership are substantially transferred from the lessor to the Government. In such cases, the economic substance of the transactions is that the assets are effectively purchased. These agreements are called "capital leases" in financial accounting. The standards for accounting for leases are prescribed in SFFAS No. 5, Accounting for Liabilities of the Federal Government, pp. 14-15, and SFFAS No. 6, Accounting for Property, Plant, and Equipment, pp. 5, 6 and 10.

133. Such leases have been treated distinctively in the budget for new leases since FY 1991, when guidance relating to the leases was phased in over a two-year period. The budgetary rules have many similarities in substance with the financial accounting standards, though there are differences in terminology. The budget classifies these leases as "lease-purchases without substantial private risk," "lease purchases with substantial private risk," and "capital leases." These categories cover approximately the same leases that financial accounting terms "capital leases." The budgetary rules and terminology are prescribed in OMB's Circular A-11, Preparation and Submission of Budget Estimates (1995), Appendix B.

134. The budgetary requirements for obligating what the budget calls capital leases and lease purchases are the same. They are discussed together here. There are differences in how the outlays related to these lease types are determined for purposes of budgetary reporting, but this does not affect the Statement of Financing. Because OMB's guidance grandfathers budgetary accounting practice for leases entered into prior to the current guidance, this section

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discusses preparing the Statement of Financing under both the current guidance and prior practice. The more generic financial accounting term, "capital leases," is used in the discussion and illustrations that follow.

135. **Current Guidance.** When an asset is purchased under a capital lease arrangement, the budget is obligated in the amount of the present value of the lease payments. The difference between the present value of the lease and the total of the lease payments represents interest expense and is amortized over the term of the lease using present value techniques. The interest expense determined for each year is recognized as an obligation in the budget for that year. Depreciation expense is not recognized in the budget. Financial accounting treats the present value of the lease payments as an asset when acquired, recognizes interest expense over the term of the lease, and reports depreciation expense over the useful life of the asset. Accordingly, the difference between obligations incurred and net cost of operations is the amount of the present value of the lease in the year of acquisition and the amounts of depreciation expense over the life of the asset.

136. Assume, for example, that a 3-year lease is entered into that calls for payments of $100 in each year. The present value of the lease payments is $250; interest expense amortized is $25, $15, and $10 for years 1, 2, and 3 respectively; and depreciation expense is $30, $30, and $30 for years 1, 2, and 3, respectively. (Note that depreciation is charged over the life of the asset, which may be different from the term of the lease.) Thus, obligations incurred are $275 (the $250 present value of the lease payments plus the first year interest of $25) in Year 1, and $15 and $10 for years 2 and 3, respectively--the amount of the interest expense for those years. The net cost of operations for each year is the sum of the interest and depreciation expenses. The resulting Statements of Financing for the three years are shown below.

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	Year 1	Year 2	Year 3
Obligations Incurred	$275	$ 15	$ 10
Resources That Do Not Fund Net Cost of Operations:			
Capitalized assets acquired	(250)	0	0
Costs That Do Not Require Resources:			
Depreciation expense	30	30	30
Net Cost of Operations	$ 55	$ 45	$ 40

137. Note that this presentation has the same reconciling items as would be the case for an asset acquired by direct purchase. This is because the resulting interest expense on the capital lease, which is the principal difference between an asset acquired by capital lease and an asset acquired by direct purchase, is recognized as an obligation by the budget and as an expense in the cost of operations.

138. **Prior Practice.** For capital leases entered into prior to the current guidance, the budget is obligated in the amount of the annual lease payments and the interest expense is not recognized as an obligation. This is the same as for operating leases in financial accounting. Under prior practice, the budget often did not distinguish between capital and operating leases, but rather treated them all like operating leases. Depreciation expense, not recognized in the budget under current guidance, was also not recognized on assets acquired through leases reported in the budget under prior practice. The financial accounting treatment for capital leases is the same whether they fall under current budgetary reporting guidance or prior practice. Thus, the items required to reconcile obligations incurred with net cost of operations are the annual lease payments, interest expense, and depreciation expense.

139. Assume, for example, that there are three

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$100 payments remaining on a capital lease entered into prior to FY 1991. Interest expense on the capital lease for financial accounting purposes is $25, $15, and $10 and depreciation expense is $30, $30, and $30, respectively, for the three years. (Again, note that depreciation is charged over the life of the asset, which may be different from the term of the lease.) The net cost of operations is the sum of the depreciation and interest expense. The Statement of Financing for those years would appear as shown below.

	Year 1	Year 2	Year 3
Obligations Incurred	$100	$100	$100
Resources That Do Not Fund Net Cost of Operations:			
Payments on capital leases	(100)	(100)	(100)
Costs That Do Not Require Resources:			
Depreciation expense	30	30	30
Interest expense	25	15	10
Net Cost of Operations	$ 55	$ 45	$ 40

TRANSFERS OF ASSETS IN AND OUT WITHOUT REIMBURSEMENT

140. Assets are sometimes transferred from one agency to another without reimbursement. In such cases, the donating agency reports the transaction as a transfer-out (a negative financing source) in its Statement of Changes in Net Position, which reduces its cumulative results of operations and total net position. The receiving agency reports the transaction as a transfer-in (a positive financing source that increases its cumulative results of operations and total net position) on its Statement of Changes in Net Position. Treatment on the Statement of Financing is described below:

(a) Obligations are not affected for either agency, but the donating

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agency reports a decrease in its nonbudgetary resources and a decrease in its costs capitalized on the Balance Sheet in the amount of the book value of the asset transferred on its Statement of Financing. The transaction has no effect on net cost of operations of the donating agency. The receiving agency reports an increase in its nonbudgetary resources in the amount of the book value of the asset, if known, or for the fair market value of the asset, if not. Whether adjustments to obligations, as adjusted, and nonbudgetary resources are required on the receiving agency's Statement of Financing depends on whether the receiving agency capitalizes the asset or expenses it on receipt.

(b) If the receiving agency capitalizes the asset on receipt, the amount capitalized is subtracted from obligations, as adjusted, and nonbudgetary resources under the caption "resources that do not fund net cost of operations." The transaction does not affect net cost of operations.

(c) If the asset is expensed on receipt, no adjustment to obligations, as adjusted, and nonbudgetary resources is required, since the amount of the expense would be part of net cost of operations. In this case, the net cost of operations would be financed by the transfer-in of the assets without reimbursement.

141. Assume, for example, that a donating agency gives an asset with a book value of $5,000 to a receiving agency, which knows the book value. The transaction would be reported on the Statements of Financing for the agencies as shown below under the following scenarios: (a) the receiving agency capitalizes the asset, and (b) the receiving agency expenses the asset. Note that the reporting is the same under both scenarios for the donating agency, but it differs for the receiving agency.

a. If the receiving agency capitalizes the asset on receipt, the Statements of Financing would be prepared in this manner:

	Receiving Agency	Donating Agency

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Obligations Incurred	$ 0	$ 0
Nonbudgetary Resources:		
Transfers of Assets from (to) Others without Reimbursement	5,000	(5,000)
Obligations, as adjusted, and Nonbudgetary Resources	5,000	(5,000)
Resources That Do Not Fund Net Cost of Operations		
Costs capitalized on the Balance Sheet	(5,000)	N/A
Capitalized costs removed from the Balance Sheet	N/A	5,000
Net Cost of Operations	$ 0	$ 0

b. If the receiving agency expenses the asset on receipt, the Statements of Financing would be prepared in this manner:

	Receiving Agency	Donating Agency
Obligations Incurred	$ 0	$ 0
Nonbudgetary Resources:		
Transfers of assets from (to) others without reimbursement	5,000	(5,000)
Obligations, as adjusted, and Nonbudgetary Resources	5,000	(5,000)
Resources That Do Not Fund Net Cost of Operations		
Costs capitalized on the Balance Sheet	0	N/A
Capitalized costs removed from the Balance Sheet	N/A	5,000
Net Cost of Operations	$5,000	$ 0

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SALE OF CAPITALIZED ASSETS

142. An agency may sell its capitalized assets at a gain, a loss, or for book value (which would result in no gain or loss). The budget would recognize the amounts collected from the sale, regardless of whether they resulted in gains and losses, and would subtract those amounts as adjustments to yield obligations, as adjusted. Thus, the reconciling factor for each instance would be the book value of the capitalized assets sold.

143. Assume, for example, three scenarios in which an agency has a piece of equipment with a book value of $25 and sells it for (a) $30, (b) $15, and (c) $25. Obligations would be -$30, -$15, and -$25, and net cost of operations would be -$5, +$10, and $0 for each of the scenarios, respectively. The Statements of Financing are illustrated as follows.

Scenarios:	(A)	(B)	(C)
Obligations Incurred	$ 0	$ 0	$ 0
Spending authority from offsetting collections	(30)	(15)	(25)
Obligations, as adjusted, and Nonbudgetary Resources	($30)	($15)	($25)
Resources That Do Not Fund Net Cost of Operations			
Capitalized costs removed from the Balance Sheet	25	25	25
Net Cost of Operations	($5)	$10	$ 0

144. Note in this example that the capitalized costs removed from the Balance Sheet were added to obligations. Costs capitalized on the Balance Sheet are subtracted from obligations, because those obligations do not fund costs (see the illustrations in chapter 4). When capitalized costs are removed, they must be treated in the opposite manner and added back in the reconciliation between obligations and net cost of

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operations.

145. The present illustration provides a line item for “capitalized costs removed from the Balance Sheet.” An alternative display might net those costs removed against the costs of assets acquired and capitalized on the Balance Sheet. If the costs removed are not material, it might present the net as a single line item entitled "net costs capitalized on the Balance Sheet."

EXCHANGE REVENUE FROM THE PUBLIC

146. OMB Circular A-34 provides that when an agency performs reimbursable services for others, receivables from work performed are normally considered budgetary resources if the work is performed for another Government agency. If the work is performed for the public, however, budgetary resources are recognized only to the extent receivables are collected. Financial accounting recognizes revenue accrued from both intragovernmental and public receivables. Thus, the change in accrued receivables relating to exchange revenue from the public is a reconciling item between obligations and net cost of operations.

147. Assume, for example, that at the beginning of Year 1, receivables were zero. During Year 1, $100 was collected from the public for services performed and $15 additional was billed but not yet collected at year-end. In Year 2, $125 was collected, including the $15 owed at the beginning of the year, and an additional $10 was accrued.

148. The collections of $100 and $125 are subtracted from obligations incurred on the Statement of Financing for Years 1 and 2, respectively. However, the amounts subtracted from expenses on the Statement of Net Cost are $115 for Year 1 and $120 for Year 2. This is because financial accounting, on which the Statement of Net Cost is based, essentially recognizes revenue when it is earned by providing goods or services regardless of when collections are made.

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149. The $15 of receivables from the public at the end of Year 1 is part of the revenue recognized for financial accounting purposes. Thus, the Year 1 revenue reported on the Statement of Net Cost is the sum of the collections, $100, and the $15 receivable from the public at year-end: $115. In Year 2, only $110 of the $125 in collections is recognized as revenue for financial accounting purposes, because the $15 collected for receivables from the public as of the end of Year 1 was already counted as revenue in Year 1. The $10 of receivables from the public accrued at the end of Year 2 is also recognized as revenue for financial accounting purposes. The $110 and $10 together equal $120: the Year 2 revenue reported on the Statement of Net Cost.

150. The Statements of Financing reconciling the differences between obligations and net cost of operations are illustrated and explained below:

	Year 1	Year 2
Obligations Incurred	$ 0	$ 0
Spending Authority from Offsetting Collections	(100)	(125)
(Increase) Decrease in Exchange Revenue Receivable From the Public	(15)	5
Obligations, as adjusted, and Nonbudgetary Resources	($115)	($120)
Net Cost of Operations	($115)	$(120)

151. Note that in Year 1, collections were $100, which was recognized as spending authority from offsetting collections in the budget. This is subtracted from obligations incurred. However, the net cost of operations is -$115 (indicating an excess of exchange revenue over expenses). The $15 difference is explained by the $15 increase in accounts receivable from the public. This is not considered to be spending authority for budgetary purposes, but is recognized and accrued as revenue on the Statement of Net Cost. It was not included in spending authority from offsetting collections, but it was subtracted from expenses to yield net cost of operations. Hence, to reconcile

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obligations incurred with net cost of operations, it must be subtracted in the reconciliation on the line for exchange revenue accrued from the public.

152. In Year 2, collections were $125 and were recognized as spending authority from offsetting collections in the budget. However, the net cost of operations is -$120, indicating an excess of revenue over expenses. In this case the difference is explained by two factors. First, for the same reasons as explained for Year 1, the ending $10 in accounts receivable from the public must be subtracted in the reconciliation. Second, the collections would have included the $15 of receivables accrued at the end of Year 1. This is considered spending authority from offsetting collections, but it is not recognized as revenue on the Statement of Net Cost in Year 2 because it was already recognized there in Year 1. Because it was subtracted in the line for spending authority from offsetting collections but was not subtracted from expenses to yield net cost, it must be added back in the reconciliation. The difference between the $10 subtraction and $15 addition is reflected in the $5 addition on the line for exchange revenue accrued from the public.

SPECIAL TOPICS RELATED TO DISCRETIONARY DIRECT LOAN AND LOAN GUARANTEE PROGRAMS

Introduction

153. Reporting loans made subsequent to the Credit Reform Act of 1990 on the Statement of Financing is illustrated in chapter 4. The following paragraphs set forth some important observations about the illustrations and information regarding these and additional transactions related to credit reform and pre-credit reform loans. The transactions are applicable to direct loans and loan guarantees in programs operated under both credit reform and pre-credit reform authority unless otherwise specified. They include:

- making direct loans;
- collecting loan principal for direct loans and for defaulted guaranteed loans assumed by the Government for direct collection;

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- making upward and downward subsidy re-estimates for direct loan and loan guarantee programs (credit reform only)
- writing off defaulted loans; and
- accruing bad debts expense (pre-credit reform only).

154. The transactions discussed in the following sections are only for normal situations applicable to the program, financing, and liquidating funds of discretionary credit programs under the Credit Reform Act, which constitute most credit programs. Mandatory credit programs have different accounting requirements for some transactions, which would be reported differently on the Statement of Financing. In addition, some credit programs may operate in part under separate legislation which also has different accounting and reporting requirements. Authoritative information on credit program terminology and related accounting and reporting is found in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, in Section 12 of OMB Circular A-34, Instructions on Budget Execution (December 1995), in Section 33 of OMB Circular A-11, Preparation and Submission of Budget Estimates, and in OMB Bulletin 94-01, Form and Content of Agency Financial Statements (or its successor).

Reconciliations and the chapter 4 case

155. The results of budgetary and proprietary accounting for direct loans require several factors on the Statement of Financing to reconcile between obligations and net cost of operations. Three reconciling factors are (1) loans made, (2) subsidy expense other than for reestimates, and (3) collections of loan principal. The reason for these reconciling factors is that, for budgetary purposes, loans made are obligations, and collections of loan principal are offsetting collections which are subtracted from obligations to obtain obligations, as adjusted. On the other hand, for financial (proprietary) accounting purposes, loans made are considered increases in assets (specifically, loans receivable),

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collections of loan principal are considered decreases in assets, and a subsidy expense is recognized for the amount of the loans financed by the subsidy (not including reestimates, which are discussed later).

156. Thus, the reconciliation requires that the loans made, less the subsidy expense (other than for reestimates), be subtracted from obligations, since this is the amount of loans made that has not been recognized as an expense and, therefore, does not affect net cost of operations. The reconciliation also requires that collections of loan principal must be added back in reconciling net cost of operations to obligations. This is because these collections are subtracted from obligations in calculating "obligations, as adjusted," as explained above, but do not enter into the computation of the net cost of operations for financial accounting purposes (although they reduce the asset "loans receivable"). The same reconciliation is also needed for collections of the loan principal of guaranteed loans assumed for direct collection by the Government when the lender declares them in default. These three reconciling factors are types of "resources that do not fund net cost of operations" in the Statement of Financing. They explain the crosswalk regarding loans provided in figure 11 of the chapter 4 case illustration: "4800 Obligations for Loans Made (D) minus 4262 Collections of Loan Principal minus 6100 Subsidy Expense other than for reestimates (D)."

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157. The fourth reconciling factor between obligations incurred and net cost of operations for direct loans is interest income from amortization of the allowance for subsidy. The reconciliation is required because the interest is recognized as an exchange revenue for financial accounting purposes and reduces net cost of operations, but it is not included in obligations for purposes of the budget. The interest is reported on the Statement of Financing as a subtraction under "exchange revenue not in the budget" in the section on obligations and nonbudgetary resources. The reporting is illustrated in figure 11 of chapter 4 (the $5 of "Interest Income--Subsidy Amortization"). The same reconciliation is needed for the amortization of subsidy related to loans under loan guarantee programs assumed for direct collection by the Government when the lender declares them in default.

158. The chapter 4 case also illustrated proprietary accounting for an upward reestimate of the subsidy as of the end of the year and an accompanying accrual of interest expense and interest income on the reestimate amount. The budget did not recognize these transactions in the year of accrual, and other reconciling factors between obligations and net cost of operations arose as a result. Of course, downward reestimates can also occur, with similar need for reconciliation. Reporting upward and downward subsidy reestimates and related interest on the Statement of Financing for the year of accrual and the succeeding year is discussed in the next sub-section, which deals with subsidy reestimates (see page 99).

159. The chapter 4 case covered loans made under the Credit Reform Act. However, agencies still operate liquidating funds for programs authorized under legislation prior to that Act. Because the proprietary rules for recognizing expenses are different for loans made under pre-credit reform authority, the reconciliation between obligations incurred and net cost of operations is different. This is discussed in more detail in the subsection on pre-credit reform loans (see page 104).

160. The chapter 4 case did not illustrate writeoffs of defaulted loan principal. Such

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writeoffs--under both the Credit Reform Act and authority prior to the Act--do not enter into the reconciliation between obligations incurred and net cost of operations. This is because they do not affect obligations, nor are they recognized in the Statement of Net Cost. For financial accounting purposes, they reduce both loans receivable and (for Credit Reform Act loans) the related allowance for subsidy account, which are offset in the assets section of the Balance Sheet, as shown in figure 9 of chapter 4. For loans made prior to the Credit Reform Act, the related allowance account is termed "allowance for uncollectible accounts" (or an equivalent title) rather than "allowance for subsidy." Although an allowance for uncollectible accounts is computed differently than an allowance for subsidy, the nature of the reporting display is the same--it is offset against loans receivable. The same reconciliation is needed for the writeoff of guaranteed loans assumed for direct collection by the Government when the lender declares them in default.

Subsidy reestimates

161. When an upward subsidy reestimate for credit reform loans is made as of the end of the year, it is accrued in the program fund as additional subsidy expense payable to the financing fund, along with interest expense on the subsidy, which is also payable to the financing fund. The financing fund accrues a related receivable for the total of the reestimate and interest, recognizes an increase in the allowance for subsidy in the amount of the re-estimate, and recognizes an exchange revenue for the interest on the subsidy. The payable in the program fund is eliminated against the receivable in the financing fund before proprietary financial statements are prepared. Although monies will come from a permanent indefinite appropriation in the following year, the amount is not apportioned in the year of accrual, and, accordingly, no receivable from the appropriation may be accrued. For budgetary purposes, the obligation for the subsidy reestimate and interest is recognized in the succeeding year. The table below summarizes this information:

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	Current Year	Succeeding Year
Budgetary Accounting		
Recognition of obligations	No	Yes
Proprietary Accounting		
Recognition of expenses	Yes	No
Recognition of exchange revenue	Yes	No

162. Because of this difference in timing, the reconciliation between obligations incurred and net cost of operations for an upward revision of subsidy is different both for the year of accrual, in which the subsidy and interest expense and related interest revenue are recognized for financial accounting purposes, and for the subsequent year, in which the related obligations are recognized for budgetary purposes. Using the information in chapter 4, assume, for example, that in Year 1, an upward subsidy reestimate of $8, with interest of $1, is recorded as of the end of the year. Because the budget does not recognize this until the following year, obligations are zero in Year 1 and $9 in Year 2. Net Cost of Operations will be $8 in Year 1 ($9 in expenses less $1 of interest income) and zero in Year 2. The Statement of Financing reconciliation for this is shown below. Note that the additional interest income to offset interest expense on the subsidy reestimate is recognized in the financing fund, which is nonbudgetary. Accordingly, it is shown under the caption "exchange revenue not in the budget."

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	Year 1	Year 2
Obligations and Nonbudgetary Resources		
Obligations Incurred	$ 0	$ 9
Less Exchange Revenue Not in the Budget: Interest Income on Subsidy Reestimate	(1)	N/A
Obligations, as adjusted, and Nonbudgetary Resources	(1)	9
Resources That Do Not Fund Net Cost of Operations		
Financing Sources That Fund Costs of Prior Periods	N/A	(9)
Financing Sources Yet to Be Provided	9	N/A
Net Cost of Operations	$ 8	$ 0

163. When a recomputation of the subsidy as of the end of the year results in a smaller amount than previously recognized, the reestimate is downward. For proprietary accounting purposes, three adjustments are required for this. They are recognized in the year for which the reestimate is made. First, the excess subsidy and interest on that excess must be paid to a special receipt account of the Treasury. Second, more allowance for subsidy must be amortized to interest income. Amortization is based on the amount of interest expense from all sources less interest expense other than the reestimate. Had the subsidy initially been calculated correctly, it would have been less, and correspondingly more would have been borrowed from Treasury. This would have caused interest expense on the borrowing to be greater, and more would have been amortized from the subsidy as a result. However, because the subsidy was greater than it should have been, less was borrowed from Treasury, and less was amortized from the allowance for subsidy account. Hence, the allowance for subsidy is overstated and must be further amortized to interest income in the amount of interest expense from the reestimate--just as it would have been had more been borrowed from Treasury in the first place and more interest expense had been incurred. Third, both subsidy

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expense and the related financing source "appropriations used" must be reduced by the amount of the excess subsidy received.

164. The result of the adjustments discussed above which affect the Statement of Financing is that net cost of operations is reduced by the amount of the excess subsidy. This is because of the following effects of the adjustments. First, interest expense is recognized in the amount of the actual interest incurred on the borrowing from Treasury plus the amount of the interest on the reestimate. This provides for the same amount of interest expense as would be the case if the subsidy had initially been estimated correctly, the borrowing from Treasury greater, and the interest on that borrowing greater. The interest is divided into two parts--interest expense on the borrowing from Treasury and interest expense on the downward reestimate. Second, the adjustments provide for the same amount of interest income that would have been amortized from the allowance for subsidy if the interest expense had been based on a greater borrowing from Treasury. That interest income is also divided into two parts--interest income from the basic amortization and interest income from the reestimate. The total interest expense and total interest income (which would also include interest income from borrowers), both of which appear on the Statement of Net Cost, will be the same. Hence, the net cost of operations is unaffected by interest.

165. Third, the allowance for subsidy is reduced by the amount to be paid to the special receipt account, and that amount is shown as a liability. Neither the allowance for subsidy nor the liability to Treasury appears on the Statement of Net Cost, and, again, the net cost of operations is unaffected. Finally, both subsidy expense and appropriations used are reduced in the amount of the excess subsidy. The reduction in subsidy expense appears on the Statement of Net Cost. However, the reduction in appropriations used, which is not an expense or an exchange revenue, does not. Thus, the net cost of operations is reduced by the amount of the excess subsidy received. (Net results of operations, which includes appropriations used and additional financing sources other than exchange revenue, is unchanged by the transactions, as is net position. This is appropriate, because the adverse effects

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on cash flows from returning the excess subsidy and interest should be offset by increased cash inflows from other sources over the life of the loans. These sources might include a lower default rate on loans than originally estimated or other items which were factors in reestimating the subsidy.)

166. Under budgetary accounting rules, an obligation for the excess subsidy and interest would be recorded in the year following the reestimate rather than in the year the reestimate was made. In the year following the reestimate, the amount of the obligation, which is paid to a special receipt account of the Treasury, is also reported in the budget as an offsetting receipt (which does not adjust obligations) rather than as an offsetting collection credited to an expenditure account (which does). Hence, the factors necessary to reconcile obligations with net cost of operations involve (1) the timing of the recognition of obligations for budgetary purposes and of expenses and revenues for proprietary purposes, (2) the additional interest income to offset interest expense on the reestimate, and (3) the decrease in subsidy expense from the reestimate. Assuming the same facts as in paragraph 0, except that the reestimate is downward rather than upward, net cost of operations would be -$8 in Year 1 (the $1 of interest expense less the $8 reduction in subsidy expense and less the $1 of interest income) and zero in Year 2. Obligations would be zero in Year 1 and $9 Year 2. The credit agency's Statement of Financing for the two years would be as shown below. Note that the interest income appears under the caption "exchange revenue not in the budget."[27]

[27]For purposes of the Statement of Financing, exchange revenues categorized in the budget as offsetting receipts, which do not provide spending authority from offsetting collections credited to an expenditure account, are treated as nonbudgetary exchange revenues.

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	Year 1	Year 2
Obligations and Nonbudgetary Resources		
Obligations Incurred	$ 0	$ 9
Less Exchange Revenue Not in the Budget: Interest Income on Subsidy Reestimate	(1)	N/A
Other Nonbudgetary Resources: Reduction in Subsidy Expense from Downward Reestimate	(8)	N/A
Obligations, as adjusted, and Nonbudgetary Resources	(9)	9
Resources That Do Not Fund Net Cost of Operations		
Obligations for payment of excess subsidy and interest	N/A	(9)
Costs That Do Not Require Resources		
Interest Expense-Downward Reestimate	1	N/A
Net Cost of Operations	$ (8)	$ 0

167. The observations and illustrations in paragraphs 0-0 would also be applicable to subsidy reestimates for loan guarantee programs, except that the loan guarantee liability rather than the allowance for subsidy would be involved in the journal entries and computations, and direct loans would not be made. If the Government assumes defaulted guaranteed loans for direct collection, both the loan guarantee liability and the allowance for subsidy would be involved.

Pre-credit reform loans

168. There are many similarities in accounting for loans under credit reform and pre-credit reform rules. For budgetary accounting purposes, the making of pre-credit reform loans also results in an obligation, albeit the obligation is against different budget authority. Collection of loan principal is also recorded as an offsetting collection. There is no subsidy appropriation connected with pre-credit reform loans, however, and no obligation is recognized for defaults when they occur. For

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financial accounting purposes, loans issued under pre-credit reform authority are accounted for as assets, and collections of loan principal are recorded as decreases in those assets. However, instead of a subsidy expense, a bad debts expense for defaults is recognized.

169. Accordingly, for pre-credit reform loans, the reconciliation between obligations and net cost of operations requires that bad debts expense be added to obligations, as adjusted. Assume, for example, that during a year $500 of pre-credit reform loans are made; $30 of principal is collected; and $100 of bad debts expense is recognized. In this case, obligations, as adjusted, are $470 ($500 in loans made less $30 in principal collections), and the net cost of operations is $100 (the amount of the bad debts expense). The resulting reconciliation on the Statement of Financing is shown in the pre-credit reform column below. Loans made, less collections of principal, are subtracted from obligations, as adjusted, under the caption "resources that do not fund net cost of operations"--the same reconciliation adjustment as for credit reform loans; and bad debt expenses are added under "costs that do not require resources." The next column contrasts that with the reconciliation for credit reform loans (assuming for sake of illustration a subsidy expense of $100 rather than a bad debts expense of $100).

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	Pre-Credit Reform	Credit Reform
Obligations Incurred	$500	$500
Spending Authority from Offsetting Collections	(30)	(30)
Obligations, as adjusted, and Nonbudgetary Resources	$470	$470
Resources That Do Not Fund Net Cost of Operations		
Loans Made	(500)	(500)
Less: Subsidy Expense	N/A	100
Collections of Loan Principal	30	30
Costs That Do Not Require Resources		
Bad Debts Expense	100	N/A
Net Cost of Operations	$100	$100

170. The lines for spending authority from offsetting collections and for collections of loan principal in the illustration above would also be applicable to both credit reform and pre-credit reform guaranteed loans assumed for direct collection by the Government when the lender declares them in default. Note that the negative $30 and the positive $30 for those two lines would cancel and result in zero net cost of operations under both credit reform and pre-credit reform programs. Net cost of operations from this transaction is zero because, as explained above, the collection of loans does not affect net cost of operations.

171. The line for bad debts expense would also apply to the recognition of the expense related to pre-credit reform defaulted guaranteed loans that have been assumed. Considering only the bad debts expense in the illustration above, net cost of operations would be $100, but, because the budget does not recognize bad debts expense as an obligation, obligations would be zero. The reconciling factor would be the $100 of bad debts expense, as shown in the pre-credit reform column of the illustration.

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172. Bad debts expense is not applicable to programs operating under authority of the Credit Reform Act.

Subsidy expense for defaulted guaranteed loans: credit reform

173. Subsidy expense related to defaulted guaranteed loans assumed for direct collection by the Government would not be a reconciling item between obligations and net cost of operations, as it is for loans made in a direct loan program under the Act. This is because the only accounting requirement for subsidy relating to the assumed loans in the guarantee program is that a portion of the loan guarantee liability be reclassified as "allowance for subsidy," which is subtracted from the asset "loans receivable" on the Balance Sheet. Such a reclassification does not involve expenses or exchange revenue and, accordingly, would not affect net cost of operations. The reclassification is also not recognized as an obligation under budgetary accounting rules. Since neither net cost of operations nor obligations is affected, no reconciliation is required.

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FASAB TASKFORCE ON REVENUE AND OTHER FINANCING SOURCES

Donald H. Chapin, Taskforce Chair--FASAB Member/GAO*
Peter BenEzra--Agriculture
Christine Bonham--GAO
Debra Carey--Interior
Christine Chang--Treasury
Robert Dacey--GAO*
Lowell Dworin--Treasury
Robert Hamilton--Customs Service
Gregory Holloway--GAO
Linda Hoogeveen--OMB
Martin Ives--FASAB Member/New York University
Robert Kilpatrick--OMB*
Allan Lund--Treasury
Thomas Luter--Treasury*
JoEllen McCormack--GAO*
Dennis Mitchell--Treasury
Richard Nieman--Energy Department
Marvin Phaup--CBO
Joel Platt--Treasury
Darlene Schongalla--Interior
Charles Sims--Interior
Deborah Taylor--GAO
Dana Thiebeau--Treasury
William Truitt--Justice
Ellen Waterhouse--IRS

*working group member

Individual members of the task force do not necessarily agree with all aspects of the Board's recommendations.

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The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board") in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The Board's sponsors, i.e., the officials who established the Board, then decide whether to adopt the recommendations. If they do, the standard is published by OMB and the GAO and then becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board
Ronald S. Young, Executive Director
750 First Street, NE, Room 1001
Washington, DC 20002
Telephone (202) 512-7350
Fax (202) 512-7366

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FASAB

ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES

AND

CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING

Statement of Recommended Accounting Standards Number 7

April 1996

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APPLICABILITY, MATERIALITY, AND TERMINOLOGY

These standards apply to general purpose financial reports of U.S. Government reporting entities. These standards need not be applied to immaterial items unless otherwise noted. Statement of Federal Financial Accounting Concepts No. 2 (SFFAC No. 2), Entity and Display, lists criteria for defining Government reporting entities. Paragraph 78 of Entity and Display notes that some of a reporting entity's components may be required by law or policy to issue financial statements in accordance with accounting standards other than those recommended by the FASAB and issued by the OMB and the GAO, e.g., accounting standards issued by the Financial Accounting Standards Board or by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part, however, need to be sensitive to differences that may arise because of different accounting standards. If these differences are material, the standards recommended by the FASAB and issued by the OMB and the GAO should be applied. The components would need to provide any additional disclosures or different recognition and measurement required by the accounting standards issued by the OMB and the GAO that are not required by other standards.

"Disclosure" in this document indicates providing information in notes or narrative regarded as an integral part of the basic financial statements. "Supplementary" indicates providing information that is regarded as "required supplementary information" as that term is used in accounting and auditing standards. The limited auditing procedures for this information are defined in auditing standards. "Other accompanying information" refers to unaudited information that accompanies the audited financial statements. It is not regarded as essential for "fair presentation." Another kind of supplementary information is "Required Supplementary Stewardship Information." This is a proposed category unique to Federal Government accounting and auditing standards. It refers to certain information for which FASAB expects OMB and GAO in collaboration to agree upon appropriate auditing procedures. It will be regarded as essential for "fair presentation."

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STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NUMBER 7

PREFACE i

EXECUTIVE SUMMARY 1

ACCOUNTING STANDARDS FOR REVENUE AND OTHER FINANCING SOURCES .. 1
SCOPE 1
CLASSIFICATION, RECOGNITION, AND MEASUREMENT 1
DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER INFORMATION 4

CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING ... 4

PART I: ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES

INTRODUCTION 6

BACKGROUND 6

MATERIALITY 10

EFFECTIVE DATE 10

ACCOUNTING STANDARDS 11

SCOPE 11

EXCHANGE REVENUE 11
RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE 12
DISCLOSURES AND OTHER ACCOMPANYING INFORMATION 16

NONEXCHANGE REVENUE 17
RECOGNITION AND MEASUREMENT OF NONEXCHANGE REVENUE 17
The General Standard 17
Taxes and Duties 17
Fines and Penalties 23
Donations 24
Other Nonexchange Revenue 24
DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER ACCOMPANYING INFORMATION 24
Disclosures 24

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

Supplementary Information 26
Other Accompanying Information 27

OTHER FINANCING SOURCES 28
RECOGNITION AND MEASUREMENT OF OTHER FINANCING SOURCES ... 29
Appropriations 29
Financing Imputed for Cost Subsidies 29
Transfers of Assets 30

PRIOR PERIOD ADJUSTMENTS 30

BUDGETARY INFORMATION 31

ACCOUNTABILITY FOR DEDICATED COLLECTIONS 33

PART II: CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING 36

INTRODUCTION 36

AMENDMENTS TO SFFAC No. 2, ENTITY AND DISPLAY 36
RECONCILIATION STATEMENT--BUDGETARY AND FINANCIAL ACCOUNTING 37
STATEMENT OF FINANCING 37
Entity and Display, Appendix 1-G 39

APPENDICES 40

APPENDIX A: BASIS FOR CONCLUSIONS 40

EXCHANGE REVENUE 42
Special Nature of Government Exchange Transactions .. 42
Recognition: General Considerations 43
Recognition: Special Cases 49
Measurement 58
NONEXCHANGE REVENUE 61
Inherent Limitations 61
Practical Limitations 62
Modified Cash Basis for Taxes and Duties 63
Cash Basis Information Needed 63
Potential Changes 63
Entities Responsible for Measuring and Recognizing Revenue 64
Possible Over- and Under-funding of Trust Funds 64
Conceptual Criteria for Accrual and Limitations on Their Application 65
Limitations on the Scope of Accounting 67
Some Benefits of this Standard 67
Some Things this Standard Does Not Accomplish 68
Accounting Systems Changes 69
Disclosures, Supplementary Information, and Other

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

Accompanying Information 70
Tax Gap 73
Tax Expenditures 75
Directed Flows of Resources 76

OTHER FINANCING SOURCES AND BUDGETARY RESOURCES 78
General Principles 78
Reducing Differences 79
The Budgetary Process and Its Linkage to Accounting 80
Implications of the term "Net Results of Operations" 85

DEDICATED COLLECTIONS 86

APPENDIX B: GUIDANCE FOR THE CLASSIFICATION OF TRANSACTIONS ... 90
INTRODUCTION 90
TABLE OF TRANSACTIONS. 93
TRANSACTIONS WITH THE PUBLIC 97
Nonexchange Transactions With The Public 97
Exchange Transactions With The Public: Revenue 107
Exchange Transactions With The Public: Gains And Losses 115
Other Financing Sources From The Public 118
INTRAGOVERNMENTAL TRANSACTIONS 119
Nonexchange Transactions--Intragovernmental: Revenue 119
Nonexchange Transactions--Intragovernmental: Gains And Losses 121
Exchange Transactions--Intragovernmental: Revenue ... 122
Exchange Transactions--Intragovernmental: Gains And Losses 127
Other Financing Sources--Intragovernmental 128
REVALUATIONS 133
TRANSACTIONS NOT RECOGNIZED AS REVENUES, GAINS, OR OTHER FINANCING SOURCES 134

APPENDIX C: GLOSSARY 141

INDEX OF TRANSACTIONS 149

LIST OF ABBREVIATIONS 151

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PREFACE

This document contains two separate parts. The first, on revenue and other financing sources, is composed of the introduction, accounting standards, and appendices. After the standards recommended by FASAB are approved by the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General and are published, the standards provide authoritative guidance to those who prepare and audit general purpose financial reports of U.S. Government entities.

The second part of this document amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a new concept to satisfy users' needs for information that reconciles budgetary and financial accounting. This concept is presented in the section of this document that begins on page **Error! Bookmark not defined.**. Statements of Federal Financial Accounting Concepts articulate the framework within which the Board considers and recommends accounting standards. Statements of concepts do not provide authoritative guidance to preparers and auditors.

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EXECUTIVE SUMMARY

ACCOUNTING STANDARDS FOR REVENUE AND OTHER FINANCING SOURCES

SCOPE

1. This Statement presents standards to account for inflows of resources from revenue and other financing sources. It provides standards for classifying, recognizing, and measuring resource inflows. These financial (proprietary) accounting standards differ from those used for budgetary accounting only to the extent essential to meet the Objectives of Federal Financial Reporting.

CLASSIFICATION, RECOGNITION, AND MEASUREMENT

2. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. The term "revenue" does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, so this Statement includes accounting standards for them.

3. These accounting standards recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price

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likely to be received. Thus, with some differences that are explained in the standard, the accounting for earned revenue is comparable to the private sector's accrual accounting for earned revenue. Exchange revenue includes most user charges other than taxes. Such user charges include regulatory user charges, in which the exchange is not wholly voluntary but the revenue is generally, but not always, related to the cost of providing service to identifiable groups. One example is the revenue derived from the Securities and Exchange Commission's registration fees. Exchange transactions also include those intragovernmental transactions where the price serves as a full or partial reimbursement for the costs incurred.

4. Distinguishing exchange revenue from non-exchange revenue and other financing sources enables the entity to report the net cost of operations of its programs (and the cost of the entity to the taxpayer) and provides the accounting foundation to report unit cost of output measures for performance evaluations. Requiring that exchange revenue be matched with the cost of outputs of goods and services sold to the public enables the entity to report the cost to the taxpayer of not charging the full cost of those goods and services.

5. Nonexchange revenues include income taxes, excise taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., reasonably estimable).[1]

6. In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power

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to demand payment becomes a legally enforceable claim to cash or other assets. For this reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. This basis of accounting amends the standard for the recognition of accounts receivable for taxes and duties. Cash basis tax revenue will continue to be accounted for as well, because of the fiscal importance of the information. The accrual accounting required will provide more accurate and complete information about receivables and refunds legally receivable and payable and about the components of the Government's revenue stream. The Board may review the standard for accrual of taxes and duties after several years. The Board has provided that in the interim the IRS and Customs may on their own initiative modify this standard so that it reflects a fuller application of the accrual concept.

7. Budgetary resources are recognized from two perspectives: the proprietary accounting perspective and the budgetary perspective. From the proprietary perspective, appropriations are accounted for as a financing source when used. Appropriations are used when an entity has acquired goods and services or has provided benefits and grants that are authorized to be paid by an appropriation. The remaining amount of appropriations enacted into law, but not yet recognized as "appropriations used," is treated as capital, i.e., "unexpended appropriations." This treatment parallels the recognition of expended appropriations during budgetary execution.

8. To the extent that other standards require that costs not on the entity's books be imputed to the entity, the standards for other financing sources require recognition of the corresponding imputed financing.

9. Financial statements have not previously presented budget execution information needed by users of those reports. Furthermore, concerns have been expressed about whether the budget is being properly executed in all cases. The standards presented in this document require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. The standards also require a reconciliation of proprietary and budgetary information in

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a way that helps users relate the two.

DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER INFORMATION

10. The different types of revenue, and the complexity of accounting for revenue and other financing sources, increase the importance of certain disclosures and other information.

11. Extensive disclosures and other information about taxes and duties compensate to some extent for the limited accruals under the modified cash basis of accounting. Such disclosures and other information also provide a better basis for estimating future cash flows, overseeing the custodial responsibilities given to the tax collecting entities, and understanding how the tax burden is shared.

12. Certain disclosures are required about exchange transactions where the full cost of goods and services sold is not recovered.

13. Limited disclosure concerning accountability for dedicated collections is required for reporting entities responsible for administering such funds. Supplementary information is required from those entities and the entities that make the collections in cases where trust funds may be over- or under-funded in terms of applicable law.

14. Disclosures are required about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING

15. This statement amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a category of financial information to further satisfy users' needs and the objectives of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how

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information on the use of budgetary resources relates to information on the cost of program operations . . ." (sub-objective 1C). The objective of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

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6 PART I: ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES

INTRODUCTION

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BACKGROUND

16. The essential differences among exchange revenues, nonexchange revenues, and other financing sources affect the way they are recognized and measured under the accrual method of accounting. Properly classifying these inflows according to their nature, therefore, provides the basis for applying different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting objectives,[2] as they have been described in Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

17. To help meet those objectives, classifications were developed to determine what specific kinds of revenue should be deducted from the cost of providing goods and services by the reporting entities. Only revenue classified as exchange revenue should be matched with costs. Nonexchange revenue and other financing sources are not matched with costs because they are not earned in the operations process. Because they are inflows that finance operations, nonexchange revenues and other financing sources should be classified in accordance with other rules and should be recognized only in determining the overall financial results of operations for the period. This differs from the focus used in the private sector, where the focus is on net income for business organizations, and on changes in net assets for not-for-profit organizations. It is also a different focus from that used previously in reporting on U.S. Government operations. Under the old federal accounting standards, the focus was on matching all of an entity's financing with incurred expenses to report "net results of operations" which generally was not useful in evaluating performance. The new focus is on costs --both gross and net--which are useful in evaluating performance on many levels.

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18. The concept of matching costs and revenue has little relevance in government except where there is an exchange transaction. An exchange transaction occurs when one party sacrifices value and receives a valuable good or service in return. The operations of an entity engaged in exchange transactions produce the revenue earned as well as the associated cost incurred. Therefore, financial accounting should relate the revenue to the cost for these transactions. The net effect--the gross cost minus the revenue, or the net cost--generally determines the extent to which taxpayers bear the cost of the operations.[33]

19. Information about the net cost of exchange transactions serves other purposes as well. Net cost gives one indication of the extent to which people are willing to make voluntary payments to acquire goods or services of the kinds that are sold. It thus can give an indication of the extent to which people judge the products to have value. Net cost also can be used in evaluating an entity's pricing policy.

20. Most importantly of all, both net cost and gross cost can be compared with outputs and outcomes in assessing the effectiveness and efficiency with which resources are used to achieve results. Such comparisons can be used by agency management, the President, and the Congress in making decisions about allocating resources. These standards, together with those in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards, provide information essential to effective implementation of the Government Management Reform Act, which requires agencies to report performance measures such as unit cost. These standards, when applied in the context of applicable entity and display concepts, will make federal financial reporting more meaningful to those concerned with performance measurement.

[33] The only major exception is for intragovernmental sales of goods and services. The extent to which taxpayers bear the costs of these goods and services depends on whether the goods and services are sold to entities that in turn sell goods and services to the public, or to entities that are financed by taxes. The net cost of operations may also be financed by other nonexchange revenue such as fines, forfeitures, and donations.

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21. Nonexchange revenue transactions do not require a Government entity to give value directly in exchange for the inflow of resources. The Government does not "earn" the nonexchange revenue. The cost that nonexchange revenue finances falls on those who pay the taxes and make the other nonexchange payments to the Government. The different character of nonexchange revenues requires that they be distinguished from exchange revenues. They should, therefore, be shown in a way that does not obscure the entity's net cost of operations.

22. Although Board Members have differing views on whether social insurance programs result in exchange or nonexchange transactions, they agree that social insurance tax revenues should be shown in the same way as other tax revenues for the purposes of financial reporting.[34] Social insurance taxes, like other taxes, are determined by the Government's power to compel payment. Individuals and businesses that pay social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business. Especially for the major, broad-based social insurance programs-- Social Security, Medicare (hospital insurance), and unemployment compensation--the individuals and businesses have virtually no option except to pay.

23. The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.

[34] See discussion of social insurance programs in FASAB's Exposure Draft, Supplementary Stewardship Reporting.

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24. Budgetary resources have a different character than both exchange revenue and nonexchange revenue. Budgetary inflows should be shown in a way that reflects two different perspectives: the proprietary effect and the budgetary effect. Proprietary accounting treats these resources much as capital and lines of credit are treated in private sector accounting, and provides information about their availability in the Balance Sheet or in notes. Appropriations are recognized as capital when enacted into law, while borrowing authority is disclosed in notes. Because Government entities are expected to expend capital from appropriations rather than maintain it, the accounting for the use of appropriations differs in this respect from the private sector's accounting for capital. The accounting for "appropriations used" has been simplified and parallels their budgetary effect.

25. The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.

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26. Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations. U.S. Government financial statements have not been used for planning and control as well as they might have been. In part, this is because accounting standards have not been fully attuned to the Government's needs and circumstances. Another important reason is the continuing primacy of the budget as a financial planning and control tool. General purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

MATERIALITY

27. Except as otherwise noted, the provisions of the accounting standards in this statement need not be applied to items that are qualitatively and quantitatively immaterial.

28. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

EFFECTIVE DATE

29. The provisions of this statement are effective for reporting periods that begin after September 30, 1997. Earlier application is encouraged.

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ACCOUNTING STANDARDS

SCOPE

30. These standards determine how a Government reporting entity should account for inflows of resources from revenue and other financing sources in its general purpose financial reports. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public, such as taxes, duties, fines, and penalties. Nonexchange revenue also includes donations.

31. The term "revenue" does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, although not to the Government as a whole. Accordingly, standards for accounting for these inflows are also provided.

32. Appendix B, "Guidance for the Classification of Transactions," provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or other financing sources.

EXCHANGE REVENUE

33. Exchange revenue and gains are inflows of resources to a Government entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return. That is, exchange revenue arises when a Government entity provides something of value to the public or another Government entity at a price.

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RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE

34. Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price.

35. When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.

36. Revenue from specific types of exchange transactions should be recognized as follows:

(a) When services are provided to the public or another Government entity (except for specific services produced to order under a contract), revenue should be recognized when the services are performed.

(b) When specific goods are made to order under a contract (either short- or long-term), or specific services are produced to order under a contract (either short- or long-term), revenue should be recognized in proportion to estimated total cost when goods and services are acquired to fulfill the contract. If a loss is probable (more likely than not), revenue should continue to be recognized in proportion to the estimated total cost and costs should continue to be recognized when goods and services are acquired to fulfill the contract. Thus, the loss should be recognized in proportion to total cost over the life of the contract.[3]

(c) When goods are kept in inventory so that they are available to customers when ordered, revenue should be recognized when the goods are delivered to the customer.

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(d) When services are rendered continuously over time or the right to use an asset extends continuously over time, such as the use of borrowed money or the rental of space in a building, the revenue should be recognized in proportion to the passage of time or the use of the asset. The interest received on money borrowed in an intragovernmental transaction is an exchange revenue when the source of the borrowed funds is predominantly exchange revenue and is a nonexchange revenue when the source of the borrowed funds is predominantly nonexchange revenue or other financing sources.

(e) When an asset other than inventory is sold, any gain (or loss) should be recognized when the asset is delivered to the purchaser.

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37. When advance fees or payments are received, such as for large-scale, long-term projects, revenue should not be recognized until costs are incurred from providing the goods and services (regardless of whether the fee or payment is refundable). An increase in cash and an increase in liabilities, such as "unearned revenue," should be recorded when the cash is received. "Unearned revenue" should also be recorded if an agency requests advances or progress payments prior to the receipt of cash and records the amount.[35]

38. The measurement basis for revenue from exchange transactions should be the actual price that is received or receivable under the established pricing arrangements.

39. When cash has not yet been received at the time revenue is recognized, a receivable should be recorded. An appropriate allowance for estimated bad debts should be established.

40. To the extent that realization of the full amount of revenue is not probable due to credit losses (caused by the failure of the debtor to pay the established or negotiated price), an expense should be recognized and the allowance for bad debts increased if the bad debts can be reasonably estimated.[36] The amount of the bad debt expense should be separately shown.

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[35] SFFAS No. 1, para. 41, provides that such request should be recorded if a claim to cash is established based on legal provisions, such as a payment due date.

[36] SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 40-52, is the standard for estimating bad debts. The standard is further explained in SFFAS No.1's Basis for Conclusions, paragraphs 116-133.

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41. To the extent that realization of the full amount of revenue is not probable due to returns, allowances, price redeterminations, or other reasons apart from credit losses, the revenue that is recognized should be reduced by separate provisions if the amounts can be reasonably estimated. The amounts of such provisions should be reflected as revenue adjustments, rather than costs of operations, and should be separately shown.

42. The recognition and measurement of revenue and credit losses due to direct loans and loan guarantees is determined by SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. Appropriate allowances should be established as determined by those standards.

43. Exchange revenue should be recognized in determining the net cost of operations of the reporting entity during the period. The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the costs of outputs and the total net cost of operations of the reporting entity. The components of the net cost calculation should separately include the gross cost of providing goods or services that earned exchange revenue, less the exchange revenue earned, and the resulting difference. The components of net cost should also include separately the gross cost of providing goods, services, benefit payments, or grants that did not earn exchange revenue.

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44. The net amount of gains (or losses) should be subtracted from (or added to) gross cost to determine net cost in the same manner as exchange revenue is subtracted. Exchange revenue that is immaterial or cannot be associated with particular outputs should be deducted separately in calculating the net cost of the program, suborganization, or reporting entity as a whole as appropriate. Nonexchange revenues and other financing sources should not be deducted from the gross cost in determining the net cost of operations for the reporting entity.

45. Under exceptional circumstances, such as rents and royalties on the Outer Continental Shelf, an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects.

45.1. The collecting entity should not offset its gross costs by such exchange revenue in determining its net cost of operations. If such exchange revenue is retained by the entity, it should be recognized as a financing source in determining the entity's operating results. If, instead, such revenue is collected on behalf of other entities (including the U.S. Government as a whole), the entity that collects the revenue should account for that revenue as a custodial activity, i.e., an amount collected for others.

45.2. If the collecting entity transfers the exchange revenue to other entities, similar recognition by other entities is appropriate.

a. If the other entities to which the revenue is transferred also recognize virtually no costs in connection with the Government earning the revenue, the amounts transferred to them should not offset their gross cost in determining their net cost of operations but rather should be recognized as a financing source in determining their operating results.

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b. If the other entities to which the revenue is transferred do recognize costs in connection with the Government earning the revenue, the amounts transferred to them should offset their gross cost in determining their net cost of operations.

45.3. Because the revenue is exchange revenue regardless of whether related costs are recognized, it should be recognized and measured under the exchange revenue standards.

DISCLOSURES AND OTHER ACCOMPANYING INFORMATION

46. Each reporting entity that provides goods or services to the public or another Government entity should disclose the following:

(a) differences in pricing policy from the full cost or market pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, *User Charges* (July 8, 1993), or in subsequent amendments in circulars that set forth pricing guidance;

(b) exchange transactions with the public in which prices are set by law or executive order and are not based on full cost or on market price;[4]

(c) the nature of intragovernmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, with explanations of the amount and reason for disparities between the billing (if any) and the full cost; and

(d) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract, and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable).

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47. When making the disclosures called for by (a) and (b) in paragraph 0, cautionary language should be added to the effect that higher prices based on full cost or market price might reduce the quantity of goods or services demanded and, therefore, the difference between revenue received and such higher prices does not necessarily provide an indication of revenue forgone. If a reasonable estimate is practicable to make, the entity should provide as other accompanying information the amount of revenue forgone and should explain whether, and to what extent, the quantity demanded was assumed to change as a result of a change in price.

NONEXCHANGE REVENUE

RECOGNITION AND MEASUREMENT OF NONEXCHANGE REVENUE

The General Standard

48. Nonexchange revenues are inflows of resources that the Government demands or receives by donation. Such revenue should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. Nonexchange revenue should be **measured** by the collecting entities, but should be **recognized** by the entities legally entitled to the revenue (the recipient entities). Paragraphs 0 through 0 describe the application of this general standard.

Taxes and Duties

49. **Revenue measured by the collecting entities.** Taxes and duties also should be measured on the cash basis, and the cash basis amount(s) should be shown in conjunction with the accrual amounts recognized. The source and disposition of revenue

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from taxes, duties (which are a type of tax), and related fines, penalties and interest should be measured by the collecting entities in a manner that enables reporting of (1) cash collections, refunds, and the "accrual adjustment" necessary to determine the total revenue and (2) cash or cash equivalents transferred to each of the recipient entities and the revenue amounts to be recognized by each of them. The collecting entities function in a custodial capacity with respect to revenue transferred or transferable to the recipient entities. The collecting entities should not recognize such revenue, but should account for and report upon the above mentioned custodial activities. The entities that collect taxes and duties may change the general standard (para. 0) to accrue amounts now required to be presented as supplementary information (paragraphs 0 and 0) and make other changes that would result in a fuller and more complete application of accrual accounting.

50. **Cash collections** should be based on amounts actually received during the fiscal period, including withholdings, estimated payments, final payments, and collections of receivables. Cash collections include any amounts paid in advance of due dates unless they are deposits.

51. **Cash refunds** should be based on repayments of taxes and duties during the period. Refunds include refund offsets and drawbacks. Refund offsets are amounts withheld from refunds on behalf of other agencies and paid to such agencies. Drawbacks are refunds of duties paid on imported goods that are subsequently exported or destroyed.

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52. **The "accrual adjustment,"** which modifies the net of cash collections and refunds to determine the amount of revenue recognized, should be the net increase or decrease during the reporting period in net revenue-related assets and liabilities. The net revenue-related assets and liabilities include accounts receivable, the allowance for uncollectible accounts, and amounts payable for refunds. Recognition standards for these accounts of the collecting entities are described in paragraphs 0 to 0.

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53. **Accounts receivable** should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment processes to the extent the amount is measurable. This definition of accounts receivable from nonexchange transactions requires the standard for recognition of accounts receivable to be amended so that such receivables are not recognized on the basis of payment due dates but rather on the basis of the completion of the assessment processes.[5] Under such processes, assessments are enforceable claims for which specific amounts due have been determined and the person(s) or entities from whom the tax or duty is due have been identified. Assessments include both self-assessments made by persons filing tax returns or entry documents and assessments made by the collecting entities.

54. Assessments recognized as accounts receivable include tax returns filed by the taxpayer (or customs documents filed by the importer) without sufficient payments, taxpayer agreements to assessments at the conclusion of an audit or to a substitute for a return (or importer agreements to supplemental assessments), court actions determining an assessment, and taxpayer (or importer) agreements to pay through an installment agreement or through accepted offers in compromise. Receivables determined to be currently not collectable are included, but assessments where there is no future collection potential such as where the taxpayer (or importer) has been either insolvent or deceased for specified periods are not included. Accounts receivable, therefore, include only unpaid assessments made through the end of the period plus related fines, penalties, and interest. Accounts receivable do not include amounts received or due with tax returns received after the close of the reporting period or amounts that are compliance assessments[37] or pre-assessment work in process.

55. **Compliance assessments and pre-assessment work in process.** Compliance assessments and pre-assessment work in process may or may not be legally assessed depending on the resolution of subsequent events.

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[37] Customs refers to "compliance assessments" as protested assessment amounts.

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55.1. **Compliance assessments** are proposed assessments by the collecting entity in definitive amounts, but the taxpayer (or importer) still has the right to disagree or object, such as in the case of assessments made at the conclusion of an audit (or at the conclusion of a review by an import specialist or when a violation of applicable law is discovered), or the issuance by IRS of a substitute for a return, or where assessment is in appeals or in the tax court. These compliance assessments may become accounts receivable if the taxpayer files an amended return (or Customs' protest/retention period lapses), or an appeal or court action finally determines the assessment, or the taxpayer (importer) agrees to pay currently or through an installment agreement, or an offer in compromise is accepted.

55.2. **Pre-assessment work in process** is assessments not yet officially asserted by the collecting entity which are subject to a taxpayer's right to conference in response to initial information notices, e.g., revenue agent reports (or are unasserted assessments on merchandise released into commerce for which the importer did not submit an entry summary document or for projected revenues due as a result of Customs' compliance measurement programs). The amount or range of amounts that will ultimately be assessed or the duration of the notice period may be reasonably estimable, but there are no amounts for pre-assessment work in process presently included in the dollar based accounting systems. Estimates of the amount or range of amounts of pre-assessment work in process that may ultimately be collectable are not presently sufficiently reliable to be recognized.

56. **Allowance for uncollectible amounts** should be recognized based on an analysis of both individual accounts receivable and groups of accounts receivable, as prescribed by other standards.[38] A

[38] SFFAS No. 1, Accounting for Selected Assets and Liabilities, para. 44 to 51, provides the basis for determining this allowance.

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provision to increase or decrease the allowance will result in an adjustment of nonexchange revenue, rather than a bad debt expense.

57. **Amounts payable for refunds** (including refund offsets and drawbacks) should be recognized when measurable and legally payable under established processes of the collecting entities. The amounts include those refunds, where returns (or claims for refund) have been filed by the taxpayer and the Government has determined the specific amounts refundable and has identified the payee. Refunds with respect to returns or claims filed as of the end of the reporting period that do not require specific approval before payment are included in accounts payable for refunds.

58. **Other claims for refunds.** Claims filed for which specific administrative actions are required before payments can be made and unasserted claims for refund by taxpayers or importers that may or may not become payable depending upon the resolution of subsequent events.

58.1. Claims filed for refunds where required administrative actions are not yet complete as of the close of the reporting period are not recognized. The refunds, however, may be reasonably estimable.

58.2. Unasserted claims for refund such as unfiled claims for refunds or drawbacks for which no claim has been filed, are not recognized.[39] These amounts may be reasonably estimable, but are not presently included in dollar-based accounting systems.

[39] Future income taxes from corporations may be reduced by more than $100 billion dollars as a result of net operating loss carryforwards and tax credit carryforwards. Information in returns filed by corporations and in their financial statements appears to provide the basis for a reasonable estimate of the amount of potential reduced future income tax revenue attributable to these provisions of tax law. Information about net operating loss carryforwards is not an unasserted claim, as defined here.

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59. **Deposits**. Amounts voluntarily paid to the reporting entities as deposits, such as those made to stop the accrual of interest or those made pending settlements and judgments, are separately recognized as deposit liabilities.

60. **Revenue recognized by the recipient entities** should equal the sum of (a) cash or cash equivalents transferred to them by collecting entities and (b) the net change in any related inter-entity balances between the collecting and receiving entities (i.e., the amount to be transferred to the recipient entities from the collecting entity or vice versa). Equivalents are normally special Treasury securities issued by the Treasury Department acting in conjunction with the collecting entities. Inter-entity balances of amounts to be transferred normally should be recognized when (1) a legally enforceable claim exists between a collecting entity and a recipient entity for the transfer or repayment of taxes or duties, and (2) payment of such claim is probable and measurable. Inter-entity balances typically represent estimated settlements of transfers made during the period and revenue received by the collecting entity at year end but not yet transferred. Revenue should be recognized as a financing source in calculating the results of operations and not as a deduction in determining net cost of operations. Principles for the application of this standard to major groups of recipient entities are described in paragraphs 0 through 0.

60.1. **Trust funds legally entitled to excise taxes collected**. Certain trust funds are legally entitled to receive only excise taxes that are actually collected by the collecting entity. However, transfers to such trust funds currently are based on assessed excise taxes, because data on the components of cash collections by type of tax are not currently obtained from taxpayers. This standard affirms that revenues may be recognized on the basis of assessed excise taxes in lieu of excise taxes actually collected.

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60.2. **Trust funds legally entitled to receive Social Security taxes accrued.** By law, the trust funds are to receive Social Security taxes on the basis of the earnings of participants and the applicable tax rates. Social Security taxes accrued are presently determined by the assessment processes of the Internal Revenue Service (IRS). Non-compliance by taxpayers may result in such amounts being less than taxes based on actual earnings of participants. Amounts for individual participants are separately reported to the Social Security Administration (SSA), but because of employer reporting deficiencies these amounts are currently even less than amounts determined by the IRS. SSA is legally entitled to retain the higher amounts actually transferred by the IRS. This standard affirms that revenue should be recognized on the basis of the best available information, i.e., on the basis of the higher of the amount determined by the IRS assessment process or the individual participant amounts based on reports to SSA of participants' earnings, subject to any later adjustments necessary to bring the amounts transferred to the trust funds up to the amount of taxes due based on the actual earnings history of the participants.

60.3. **Collecting entities entitled to retain revenue.** When legally retained by the collecting entity as a reimbursement of the cost of collection, revenue should be recognized as an exchange revenue and deducted in determining the collecting entity's net cost of operations.

60.4. **General Fund.** The General Fund recognizes all nonexchange revenue not recognized by trust funds and other recipient entities. Interest on delinquent taxes should be recognized as exchange revenue. The General Fund should recognize in succeeding periods revenue adjustments for any recognized revenue that is determined after the books are closed for the period to have been properly transferable (or improperly transferred) to other recipient entities.

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Fines and Penalties

61. Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. They may be imposed by the entities collecting taxes and duties, or by other government entities. The time when a claim to resources arises will depend on the nature of the fine and the associated legal and administrative processes. Some examples of conditions that, depending on the circumstances, could establish a legally enforceable and measurable claim include (1) the date by which an individual may contest a court summons expires, (2) the offender pays the fine before a court date, or (3) the court imposes the fine. An allowance for uncollectible accounts should, as in the case of taxes and duties, be recognized as a revenue adjustment and determined in accordance with other standards.[6] The allowance should reduce the gross amount of the receivable and revenue to its net realizable value, based on the criterion that losses should be recognized to the extent it is probable (more likely than not) that some or all of the receivables will not be totally collected.

Donations

62. Donations are contributions to the government, i.e., voluntary gifts of resources to a government entity by a nonfederal entity. Donations may be financial resources, such as cash or securities, or nonfinancial resources such as land or buildings. Revenue arising from donations should be recognized for those inflows of resources which meet recognition criteria for assets[7] and should be measured at the estimated fair value of the contribution.

Other Nonexchange Revenue

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63. The various types of nonexchange revenue are described in Appendix B: Guidance for the Classification of Transactions. Some of these are not specifically mentioned in this standard. They should be recognized and measured in accordance with the general rule (see para. 0) except where other Board standards apply.

DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER ACCOMPANYING INFORMATION

Disclosures

64. **Basis of Accounting**. Collecting entities should disclose the basis of accounting when the application of the general rule of paragraph 0 results in a modified cash basis of accounting. The disclosure should point out the specific potential accruals which are not made as a result of this practice and the practical and inherent limitations affecting the accrual of taxes and duties. The disclosure should refer to the related other required disclosures and to the supplementary information and should mention that other accompanying information also provides related information. If a collecting entity adopts accounting standards that embody a fuller application of accrual accounting concepts, as permitted in paragraph 0, then the disclosure should describe that change in accounting and point out how it differs from that prescribed by this standard.

65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

65.1. **Accounts receivable.** Factors affecting collectability and timing of categories of accounts receivable and the amounts involved.

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65.2. **Material revenue-related transactions.** Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.

65.3. **Cumulative cash collections and refunds by tax year and type of tax.** Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes.

66. If trust fund revenues are not recorded in accordance with applicable law, both the collecting and recipient entities should disclose the reasons.

Supplementary Information

67. Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial

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responsibilities:

67.1. The estimated realizable value, as of the end of the reporting period, of compliance assessments and, if reasonably estimable, pre-assessment work in process. The amounts furnished should represent management's best estimate of additional revenues likely to be collected from compliance assessments and from pre-assessment work in process, appropriately qualified as to their reliability. A range of amounts may be provided for pre-assessment work in process if estimable. The change in the total(s) of compliance assessments and of pre-assessment work in process during the reporting period also should be provided.

67.2. If reasonably estimable, other claims for refunds that are not yet accrued but are likely to be paid when administrative actions are completed. If estimated, unasserted claims for refunds should be provided separately from claims filed and may be expressed as a range of amounts. The amounts furnished should represent management's best estimates, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.

67.3. The amount of assessments that the entity still has statutory authority to collect at the end of the period, but that have been written off and thus excluded from accounts receivable.

67.4. If reasonably estimable, the amounts by which trust funds may be over- or under-funded in comparison with the requirements of law.

68. Recipient entities that are trust funds should provide the same information as required for collecting entities in para. 0.

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Other Accompanying Information

69. The following guidance for other accompanying information is intended to provide flexibility to enable preparers to present the most relevant information with respect to these topics, considering the needs and interests of users and the availability of data.

69.1. **A perspective on the income tax burden.** The IRS should provide a perspective on the income tax burden. This could take the form of a summary of the latest available information on the income tax and on related income, deductions, exemptions, and credits for individuals by income level and for corporations by size of assets. The objective is to show the tax burden borne by different classes of individuals and corporations and how that burden is affected by the tax rates, deductions, credits, etc., provided by the tax laws.

69.2. **Available information on the size of the tax gap.** Collecting entities should provide any relevant estimates of the annual tax gap that become available as a result of federal government surveys or studies. The tax gap is defined as taxes or duties due from non-compliant taxpayers or importers. Amounts reported should be specifically defined, e.g., whether the tax gap includes or excludes estimates of taxes due on illegally earned revenue. Appropriate explanations of the limited reliability of the estimates also should be provided. Cross references should be made to portions of the tax gap due from identified non-compliant taxpayers which are shown as supplementary information, i.e., compliance assessments and pre-assessment work in process (para. 0).

69.3. **Tax expenditures related to entity programs.** Information on tax expenditures that a reporting entity considers relevant to the performance of its programs may be presented, but should be qualified and explained appropriately to

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help the reader assess the possible impact of specific tax expenditures on the success of the related programs.

69.4. **Directed flows of resources related to entity programs.** Information on directed flows of resources related to an entity's programs may be presented, but if this information is presented the estimated amounts should be accompanied by a description of the basis for the estimates and appropriate cautionary language about their reliability. Information should also be appropriately qualified and explained to help the reader assess the possible impact on the success of the programs.

OTHER FINANCING SOURCES

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70. Financing sources, other than exchange and nonexchange revenues, that provide inflows of resources that increase results of operations during the reporting period include appropriations used, transfers of assets from other Government entities, and financing imputed with respect to any cost subsidies.[8] Financing outflows may result from transfers of the reporting entity's assets to other Government entities or from exchange revenues earned by the entity but required to be transferred to the General Fund or another Government entity. Unexpended appropriations are recognized separately in determining net position but are not financing sources until used.

RECOGNITION AND MEASUREMENT OF OTHER FINANCING SOURCES

Appropriations

71. **Unexpended Appropriations.** Appropriations, until used, are not a financing source. They should be recognized in capital as "unexpended appropriations" (and among assets as "funds with Treasury") when made available for apportionment, even if a Treasury Warrant has not yet been received, or the amount has not been fully apportioned. Unexpended appropriations should be reduced for appropriations used and adjusted for other changes in budgetary resources, such as rescissions and transfers. The net increase or decrease in unexpended appropriations for the period should be recognized as a change in net position of the entity.

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72. **Appropriations Used.** When used, appropriations should be recognized as a financing source in determining net results of operations.[9] Appropriations are used in operations when goods and services are received or benefits and grants are provided. Goods and services (including amounts capitalized) are considered received when a liability is established. Benefits are considered to be provided when the related liability is established. Grants are considered to be provided when grantees meet the requirements that allow them to use the grants.[40]

Financing Imputed for Cost Subsidies

73. Government entities often receive goods and services from other Government entities without reimbursing the providing entity for all the related costs. In addition, Government entities often incur costs, such as for pensions, that are paid in total or in part by other entities. These constitute subsidized costs to be recognized by the receiving entity to the extent required by other accounting standards. An imputed financing source should be recognized equal to the imputed cost. This offsets any effect of imputed cost on net results of operations for the period.

Transfers of Assets

74. An intragovernmental transfer of cash or of another capitalized asset without reimbursement changes the resources available to both the receiving entity and the transferring entity. The receiving entity should recognize a transfer-in as an additional financing source in its result of operations for the period. Similarly, the transferring entity should recognize the transfer-out as a decrease in its result of operations. The value recorded should be the transferring entity's book value of the asset. If the receiving entity does not know the book value, the asset should be recorded at its estimated fair value as of the date of transfer.

[40] FASAB plans to undertake a project on accounting for grants.

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75. To the extent that a Government entity's exchange revenue that is included in calculating net cost of operations is required to be transferred to the Treasury or another Government entity, the amount should be recognized as a transfer-out[10] in determining the net result of operations.

PRIOR PERIOD ADJUSTMENTS

76. Prior period adjustments should be limited to corrections of errors and accounting changes with retroactive effect, including those occasioned by the adoption of new federal financial accounting standards, and should be recognized and measured under applicable standards. Adjustments should be recognized as a change in cumulative results of operations (rather than as an element of net results of operations for the period). Prior period financial statements should not be restated for prior period adjustments recognized in the current period.

BUDGETARY INFORMATION

77. The budget is the primary financial planning and control tool of the government. For this reason, and because of the importance of this information to users of federal financial information, the following material budgetary information should be presented by reporting entities whose financing comes wholly or partially from the budget:

(a) total budgetary resources available to the reporting entity during the period;

(b) the status of those resources (including "obligations incurred");

(c) outlays.

78. Recognition and measurement of budgetary resources should be based on budget concepts and definitions contained in OMB Circulars A-11 and A-34. In addition, the reporting entity should provide this information for each of its major budget accounts as supplementary information. Small budget accounts may be aggregated.

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79. The following information about the status of budgetary resources should be disclosed.

(a) the amount of budgetary resources obligated for undelivered orders at the end of the period;

(b) available borrowing and contract authority at the end of the period;

(c) repayment requirements, financing sources for repayment, and other terms of borrowing authority used;

(d) material adjustments during the reporting period to budgetary resources available at the beginning of the year and an explanation thereof;

(e) existence, purpose, and availability of permanent indefinite appropriations;

(f) information about legal arrangements affecting the use of unobligated balances of budget authority such as time limits, purpose, and obligation limitations;

(g) explanations of any material differences between the information required by paragraph 0 and the amounts described as "actual" in the Budget of the United States Government;

(h) the amount, and an explanation that includes identification of balance sheet components, when recognized unfunded liabilities do not equal the total financing sources yet to be provided; and

(i) the amount of any capital infusion received during the reporting period.

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80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different, causing differences in the basis of accounting. To better understand these differences, a reconciliation should explain the relationship between budgetary resources obligated by the entity during the period and the net cost of operations. It should reference the reported "obligations incurred" and related adjustments as defined by OMB Circular A-34. It also should include other financing sources not included in "obligations incurred" such as imputed financing, transfers of assets, and donations of assets not included in budget receipts. Further, it should include decreases (increases) in receivables from the public related to exchange revenue when only the cash amount is included in budgetary resources. The total of these items comprises obligations and nonbudgetary resources.

81. This total should then be adjusted by:

(a) Resources that do not fund net cost of operations (e.g., changes in undelivered orders, appropriations received to pay for prior period costs, capitalized assets),

(b) Costs included in net cost of operations that do not require resources (e.g., depreciation and amortization expenses of assets previously capitalized), and

(c) Financing sources yet to be provided (those becoming available in future periods which will be used to finance costs recognized in determining net cost for the present reporting period).

82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between the obligations basis used in the budget and the accrual basis used in financial (proprietary) accounting.

ACCOUNTABILITY FOR DEDICATED COLLECTIONS

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83. A reporting entity may be responsible for funds financed with dedicated collections that are held for later use to accomplish the fund's purpose. Some of these are held in a fiduciary capacity. Special accountability is required for the sake of the taxpayers or other contributors who make payments to the fund with the expectation that the collections will be used for the purposes for which they were dedicated, and for the sake of those who expect to benefit from the fund's future expenditures. Such funds include all funds within the budget classified as trust funds, those funds within the budget that are classified as "special funds" but that are similar in nature to trust funds, and those funds within the Federal universe (inside or outside the budget) that are fiduciary in nature. Management should, therefore, identify those special funds that are similar in nature to trust funds and those funds inside and outside the budget that are fiduciary in nature. Identification of funds that are similar in nature to trust funds is a judgmental matter; management is best qualified to make this judgment.

84. Separate financial information about these dedicated collections should be provided if they are material either to the reporting entity or to the beneficiary or contributors. The separate information may be reported on the face of the entity's general purpose financial statements, or the information may be disclosed in the notes to the financial statements. When not material to the reporting entity, this information may be provided separately in special reports to the contributors and beneficiaries (or their representatives) rather than separately in the reporting entity's general purpose financial statements or notes thereto.

85. The following information, at a minimum, should be reported for individual funds that account for dedicated collections.

(a) A description of each fund's purpose, how the administrative entity accounts for and reports the fund, and its authority to use those collections.

(b) The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.

(c) Condensed information about assets and liabilities showing

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investments in Treasury securities, other assets, liabilities due and payable to beneficiaries, other liabilities, and fund balance.

(d) Condensed information on net cost and changes to fund balance showing revenues by type (exchange/nonexchange), program expenses, other expenses, other financing sources, and other changes in fund balance.

(e) Any revenues, other financing sources, or costs attributable to the fund under accounting standards, but not legally allowable as credits or charges to the fund.

When the above information is provided separately in special reports, as described in paragraph 0, the financial information required in (c) and (d) above should be combined for all such funds and the information described as "amounts for immaterial funds not presented separately in this general purpose report."

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86. The law may require the accounting for a fund to be done in a particular way. The disclosures called for by item (e) are required if the fund's recognition requirements, as determined by law, are contrary to applicable accounting standards with respect to certain revenue, other financing sources, or costs. For example, a trust fund may be required to recognize revenue based on cash collected by the Government during the reporting period rather than the accruals due the Government. In the case of some funds, payments from the fund are also subject to legal limitations. Although the accounting used within the fund itself should be in accordance with the applicable legal requirements, the larger reporting entity of which the fund is a component, the administrative entity, or the next higher level of the Government (e.g., a department or the governmentwide entity), should recognize the revenues, other financing sources, or costs associated with but not legally allowable to the fund.[11]

87. Most dedicated collections are included in the financial statements of the entity carrying out the program and responsible for administration of the fund. However, this may not be the case where collections are outside the budget or are not otherwise included in the reporting entity under the concepts of Entity and Display. In either case, the information is required to be disclosed. If more than one reporting entity is responsible for carrying out the program financed with the dedicated collections, then the entity with the largest share of the activity should be responsible for reporting all revenues, other financing sources, assets, liabilities, and costs of the fund.

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PART II: CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING

INTRODUCTION

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88. The Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, Entity and Display, was issued to provide conceptual guidance as to what would be encompassed by a federal entity's financial report. It identifies the types of financial information to be communicated to users and suggests the types of information to be included in an entity's report to help meet the objectives of federal financial reporting. Among other things, SFFAC No. 2 supports reporting both budget information and operating performance (i.e., proprietary) information to meet the needs of users and the objectives of reporting. The budget information focuses on the obligation and outlay of financial resources to acquire or provide goods and services as defined by budget concepts. Operating performance information focuses on the cost of resources used as defined by accrual accounting standards.

89. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition is necessarily different because of the difference in focus. To better understand the differences and make better use of the complementary information provided, information needs to be provided to reconcile the use of budgetary resources to acquire or provide goods and services with the net cost of using those goods and services. An approach to doing this was explored in the exposure draft, Accounting for Revenue and Other Financing Sources, and received substantial support from respondents. Therefore, Entity and Display is being amended to include in its concepts the need to communicate information about the differences between the use of resources as reported in the budget and in the net cost of operations.

AMENDMENTS TO SFFAC No. 2, ENTITY AND DISPLAY

90. The following heading and two paragraphs (numbered 0 and 0 in this document) are added to the section of SFFAC No. 2 titled "Displaying Financial Information."

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RECONCILIATION STATEMENT--BUDGETARY AND FINANCIAL ACCOUNTING

91. Subobjective 1C of the budgetary integrity objective states that information is needed to help the reader to determine "how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities." This objective arises because accrual-based expense measures used in financial statements differ from the obligation-based measures used in the budgetary reports.

92. To satisfy this objective, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a **Statement of Financing** that reconciles the budgetary resources obligated for a federal entity's programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity.

93. The Statement of Financing is added to SFFAC No. 2's suggested list of items included in the section titled "Financial Reporting for an Organizational Entity." In addition, a footnote (referenced to the Statement of Financing) shall be added stating:

OMB will provide guidance regarding details of the display for the Statement of Financing, including whether it shall be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

94. The following heading and paragraphs (numbered 0 through 0 in this document) are added to the section of SFFAC No. 2 titled "Recommended Contents for the Recommended Displays."

STATEMENT OF FINANCING

95. The purpose of the Statement of Financing is to explain how budgetary resources obligated during the period relate to the net cost of operations for that reporting entity. This information should be presented in a way that clarifies the relationship between the obligation basis of budgetary

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accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship through a reconciliation, the statement provides information necessary to understand how the budgetary (and some nonbudgetary) resources finance the cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the Statement of Financing would be as indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from obligations to net cost of operations.

96. **Obligations incurred** are amounts of new orders placed, contracts awarded, services received, and other similar transactions during the period that will require payments during the same or a future period. A deduction is needed for spending authority from offsetting collections and recoveries of prior period obligations.

97. **Nonbudgetary resources** represent the net amount of resources received by the entity that are not included in budgetary resources. These items could include donations of assets, transfers of assets from (to) other federal entities, and financing imputed for cost subsidies. This amount would also include decreases (increases) in receivables related to revenue accrued from the public because, while the cash collected for exchange revenue is a budgetary resource, the accrual amount is not.

98. **Resources that do not fund net cost of operations** are primarily (a) the change in amount of goods, services, and benefits ordered but not yet received or provided, (b) amounts provided in the current reporting period that fund costs incurred in prior years, and (c) amounts incurred for goods or services that have been capitalized on the balance sheet.

99. **Costs that do not require resources** are most commonly the result of allocating assets to expenses over more than one reporting period (e.g., depreciation) and the write-down of assets (due to revaluations).

100. **Financing sources yet to be provided** are the financing amounts needed in a future period to cover cost incurred in the current period.

101. The bottom line of this reconciliation would be the **net cost of operations**.

102. The following example financial statement format will be added to the appendices of SFFAC No. 2:

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Entity and Display, Appendix 1-G

EXAMPLE FINANCIAL STATEMENT FORMATS
STATEMENT OF FINANCING
For the year ended September 30, 19X4

Obligations and Nonbudgetary Resources		
Obligations incurred	$XXX	
Spending authority for offsetting collections and oth		
Donations not in the budget	X	
Financing imputed for cost subsidies	X	
Transfers-in (out)	X	
Exchange revenue not in the budget	(X)	
Other	X	
Obligations, as adjusted, and Non		
Resources That Do Not Fund Net Cost of Operations		
Change in amount of goods, services, and benefits ordered but not yet received or provided	(X)	
Cost capitalized on the balance sheet	(X)	
Financing sources that fund costs of prior periods	(X)	
Other	(X)	
Costs That Do Not Require Resources		
Depreciation and amortization	X	
Revaluation of assets and liabilities	X	
Other	X	
Financing Sources Yet to be Provided	X	
Net Cost of Operations	$XXX	

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APPENDICES

APPENDIX A: BASIS FOR CONCLUSIONS

103. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important considerations that FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

104. FASAB published the exposure draft Accounting for Revenue and Other Financing Sources in July 1995. The exposure draft included 18 specific questions for respondents and invited comments on other topics. The Board received 42 letters of comment from the following sources:

SOURCE
USERS, ACADEMICS & OTH
AUDITORS
PREPARERS
TOTALS

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105. FASAB also held a public hearing on the exposure draft on September 20, 1995. One individual (a professor of accounting), representatives of four federal organizations that prepare financial statements, and representatives of one federal audit organization presented comments and discussed the exposure draft with the Board. Most of those who commented orally or in writing supported most of the provisions of the exposure draft. Most responses did suggest widening the proposed disclosures for trust funds to include other funds with similar special accountability for dedicated collections. Also, most respondents suggested retaining the customary business practice of recognizing bad debt expense for credit losses from exchange transactions. The Board made these changes. (See paragraph 0 for details on the change regarding credit losses. See paragraphs 0 and following for details on the change regarding disclosures for trust funds and similar funds). Concurrently with the widening of disclosures about funds, the Board required disclosures and supplementary information about any over- and under-funding of the trust funds (see para. 0, 0 and 0). The Board also made other less material changes in the exposure draft as a result of considering the comments it received.

106. As a result of further information received from IRS following the exposure draft, the Board made terminology changes with respect to "pre-assessments," now referred to as "compliance assessments," and "proposed assessments, now called "pre-assessment work in process." More importantly, the Board provided for the possibility that amounts for pre-assessment work in process might not be reasonably estimable (see para. 0). As a result of further information from Customs following the exposure draft, the Board added a supplementary information requirement for unasserted claims for refund (see para. 0. (These include potential drawbacks that may approximate 20% of Customs reported revenue.)

107. After some deliberation, the Board also

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concluded that it would permit a fuller application of accrual accounting for taxes and duties than is required by the general rule (see para. 0). This would apply in the interim period between the issuance date of the Statement and any reconsideration of the standard by the Board. Coincident with extending the effective date of the standard for one year beyond that proposed in the exposure draft, and because of the importance of accurate information, the Board decided to require that material revenue-related transactions should be accounted for under a double entry accounting system (rather than estimated) and changed the designation of this information from supplementary to disclosure information (see para. 0 and 0).

108. Finally, the Board recognized that, under certain circumstances, reporting entities may appropriately report information about tax expenditures and directed flows of resources that are related to their programs. However, the standard only permits this information to be presented as other accompanying information if it is properly qualified and explained (see para. 0 and 0).

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EXCHANGE REVENUE

Special Nature of Government Exchange Transactions

109. Revenue from exchange transactions plays a different role in Government than in private business. Most Government output is provided to the public directly as the result of political decisions rather than in exchange for revenue. This is regardless of whether the output is the provision of services, transfer payments to individuals, or grants to state and local governments. Likewise, most of the Government's receipts are collected as a result of exercising its power to compel tax payments rather than earned by providing goods and services to the public at a price.

110. Where Government goods and services are provided in exchange for revenue, prices may be set to cover cost. Sometimes they may be set in the market as they would be set by a business (such as auctioning the right to drill for oil on Government land). However, law or policy sets many prices below the amount that might be obtained in an auction or other market transaction (such as fees for grazing rights). In some of these cases, prices may be set with little or no regard to the related cost (such as fees to visit national parks).

111. Exchange transactions also occur between entities within the Government, sometimes as stipulated by law and in other cases by mutual agreement. These exchange transactions, also, are often not conducted at fair market prices. Services are often provided to a program free, such as the litigation the Department of Justice does for the Internal Revenue Service. Another common example is a central computer used without charge by several programs within an agency. Where charges are imposed, the internal sales price or reimbursement is not necessarily based on the full

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cost of providing the goods or services or on competitive market equivalents.

112. Some exchange transactions within the Government are carried out by intragovernmental revolving funds. In many instances, these funds have been established with the goal of recovering their full cost by selling their output. This would allow them to be self-sustaining from their sales, including the maintenance of their capital, without the need for additional appropriations. Goods and services must be priced at full cost to achieve this goal, but full cost is not always charged. As a result, revolving funds have often failed to be self-sustaining and have required extra appropriations.[13]

Recognition: General Considerations

113. **Matching revenue with cost**. It is often said that private sector accounting matches expense with revenue to measure the net income of the business. This provides a measure of effort compared with accomplishment that cannot be used for most government activities. Most government activity either provides collective goods and service (such as national defense and justice) or redistributes income and wealth (as in benefit payments and grants). Therefore, the Government's output--its goods, services, transfers, and grants--is usually not provided in exchange for voluntary payments. In such cases, directly measuring the value that the Government's activity adds to society's welfare is difficult.

114. The Objectives of Federal Financial Reporting focuses on cost in relationship to accomplishment as the main objective in reporting an entity's operating performance. This is because of the fundamental importance of cost information. It is important to program managers in operating their activities efficiently and effectively. It is equally important to Executive and Congressional decision makers in making resource allocations. Subobjectives 2A and 2B declare that:

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> Federal financial reporting should provide information that helps the reader to determine ...the costs of providing specific programs and activities and the components of, and changes in, these costs...[and] the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.[14]

115. The Board's explanation of the operating performance objective defines more exactly what this means:

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> ...expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.[41]

116. SFFAS 4, Managerial Cost Accounting Concepts and Standards, discusses the need for Government accounting to emphasize cost as a way to improve decision making and program management. It says that good cost information can be used for: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees, (4) program evaluations, and (5) economic choice decisions (such as whether to contract-out a project).[42]

117. To meet these goals, cost must be matched with the provision of goods and services to the public or other Government entities. To determine the net cost of an exchange activity--i.e., the part of the cost that is not offset by revenue earned from the goods and services provided--the related revenue must be matched with the cost.

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[41] Ibid., page 38, para. 124. For more extended discussion, see ibid., chapter 8. As explained there, difficulties arise in practice for many reasons, e.g., the specific measures that are appropriate and feasible will vary from program to program, outcomes are influenced by external factors as well as actions of government, focusing attention on selected measures can have unintended--and sometimes undesired--consequences, etc.

[42] SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, pp. 11-14.

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118. Matching revenue with cost in a uniform manner is essential in evaluating agency performance and setting price. Cost and revenue must pertain to the same output in order to estimate the extent to which the revenue covers the cost. Therefore, costs should be matched against the provision of goods and services with revenue matched against those costs and thus with revenue also matched against the same provision of goods and services. When this is done, the gross and net cost of an entity can be compared with the related outputs and outcomes to evaluate its operating performance, pricing policy, and economic decisions. Similarly, when this is done, the net cost to the taxpayer can be estimated for the entity's related outputs provided to the public.

119. The standards in this Statement therefore use the accrual basis for recognizing exchange revenue and provide for matching exchange revenue against related cost as closely as practicable. The standards specify how the matching is to be achieved for different types of transactions.

120. **Assigning revenue to the costs of earning it**. Determining the net cost of producing outputs, providing programs, or carrying out missions will often be more important than determining the net cost for the reporting entity as a whole. A reporting entity may have several missions carried out by different suborganizations, all of them having component programs and outputs. For each of these, both gross and net cost are important in evaluating performance and managing cost. Furthermore, either an entity as a whole or its suborganizations and programs may have material costs that are not incurred to earn revenue, as well as material costs that are incurred for that purpose. Therefore, the revenue-earning and nonrevenue-earning components need to be separately evaluated in order to assess the net cost of particular activities. Additionally, various components may earn revenue but cover costs to different degrees.

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121. In all these cases, the net cost of the reporting entity as a whole does not show the extent to which earned revenue covers the cost of providing a particular output. This can only be calculated for the entity's components. Determining the net cost for components is therefore essential to achieve the goals of the standards in this Statement: to match exchange revenue with the gross cost of outputs and to offset exchange revenue against that related gross cost.

122. To be most useful, therefore, the gross costs and net cost of operations should be calculated by suborganization, program, or output. Suborganizations are generally equivalent to responsibility segments as defined by the standards on managerial cost accounting.[43] Each responsibility segment must be able to assign full costs to the measurable outputs of its programs.[44] As a result, users of general purpose federal financial reports will be able to relate the net costs of a program to program outputs and outcomes.

123. Preparers should decide the exact classification of suborganizations and programs based on the nature of the entity, the missions and outputs for its GPRA strategic and annual performance plans, the concepts in Entity and Display, Federal accounting standards, and OMB's bulletin prescribing the form and content of agency financial statements. Exchange revenue should be assigned to the costs of outputs unless it is not reasonably possible to do so. If that cannot be done, exchange revenue should be assigned to the costs of programs, or, if that also is not reasonably possible, to the costs of suborganizations. Assigning exchange revenue to the components of an entity in this way is more

[43] See *ibid.*, pp. 31-35. Also see SFFAC No. 2, *Entity and Display*, pp. 25-26, para. 75 and footnote 14.

[44] SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, pp. 36-42 and 51-59.

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effective for performance evaluation, price setting, and other purposes than assigning it to the reporting entity as a whole.

124. The gross cost, the exchange revenue, and the difference or net cost should be determined for each such component. The net cost and gross cost for each component could be used for such purposes as comparison with the outputs and outcomes of that component in order to assess the efficiency and effectiveness with which resources were used to achieve results.[45]

125. Good information on gross cost and net cost, determined and analyzed in this manner, is essential to the success of the Government Performance and Results Act of 1993 (GPRA)[46] in relating costs to accomplishments. GPRA requires agencies to set performance goals for program activity and establish performance indicators to measure outputs and outcomes of the program activity. Performance measurement under GPRA is to begin in FY 1999, and pilot projects started in FY 1994. Under the OMB plan to carry out GPRA, performance reports will show the results of what was actually accomplished (outputs and outcomes) with the resources used. The net cost of operations (as well as gross cost) should be a fundamental measure of these resources.

[45] As noted previously, the specific measures of program economy, efficiency, and effectiveness that are feasible and appropriate will vary among programs.

[46] Public Law 103-62.

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126. **Uncollectible amounts**. When realization of the full amount of recognized revenue is not probable, the standards require that a separate provision be made if the uncollectible amount can be reasonably estimated. The Board defines "probable" as "more likely than not." This definition, and measurability, are the criteria for recognizing losses due to uncollectible amounts of accounts receivable under Federal accounting standards.[47]

127. Government entities have an extraordinary responsibility to be accountable--to the President, the Congress, and the public. Because of this, it is appropriate to show separately (1) the full revenue due under their established pricing arrangements, and (2) the amount of this revenue that they estimate will not be realized.

128. The Exposure Draft proposed that the entire provision for estimated uncollectible amounts be recognized as a revenue adjustment. It reasoned that, if some of the potential revenue is not likely to be received, this should be viewed as the failure to realize revenue or the absence of an inflow of resources. Some of the respondents also viewed the entire uncollectible amount as a shortfall in revenue, but a majority believed that credit losses were a cost of doing business. Businesses extend credit in order to finance their customers, and any losses in this line of activity are another kind of expense. Such treatment is required for direct loans and loan guarantees that follow the credit reform accounting standards of SFFAS No. 2. A particularly telling argument, made by some, was that credit losses should be a component of full cost when establishing prices for the sale of goods and services. This would be facilitated by recognizing credit losses as a bad debt expense rather than a revenue adjustment. For these reasons, the Board concluded that credit losses should be recognized as an expense.

[47] SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, pp. 12 and 33-34, paragraphs 44-45 and 124-30.

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129. Uncollectible amounts due to other reasons--such as returns, allowances, and price redeterminations--would, however, be recognized as revenue adjustments. This treatment is parallel with the treatment in this Statement of taxes and other nonexchange revenue, where refunds, adjustments, and abatements are deducted from gross revenue rather than recognized as an expense. Under current practice and private sector standards, these uncollectible amounts are commonly treated as revenue adjustments but are not always separately disclosed.

130. The bad debt expense and the revenue adjustment each needs to be separately shown in order for the entity to be accountable for the different reasons why revenue is not collectible.

131. The allowance for bad debts should be based on an analysis of both individual accounts and groups of accounts, as appropriate under the circumstances. This principle is explained in the standard for accounts receivable.[48] For intragovernmental transactions, allowances for bad debts may not always be needed, because full payment can often be assumed.

Recognition: Special Cases

132. The general principles underlying exchange revenue recognition are supplemented for special cases.

133. **Gains and losses.** Gains and losses are recognized rather than revenues and expenses in order to differentiate unusual or nonrecurring transactions for evaluating an entity's performance or setting its prices. Material gains and losses are expected to be infrequent. They would normally be of a type that management would want to be considered in appraisals of its operations.

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[48] *Ibid.*, pp. 12-13 and 34-35.

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134. **Direct loans and loan guarantees**. Standards for direct loans and loan guarantees were established in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. The basic principle is to recognize the subsidy cost of the direct loan or loan guarantee as an expense when the loan is made. Subsidy cost is inherently a net concept: the present value of estimated cash outflows less the present value of estimated cash inflows over the life of the loan. This requires that the present value of estimated fees be recognized as a deduction in calculating subsidy cost, and that the present value of estimated defaults be included in calculating the subsidy cost. The standards for direct loans and loan guarantees that follow credit reform accounting thus differ from the standards in the present Statement in three respects: revenue is deducted in calculating the subsidy cost, bad debts are included in calculating the subsidy cost, and both revenue and bad debts are measured as present values.

135. Determining the subsidy cost in this way is a method of matching revenue with cost, and it is also a method of matching the subsidy cost with the provision of the subsidy to the public. SFFAS No. 2 is therefore consistent with the objectives of this Statement for exchange revenue, and the standards in this Statement do not apply to the recognition and measurement of revenue and credit losses for direct loans and loan guarantees that follow credit reform accounting. This exception includes pre-1992 direct loans and loan guarantees that have been restated on a present value basis. The guidance for classifying transactions in Appendix B reflects the provisions of SFFAS No. 2.

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136. **Exchange revenue collected for others**. Many entities that collect exchange revenue keep that revenue for their own use. Revolving funds keep the revenue they earn. By their nature, they are expected to finance at least a material part of their cost by selling goods and services in a continuing cycle of business-type activity. Other collecting entities may also keep the revenue they earn. Sometimes, however, the exchange revenue is transferred to the General Fund or to other entities in whole or in part. For example, the Southeastern and Southwestern Power Administrations transfer the revenue they collect from the public to the General Fund of the Treasury; similarly the Western Area Power Administration, while retaining some of the revenue that it collects, transfers the rest to the General Fund and various special funds designated by law.

137. As a general rule, exchange revenue transferred to others must be offset against the collecting entity's gross cost to determine its net cost of operations. Exchange revenue reduces the net cost of operations incurred by the entity in producing outputs, regardless of whether the entity keeps the exchange revenue for its own use or transfers it to another operating entity or the General Fund. Likewise, exchange revenue reduces the net cost of the entity’s operations to the taxpayer regardless of its disposition. Therefore, all exchange revenue related to the cost of operations must be deducted from gross cost to determine the net cost of operations for the entity.

138. Any exchange revenue that is transferred to others, however, does not affect the collecting entity's net position. Therefore, as required by the standards for other financing sources, such exchange revenue is recognized as a transfer-out in calculating the entity's operating results.

139. The only exception to the general rule occurs when the entity recognizes virtually no cost in

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earning the exchange revenue, as explained in the following section.

140. **Exchange revenue unrelated to recognized cost.** In exceptional cases, an entity may recognize virtually no costs in connection with earning exchange revenue that it collects. A major example for many years has been the Minerals Management Service (MMS) of the Department of the Interior. It manages energy and other mineral resources on the Outer Continental Shelf (OCS) and collects rents, royalties, and bonuses due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands. The rents, royalties, and bonuses are exchange revenues, earned by sales in the market. If the value of natural resources were recognized as an asset by MMS, then depletion could be recognized as a cost according to the units of production method as minerals were extracted.[15] The revenue from rents, royalties, and bonuses could then be matched against MMS's gross cost, including depletion and minor other costs, to determine its net cost of operations.

141. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards the value of natural resources is not recognized as an asset. As a result, this exchange revenue cannot be matched against the economic cost of operations and bears little relationship to the recognized cost of MMS. Therefore, it should not be subtracted from MMS's gross cost in determining its net cost of operations. If it were subtracted, the relationship between MMS's net cost of operations and its measures of performance would be distorted. The net cost of operations of the Department of the Interior would likewise be distorted.

142. MMS collects this revenue acting as an agent for the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. Therefore, MMS should account for the exchange revenue as a custodial activity, which is an amount collected for others, in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. Because the revenue collected by MMS is exchange revenue, it

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should be recognized and measured under the exchange revenue standards when the rents, royalties, and bonuses are due pursuant to the contractual agreements.

143. The rents, royalties, and bonuses transferred to Treasury for the General Fund or to other Government reporting entities should be recognized similarly by these recipient entities. The revenue is exchange revenue and should be recognized and measured under the exchange revenue standards. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, the revenue should not offset the cost of operations for the U.S. Government as a whole or for these entities. As in the case of MMS, offsetting cost by this revenue would distort the relationship between the net cost of operations and the measures of the performance of these entities. The exchange revenue should instead be a financing source in determining the operating results and change in net position.

144. The Board is addressing the accounting for natural resources in a separate project. If it concludes that the value of mineral rights should be recognized as an asset and depletion as a cost, it would be appropriate to recognize the exchange revenue from rents, royalties, and bonuses in determining the net cost of operations.

145. Although MMS is the most prominent case of an entity collecting exchange revenue for which it recognizes virtually no cost, there can be other instances. The Federal Communications Commission collects exchange revenue from the auction of the radio spectrum. Such revenue should be accounted for in the same way as the revenue collected by MMS.

146. One respondent to the Exposure Draft asked about the meaning of the term “virtually no costs.” If an entity sells scrap metal or fully depreciated equipment, the exchange revenue or gain is not related to any cost that is recognized at the time of sale. These assets are recorded on the balance sheet as having no value at the time of sale, so the gross proceeds from the sale are not offset by any remaining book value in calculating the entity’s gain. However, unlike the auctions of petroleum rights or the radio spectrum, costs were recognized in past periods for the purchase of the

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materials or the use of the equipment. Therefore, offsetting the entity's cost by its gains from sale provides a more accurate measure of its net cost of operations over time for comparison with measures of its performance over time. The standard has been clarified to say that the term "virtually no costs" means that virtually no costs are recognized during past periods as well as during the current period.

147. It is also possible that an entity's cost accounting may not assign any costs to byproducts of its major goods or services. However, cost is recognized for the activities that produced both the major products and the byproducts. All revenue earned in connection with these activities needs to be offset against the cost of these activities in determining the entity's net cost for the purpose of making comparisons with its measures of performance.

148. **Specific goods (or services) made to order compared with goods made for inventory**. When an entity produces goods for sale, revenue can be matched with cost in either of two ways: (1) revenue and expense can be recognized as costs are incurred, or (2) the expenditures can be recorded in inventory, with the revenue and expense recognized subsequently when the goods are delivered to the customer.

149. For specific goods made to order under a contract (or specific services produced to order), the standard requires that revenue be recognized as goods and services are acquired to fulfill the contract. More precisely, the standard requires that revenue, as determined by the contract price, be recognized in proportion to the estimated total cost as goods and services are acquired to fulfill the contract. This means that the percentage-of-completion method must be used and the amounts of revenue must be calculated based on the costs of the goods and services acquired to date to fulfill the contract in relationship to the estimated total cost under the contract. If the time period and estimated total cost are uncertain, revenue recognition should be deferred until a firm basis can be established to assign cost. Goods and services made (or produced) to order include such projects as building construction and ship repair, where costs are incurred over a period of time to provide a particular good or service to a specific customer according to characteristics determined by contract. They do not include the sale of standard services, such as electricity, under a contract.

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150. Recognizing revenue and cost in this way provides an up-to-date measure of the entity's operations in providing goods and services. The revenue and cost are generated by the entity's activities during the current reporting period, unlike alternative recognition standards. In particular, this is unlike the completed contract method, under which the revenue and cost recognized in a period may have been generated substantially during previous periods. Because the revenue and cost recognized in the reporting period are up-to-date, they can more readily be compared with each other and with current outputs in evaluating the entity's performance and pricing policy in that period.

151. In some instances, however, there may be no material difference between the percentage-of-completion method and the completed contract method. This is especially likely for small or short-term contracts. In such instances, the completed contract method could be followed.

152. The standard also requires that when a loss on a contract is probable (more likely than not) and measurable (reasonably estimable), it should be recognized over the life of the contract in proportion to the estimated total cost instead of immediately. This will come about by continuing to recognize revenue in proportion to estimated total cost and by continuing to recognize costs as goods and services are acquired to fulfill the contract. This requirement is an exception to SFFAS No. 5, Accounting for Liabilities of the Federal Government, under which a loss on a contract is recognized at the time when expected costs exceed expected revenue. The Board believes this exception is appropriate, because it provides a more accurate measure of the entity's net cost of operations during each reporting period than if the entire estimated loss were recognized in the single period when it was concluded that the loss was probable and measurable. The entire estimated loss, however, would be disclosed.

153. The standard is different when an entity produces goods to be kept "on the shelf" until ordered. It requires that manufacturing costs be charged to inventory and that revenue not be recognized until the goods are delivered to the customer. Costs and revenue are recognized later than when goods and services are made to order, because there is less assurance of revenue at the time when the costs are incurred. The term "delivery to the customer" includes instances in which the sale has taken place and the

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goods have been segregated or set aside for delivery.

154. **Classification of interest on intragovernmental balances**. Large amounts of interest are paid and received on intragovernmental balances. Most trust funds and some special funds and revolving funds have invested in special Treasury securities on which they earn interest due from the Treasury. Treasury and the Federal Financing Bank have made loans to a number of funds, on which those funds incur interest expense and on which interest is due to the Treasury or the Bank. The recorded interest revenue should be classified as exchange or nonexchange depending on the predominant source of funds upon which the interest payment is based. Other intragovernmental balances bear no interest. The Board is considering a project that might result in imputing interest where the balances bear no interest or the interest does not reflect the cost of borrowing by the Treasury.

155. The interest on these intragovernmental liabilities has the form of an exchange transaction, but often it does not also have the substance of an exchange. The standards in this Statement and the guidance in Appendix B, “Guidance on the Classification of Transactions,” differentiate among inflows of resources according to whether or not they should be deducted from an entity’s gross cost in determining its net cost of operations. This differentiation depends fundamentally on whether the inflow of resources is related to costs that the entity incurs and recognizes in order to produce outputs and the inflow of resources.

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156. When applied to the receipt of interest by a Government account from the Treasury, this criterion implies that interest should be classified in the same way as the predominant source of revenue to the fund: as exchange revenue, if the predominant source is exchange revenue; and as nonexchange revenue, if the predominant source is nonexchange revenue. If the invested funds come from exchange revenue, the interest on these funds derives from exchange revenue and the costs incurred to earn that revenue; if the invested funds come from nonexchange revenue, the interest on these funds is based ultimately on the government's power to compel payment rather than on a market transaction. With certain exceptions, this means that interest received by trust funds and special funds should be classified as nonexchange revenue, whereas interest received by revolving funds and trust revolving funds should be classified as exchange revenue. This is explained below, together with the exceptions and certain analogous transactions.

157. Invested balances of trust funds (and special funds) predominantly derive from earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes). To a lesser extent they derive from other financing sources (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs any costs. Therefore, the interest on Treasury securities should not be deducted from the gross costs of the trust fund (or special fund) in determining its net cost of operations. As a result, that interest should not be classified as an exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue.

158. The invested balances of revolving funds, on the other hand, predominantly derive from the funds' business-type operations. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since the holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on their securities is related to the funds' costs of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue previously earned from the sales of goods and services, for which the funds incurred

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costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net cost of operations. For this reason, interest earned by revolving funds should be classified as exchange revenue.

159. A few revolving funds are classified by law as trust funds. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services; and the source is predominantly revenue previously earned from the sales of services, for which they incurred costs of operations. Their interest should therefore be classified in the same way as for other revolving funds, which is exchange revenue.

160. The three previous paragraphs explain the rationale for the normal classification of interest received by trust funds, special funds, revolving funds, and trust revolving funds. However, in some cases, the source of balances for trust funds and special funds may not be predominantly nonexchange revenue, and the source of balances for revolving funds and trust revolving funds may not be predominantly exchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and Disability Fund and the Military Retirement Fund, consists of exchange revenue and other financing sources. In such exceptional cases, interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.

161. Agencies may receive authority to borrow from Treasury (or the Federal Financing Bank), and they pay interest on their borrowings. The interest is a cost to the agency and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the agency borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the agency is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.

162. When debt securities are retired before maturity, there may be a

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difference between the reacquisition price and the net carrying value of the extinguished debt. This difference is a gain or loss that should be classified in the same category as the interest on the extinguished debt.

Measurement

163. Exchange transactions with the public ordinarily take place at prices set by the agency or the Congress, such as electricity rates, book prices, and interest on delinquent taxes. Sometimes the market sets the price, as with the rents and royalties from companies that bid to explore and produce oil and gas on the Outer Continental Shelf. In either case the actual prices represent the inflow of resources to the entity and, therefore, are the appropriate basis for measuring revenue.

164. Except for prices set by law, OMB Circular No. A-25 and other regulations generally provide that user charges for transactions with the public should be set at full cost or market price.[16] However, compliance with these regulations is partial, and potential revenue is not realized in many cases. To help report users understand how the entity's operations are financed, disclosures are needed about (1) differences in pricing policy from the guidance in OMB's circular on user charges and (2) transactions where prices are set by law or executive order and are not based on full cost or market pricing. Other accompanying information is needed about the revenue forgone in these transactions but only if a reasonable estimate is practicable. The other accompanying information should explain whether, and to what extent, the quantity demanded was assumed to change as a result of the change in price.

165. Circular A-25 defines "full cost" as "all direct and indirect costs to any part of the Federal Government of providing a good, resource, or service."[49] This generic definition and the accompanying examples in the circular are generally consistent with the definition of "full cost" in the managerial cost accounting standards[50]

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[49] Circular A-25, section 6(d)(1).

[50] SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the*

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and the recognition and measurement of many particular expenses in other Federal accounting standards.[51] However, unlike those standards, Circular A-25 also includes as part of the definition of full cost an annual rate of return on land, structures, equipment, and other capital resources (unless they are rented);[52] and it includes depreciation not only on structures and equipment that are classified as general PP&E (property, plant, and equipment), which is required by Federal accounting standards, but also on structures and equipment classified as stewardship PP&E, which in a few cases may be used in connection with the production of goods or services for sale.[53] Aside from these differences, the cost accounting and other accounting standards should enable the Circular A-25 definition of full cost to be measured more accurately than has been possible heretofore.[54]

Federal Government, pp. 38-44.

[51]For example, the standards for expenses related to credit are stated in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*; and numerous standards for expense are stated in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.

[52]The Board currently has a project to consider whether the rate of return on capital should be recognized as a cost in financial accounting statements.

[53]The extent of differences between Circular A-25 and Federal accounting standards can be found by comparing Circular A-25, section 6(d)(1)(b), with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

[54]Circular A-25 says that "full cost shall be determined or estimated from the best available records of the agency, and new cost accounting systems need not be established solely for this purpose." See section 6(d)(1)(e). The cost accounting and other standards should improve agency records and specify the nature of costs more precisely and comprehensively.

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166. The appropriate basis for measuring revenue from intragovernmental exchange transactions is likewise the actual price (or reimbursement) that the seller receives from the buyer. Accounting systems should be able to provide the information needed to set the reimbursement at full cost, but often the full cost is not charged. In these cases, the amount of the reimbursement is an incomplete measure of the economic value of the transaction. When one entity receives goods or services from another without paying all related costs, the net operating cost of the receiving entity is understated if it does not recognize (by imputation) the additional cost paid by the providing entity.

167. Other Federal financial accounting standards require such inter-entity cost subsidies to be recognized by the receiving entity in certain cases.[55] This Statement, in the section on "Other Financing Sources," provides standards to recognize other financing sources that are imputed to offset whatever subsidy costs those other standards require to be recognized and imputed. Accounting for the imputed cost of goods and services provided by one Government entity to another requires the exercise of judgment, based on the specific circumstances of each case. Therefore, whether costs are imputed or not, the providing entity should disclose an explanation of the amount and reason for material disparities between the billing (if any) and the full cost.

[55] The general principles for recognizing imputed cost are stated in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, pp. 43-50. The accounting is similar to the accounting for employee pensions and retirement health benefits, where the entity administering the plan does not provide goods or services to the reporting entity but does pay some or all of the cost. See SFFAS No. 5, Accounting for Liabilities of the Federal Government, pp. 20-36 and 56-63.

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NONEXCHANGE REVENUE

Inherent Limitations

168. **Inherent limitations on the ability to perform accrual accounting for nonexchange revenue.** Accrual accounting recognizes the financial effects of transactions and events when they occur, whether or not cash changes hands at that time. As it does with respect to exchange revenue, full accrual accounting for nonexchange revenue would enhance financial planning, control, and accountability. Full accrual accounting could provide important data with respect to future cash flows and tax policy and could improve the ability to evaluate the performance of the collecting entities and the exercise of their custodial responsibilities.

169. Unfortunately, the degree of accrual accounting that is practicable to perform for taxes and duties is limited by difficulties in ascertaining the amount of revenue arising from the underlying events and by the assessment processes used to manage the collecting functions. Taxpayers may not ascertain taxable income until after the underlying events. They may not file returns on their due dates, and due dates are generally set by the administrative processes after the occurrence of the underlying event. Also, the extent of non-compliance is a function of the laws establishing these entities and the expectations by the Congress and the Administration about how diligently the collecting entities should perform their collection functions. These inherent limitations on the ability to perform accrual accounting were considered by the Board.

Practical Limitations

170. **Practical limitations were also considered by the Board.** The Board's standards for accrual accounting require that accruals mirror the

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established assessment processes of the collecting entities. As such, they do not require, for example, the accrual of taxes or duties which are likely to be assessed under established processes, but only those that are actually assessed under the defined processes of the collecting entities. Having accounting mirror the established process by which collecting entities interact with taxpayers has value, though arguably accounting for revenue should not be so limited.

171. At the time the Board began deliberations on this standard, accounting systems necessary to determine even the limited revenue accruals that are now required for taxes did not exist. The changes in systems required by this standard are limited to those necessary to mirror the established assessment processes. The Board understands that the Internal Revenue Service is attempting to improve its collection function and the related management information systems. Because such systems must also provide accounting information, the Board decided not to impose accounting standards at this time that might conflict with systems changes needed to improve the efficiency and effectiveness of the collection process or go beyond the minimum changes considered necessary to enable the collecting entities to properly discharge their responsibilities.

Modified Cash Basis for Taxes and Duties

172. As a result of both the inherent limitations and the practical limitations accepted by the Board, the accrual standard, as it applies to taxes and duties, might be best characterized as a "modified cash" basis of accounting. These limitations on full accrual accounting required the amendment of the accounting standard on recognition of receivables as provided in paragraph 41 of SFFAS No. 1, which said, in effect, that taxes should be recognized as receivables when they are due from taxpayers.

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173. In the future, the general standard for accrual as it applies to taxes and duties could be tightened to produce a fuller application of the accrual concept. For fines, penalties and donations, no accountable event precedes the recognition point established by this standard. Therefore, the general standard for recognition as it applies to these sources of revenue results in full accrual accounting for them.

Cash Basis Information Needed

174. Cash basis information on taxes and duties continues to be very important because it is widely used for planning purposes at present and is a component of the budget. It is also available soon after the close of the reporting period and is needed to comply with laws that require cash-basis accounting in particular instances. Unfortunately, accurate cash-basis information to meet certain legal requirements and other information needs is not presently available. This standard accepts the importance of both types of information and requires entities that collect taxes and duties to provide both types of information.

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Potential Changes

175. Requirements for disclosures, supplementary information, and other accompanying information compensate to some extent for the modified cash basis of accounting for taxes and duties being approved at this time. In the future, the Board plans to evaluate users' satisfaction with reports prepared on the basis of the standard and to give consideration to improvements being made in IRS processes and related management information systems. Based on this evaluation and consideration, it may propose to extend the degree of application of accrual accounting in several years time. In the interim, the Board will permit changes in accounting made at the initiative of a collecting entity if the changes represent a fuller application of accrual accounting than that prescribed by the standard. For example, compliance assessments for taxes or unasserted claims for drawbacks may be recognized rather than shown as supplementary information if the amounts are both probable and reasonably estimable.

Entities Responsible for Measuring and Recognizing Revenue

176. Collecting entities, e.g., the Internal Revenue Service and the Customs Service, collect cash and administer the assessment processes that provide the basis for adjusting those collections to an accrual basis. They, therefore, have measurement and reporting responsibilities for these inflows of resources. They also, at the direction of the Treasury Department, account for the disposition of these inflows to recipient entities. The Treasury determines the amounts payable to the recipient entities and, in conjunction with the collecting entities, makes the actual cash payments, or issues special Treasury securities, as necessary, to fund the amounts transferred. Because the recipient entities are designated by law to receive the inflows and make ultimate disposition of the funds, they, rather than the collecting entities,

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must recognize the inflows as revenues in order to provide financial statements which are meaningful to users.

Possible Over- and Under-funding of Trust Funds

177. The standard provides that trust funds should recognize the amounts transferred (and the change during the period of the amounts to be transferred) from the collecting entity as revenue despite the fact that those transfers may not be made on the basis of applicable law. In the case of excise taxes, transferring more than the amounts actually collected may cause these trust funds to be over-funded. The Board is advised by its legal counsel that this is a violation of law by the IRS. Such violations cannot be remedied unless, and until, the IRS adopts methods to collect the needed data from taxpayers. In the case of Social Security, weaknesses in the data collection methods may cause these trust funds to be under-funded. The Board is advised by its legal counsel that so long as IRS and SSA act on the basis of the best available information there is no violation of law. In considering these two situations, the Board concluded that it should not set an accounting standard with which the recipient entities could not comply and, therefore, accepted the present basis of making transfers to them as the basis of recognition of revenue by them. However, the Board believes that both the collecting entity and the recipient entity have the responsibility to disclose any violation of law and to provide, as supplementary information, if estimable, amounts by which the trust funds may be over- or under-funded.

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Conceptual Criteria for Accrual and Limitations on Their Application

178. As mentioned earlier, this standard recognizes both inherent and certain practical limitations on the application of the accrual concept to taxes and duties. The conceptual criteria for full accrual accounting for taxes and duties are the underlying taxable events, a precondition for the government to assert a demand for payment, and a demand date itself. A demand date conceivably could be as early as a date contemporaneous with the underlying events.

179. **The underlying taxable events.** Conceptually, certain Government taxes and duties could be accrued based on particular events, and certain others on events that take place over a period. Excise taxes and customs duties are examples of taxes based on particular events (sales or importing goods). Individual and corporation income taxes are examples of taxes based on events that take place over a period (e.g., income earned over the course of a year). Indeed, some taxpayers who prepare accrual-basis financial statements for themselves normally accrue taxes due to the government based on the underlying events.

180. Data about underlying events is supplied to collecting entities through returns required to be filed by taxpayers. Unfortunately, non-compliance with return requirements is estimated to account for more than $100 billion annually in uncollected taxes. Only a relatively small portion of this amount is ultimately collected through the enforcement processes of the collecting entities. Estimates of this tax gap made from time-to-time have provided some information to guide enforcement efforts with respect to particular groups of tax payers, but do not provide sufficient information to establish claims against individual non-compliant taxpayers or defined groups of non-compliant taxpayers. Therefore, the underlying-event criterion for recognition can only be applied to the extent that taxpayers file

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tax returns[17] or the collecting entities determine through their enforcement processes that specific non-compliant taxpayers owe or might owe taxes.

181. **The demand date.** To obtain taxes and duties, the government must demand the payment. The criterion for revenue recognition under this concept could be that the demand date for taxes and duties is the same as the date the underlying taxable event occurs or over the period that the underlying taxable event occurs, e.g., as taxable income is earned by the taxpayer. However, demand dates presently defined by established assessment processes are the dates payments are required to be received by the collecting entities. They include dates for withholding and estimated tax payment as well as the final due dates for tax returns. These dates provide administrative convenience for taxpayers and generally lag the underlying events. Because of the emphasis on cash, those payments made in advance of due dates for payment are not deferred for accounting purposes. Past-due taxes as a result of taxpayer failure to comply with established payment dates are not accrued until the collecting entities receive late tax returns from such taxpayers, or until the collecting entities determine through their enforcement processes that the Government has a legally enforceable claim. Only then are accounting accruals triggered under this standard. Those dates lag the underlying events by more than necessary to determine an accrual. The aforementioned limitations on the application of the demand criterion, which are arguably practical ones, further constrain the conceptual basis for accrual.

Limitations on the Scope of Accounting

182. Although relevant to the cost of the Government from an economic perspective, to Government fiscal policies, and to performance evaluation of Government reporting entities, the Board concluded not to require information on "tax expenditures" or expenditures that federal laws require others to make, i.e., "directed flows of resources." There were a variety of opinions among Board members on the need for this information and different reasons given for not requiring some form of disclosure, but all Board members agreed that relevant amounts are not normally measured under present accounting concepts. However,

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information may be provided under certain circumstances, but outside the financial statements themselves.

Some Benefits of this Standard

183. **Some of the benefits of the accrual requirements of this standard:**

- Reporting the "accrual adjustment" as a separately identified adjustment of taxes and duties collected. This preserves needed cash-basis information.

- Improving the data for both accrual- and cash-basis information. The standard accomplishes this because all transactions for which accounting could be performed under the standard will need to be processed. Some of these have not been accounted for in past financial reports because of delays in processing transactions at the end of the year.

- Accrual of assessments. Accounts receivable would be accrued based on returns filed or enforcement actions taken through the end of the period where such returns or actions have not yet resulted in cash receipts. A statistical estimate of the effect of this standard, as of September 30, 1993, disclosed approximately $29 billion of net accounts receivable after deducting an allowance for uncollectible amounts of $42 billion. Heretofore, net accounts receivable were thought to be in excess of $100 billion. The accounting requirements for accrual should further improve the accuracy of the amount of accounts receivable.

- Recognition of refunds payable will provide some indication of the lag in making refunds to taxpayers.

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Some Things this Standard Does Not Accomplish

184. **Some of the things this standard does not accomplish:**

- Recognizing events after the close of the reporting period, such as cash received on later due dates, even if the receipt results from the underlying taxable events of the period. For example, unemployment taxes for the September 30 quarter are due in October and will be recognized in October if received on the October due date.

- Deferring recognition of revenue for tax payments that may be received before the demand or underlying event. For example, voluntary over-withholding by taxpayers will be treated as revenue.

- Recognizing compliance assessments and pre-assessment work in process or refunds before completion of the assessment processes. As a result, variations in the speed and effectiveness of the assessment processes will affect the amount accrued at the end of a fiscal period. Another result is that accounting information relative to measurement of the performance of the compliance functions by the collecting entities will not be available.

- Recognizing the tax gap, i.e., taxes (which include duties) due from unidentified non-compliant taxpayers and importers. As a result, this large potential source of revenue will not receive as much attention as it would if it could be made a formal part of the collecting entity's accountability.

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- Accounting for "tax expenditures," which may contribute to the programs of reporting entities, or "directed flows of resources," which may substitute for program costs which might otherwise need to be incurred by reporting entities. These amounts are very large in relation to the "on budget" program amounts which are measured by accounting. As a result, these materially important performance and cost related data may not be fully considered.

Accounting Systems Changes

185. The IRS accounting system at present does not account for revenue transactions on an accrual basis and, therefore, does not establish accounts receivable, refunds payable, and the allowance for uncollectible accounts on the basis of the flow of all the various events and transactions affecting these balances. Instead of being an accrual accounting system, all assessments are recorded in an operating file not designed to do accounting and not operated under a double entry concept where the revenue effects of assessments are determined. That operating file, for example, includes multiple assessments made for the same tax claim so that the IRS can pursue all potential sources for the payment of that claim. As a result of the present limitations of this operating file, to determine the accounts receivable at any point in time, the IRS must make a statistical projection of a representative sample of valid tax claims. The potential error in the estimates made to date have been material, i.e., in excess of $5 billion.

186. This standard contemplates that systems and accounting records will be put in place to permit the accurate determination and disclosure of all revenue and cash transactions which are reflected in the formal assessment process. By treating information relating to compliance assessments, pre-assessment work in process, and refunds before the completion of the assessment process as

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supplementary information, this standard contemplates that statistical estimates, rather than transaction-driven accounting systems and auditable subsidiary accounting records for individual taxpayers, may be used to provide the dollar values for these important revenue-related items.

Disclosures, Supplementary Information, and Other Accompanying Information

187. This additional information will help users of federal financial reports in understanding the following:

187.1. **Components of the revenue stream.** By disclosing the dollar amounts of the material types of transactions reflected in the required "modified cash basis" revenue stream (from initial recognition by the established assessment process through cash collections and refunds), important accountability information for oversight and performance evaluation will be provided about the tax collection function. Providing as much accurate and detailed information as possible about the annual flow of taxpayer funds (now over $1 trillion) is important because the administration of the collection function is to some degree discretionary.[18]

187.2. **Cash flows.** By disclosing cash flows by type of tax and tax year, accurate historical information will be provided about the source and timing of the annual flow. Material trends in collection and refund patterns may be apparent from the comparative financial statements presented and by reference to financial statements of prior periods. Both the ability to accurately forecast future flows and to understand the speed and effectiveness of the collection function should be enhanced by this information. Also, an indication of the degree of potentially correctable "error" from the use of a modified cash basis of accounting should be provided by this cumulative cash flow data.

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187.3. **Other future-oriented information**. Disclosures about categories of accounts receivable provide additional information about collection problems and timing of future cash flows. At IRS, different categories of receivables vary considerably in terms of ultimate collectability and timing of collection.

187.4. **Other potentially reportable revenue.** Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment processes provides indications of the amounts of potentially accruable revenue. If such amounts were ultimately accrued, the "accrual adjustment" on a modified cash basis would be converted to an "accrual adjustment" that came closer to an estimate of the effect of full accrual accounting. Some or all of these potential accounts receivable and payable may become measurable by the collecting entities, and the Board may require their accrual when the collecting entities' management systems are improved.

187.5. **Sharing of the income tax burden.** Other accompanying information about the tax gap and IRS historical information showing income, deductions, and credits by income level (assets for corporations) responds to those concerned with the extent of non-compliance with the laws and how the income tax burden is shared among compliant taxpayers.

187.6. **Administration of the tax laws by the collecting agencies.** Disclosures, supplementary information, and other accompanying information provide a more complete picture of how the collecting agencies are functioning. This information may be relevant to allocation of resources to collecting agencies, to their performance appraisal, and to their oversight.

- Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment process shows the backlog in processing assessments and refunds.

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- The disclosure and supplementary information with respect to over- and under-funding of the trust funds identifies administrative problems to be overcome.

- Disclosure of abatement of assessed taxes with respect to non-compliant taxpayers ($37 billion by the IRS in 1993) provides some information about the administrative discretion exercised by collecting entities. However, no information is required about reductions of possibly material amounts in compliance assessments and pre-assessment work in process as a result of the resolution of examinations, investigations, protests, and litigation. Therefore, accounting reports will not include data about these processes, which involve an even higher degree of administrative discretion than the formal assessment process. Nor will they provide data, e.g., compliance assessments made during the reporting period, that might be related to the cost of compliance, e.g., salaries of revenue agents and related administrative costs, that might be relevant to evaluating the performance of the collecting entities' compliance function.

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Tax Gap

188. The exposure draft proposed that available information about the nonexchange revenue gap, including the tax gap, be provided as "other accompanying information." This information would not have been subject to audit, and the auditor's responsibility would have been limited to reporting if it was materially misleading in light of the information gathered during the audit. Substantially all of the revenue gap is the tax gap because duties are technically a type of tax, so the Board decided to deal only with the tax gap. The sources of non-compliance that cause the tax gap include unreported income, overstated exemptions, and overstated deductions. The largest component of the tax gap relates to income taxes. IRS originally estimated the gross income tax gap at $94 billion for tax year 1987. The net income tax gap for 1987, which is the gross income tax gap less the estimated amount that has been or will be collected through IRS's enforcement efforts, is now estimated at $72 billion. Thus, with respect to 1987, later collections from non-compliant taxpayers are about $22 billion. Estimates of the income tax gap cover only taxes on legally earned income of individuals and corporations--not taxes owed from illegal sources of income such as drugs and prostitution.[19]

189. Estimates of the tax gap by IRS have been made from time to time. Congress recently concluded not to authorize a current study[56] and there is no present plan to conduct another one. On the other hand, Customs makes estimates of amounts due from unknown non-compliant importers. The Board concluded, therefore, that the standard should require only that any estimates by the Government of the tax gap be presented when they were relevant, i.e., provided reasonably current information is available.

[56] The Tax Compliance Measurement Program (TCMP) planned for 1996.

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190. Some respondents to the exposure draft believed that tax gap information is important, but others believed it is too imprecise to be a required disclosure. The Board considered establishing a new category of information "Required Supplementary Stewardship Information" (RSSI) for the "unidentified persons or entities" portion of the tax gap. This concept is also being considered for application to certain "Stewardship Information." The Board concluded that for the time being this standard should say that available information about the tax gap should be provided as other accompanying information. In addition to the tax gap information requirements (see para. 0), other accompanying information is required or permitted under certain circumstances with respect to (a) the income tax burden (see para. 0), (b) tax expenditures (see para. 0), (c) directed flows of resources (see para. 0), and (d) revenue forgone for exchange transactions (see para. 0).

191. The Board intends to review the requirements in this standard to provide other accompanying information when it considers standards for the Management Discussion and Analysis (MD&A). The Board may decide to modify the information requirements when it considers the degree to which this information should be subject to some sort of audit scrutiny. Auditing standards for the MD&A have not been established by any auditing standard setters, including the Comptroller General, who establishes standards for auditors who audit federal organizations, programs, and activities. It is expected that audit standards for an MD&A will be considered by the Comptroller General's Advisory Council and standards may be set later by the Comptroller General. Particular audit requirements for MD&A may be set by agreement between OMB and GAO if consistent with any such standards then existing. When the Board's project on MD&A is considered, OMB and GAO plan to give consideration to the auditing requirements for MD&A and to the concept of RSSI.

Tax Expenditures

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192. Tax expenditures are estimates of the revenue forgone because of preferential provisions of the tax structure. They are due to special exclusions, exemptions, deductions, credits, deferrals, and tax rates that depart from a "baseline." These exceptions are generally intended to achieve public policy objectives by providing benefits to qualifying individuals or entities or by encouraging particular activities. They also may be intended to improve tax equity or offset imperfections in other parts of the tax structure. Tax expenditures are not revenue. They are not inflows of resources to the reporting entity.

193. The following are some examples of tax expenditures (with estimates from the Treasury Department of the revenue forgone in FY 1995):

- the exclusion from gross income of the housing and meals provided military personnel ($2.0 billion);
- tax credits for expenditures to preserve and restore historic structures ($0.1 billion) and to produce "alternative" fuels ($1.0 billion);
- exclusion from gross income of employee compensation in the form of health insurance premiums and other medical care ($59.4 billion); and
- deductions for mortgage interest ($48.1 billion) and state and local property taxes ($15.3 billion) on owner-occupied homes.

194. The Board considered a proposal to require each reporting entity to provide supplementary information on tax expenditures related to its missions. The amounts reported would have been the Treasury Department's estimates that are published in the President's budget.

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195. Those who supported that proposal believe that this information is relevant to evaluating the performance of Government programs that have related tax expenditures. Some of these tax expenditures are very closely tied to program operations. Others are less closely tied to an agency's operating activities but still relate to its mission. For example, the preferential treatment of owner-occupied homes can be related to HUD's mission to promote good housing for the nation.

196. Furthermore, policy makers may compare changes in tax expenditures with changes in direct budgetary outlays. They did so, for example, in 1983 and 1993 when they increased the taxation of Social Security benefits but alternatively could have reduced the cost-of-living adjustment. In ways such as these, the reporting on the costs and accomplishments of an entity is incomplete unless it includes the tax expenditures related to its missions.

197. The Board decided not to require supplementary information on tax expenditures in component entity financial statements for several reasons. The definition of the baseline for comparison is in part a matter of values and judgment. In some cases the association with particular programs is not sufficiently clear. Furthermore, the information is available elsewhere now. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on tax expenditures that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

Directed Flows of Resources

198. The Board considered a proposal to require each entity to provide supplementary estimates of the material annual expense to nonfederal entities of existing federal laws and regulations associated with its programs. The requirement

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would have been limited to regulations that establish standards for the characteristics of products or for the methods of production, or that mandate expenditures by state and local governments. These estimates would not necessarily have included nonpecuniary costs, although nonpecuniary costs might have been included to the extent identifiable. Each entity also would have provided any appropriate explanations about availability of data and limitations on the reliability of the estimates.

199. Advocates of the proposal believe that the Government pursues some of its goals by requiring states, local governments, and private entities to spend funds for specified public purposes. For example, the Government may require states to extend the coverage of Medicaid, communities to have water treatment plants that meet Government safety standards, firms to minimize their workers' exposure to asbestos, and automobile manufacturers to install air bags. When the regulations apply to state and local governments, they are generally called "unfunded mandates."

200. The costs and financing of federal regulations do not flow through the Government, but their effects are similar to the effects of direct federal expenditures and revenue. Fundamentally, both regulation and federal expenditure allocate resources to the purposes specified by the Government. The cost of regulation includes regulations imposed in the past as well as newly issued regulations. Furthermore, expenditure required by regulation may be an alternative means of achieving the same public policy goals as direct federal expenditure or other methods. For example, Medicaid coverage may be extended with or without more federal grants.

201. Advocates of this requirement believe that financial reports that omit important financial effects of Governmental action do not fairly present the results of the Government's

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operations. Such reports fail to achieve the objectives of federal financial reporting. They believe that the efforts and accomplishments with which an agency pursues its goals can be properly assessed only if the financial reports include all material information. This means that the reports should bring together information about the net cost of operations, the tax expenditures, and the directed flows of resources that are intended to achieve the same or similar missions.

202. The Board decided not to require supplementary information on directed flows for several reasons. Much of this information is not available now and will not be available to preparers of financial reports without added expense. In some cases the estimates would be very imprecise. Finally, most Board members believe that the scope of Government financial reporting should not extend to flows of financial resources that are not inflows to, or outflows from, federal Government reporting entities. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on directed flows of resources that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

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OTHER FINANCING SOURCES AND BUDGETARY RESOURCES

General Principles

203. The standards for other financing sources and budgetary resources should satisfy several of the objectives of financial reporting such as: (1) explaining the relationship of budgetary resources obligated to the net cost of operations, (2) showing how budgetary resources were used and the status of budgetary resources at the end of the period, and (3) indicating the effect on the net results of operations of the entity of all the financing sources used to finance the net cost of operations. However, financing from a financial accounting (proprietary) perspective is different than the budgetary accounting perspective.

204. The budget is the primary financial planning and control tool of the Government. Its objectives, such as planning resource allocation, authorizing and controlling obligations, planning cash disbursements, and raising revenue, differ from those of financial reporting where the focus is on net cost of the entity's programs and activities and stewardship of its assets and liabilities. Differing objectives are responsible for some but not all of the many differences in these two financial management tools. Differences in standards for measuring and reporting budgetary and financial information, coupled with unreliable data, have caused financial statements to be under-utilized by Government managers, the budget community, and others who might benefit from financial information.

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Reducing Differences

205. The problem of unreliable data is being addressed through financial statement audits that will include both proprietary and budgetary information and improvements in financial management systems. These federal accounting standards reduce unnecessary differences between the information reported in these two tools of financial management and require reconciliations and data to explain necessary differences. This should increase the utility of the financial planning and control information provided by the flow statements in general purpose financial reports and enhance the usefulness of the other accountability information provided, e.g., the Balance Sheet. This should occur because those who focus on the budget will better understand the financial statements and find them to be reliable and useful reports.

206. The new recognition and measurement standards for financial accounting adopt budgetary flow concepts for appropriations and provide consistent flow standards for nonbudgetary resources. As explained earlier, standards for recognition of nonexchange revenue reported by Government entities reflect legal requirements. These changes make the reporting on financing for entity net costs more consistent among entities and more comparable to the budget.

207. However, differences inherent in the different objectives of the budget and the financial statements must remain. The obligation basis for the budget differs from the costs-incurred basis for the financial statements. This difference must continue in order for both types of information to serve their purposes. Some budgetary resources are used to invest in assets and therefore are not reflected in operating costs. Also, an entity may incur costs that were covered by previously provided budgetary resources (e.g., depreciation), costs not yet covered by budgetary resources (e.g., accrued

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annual leave), or costs covered by budgetary resources of other entities (e.g., some pension costs). Continuing these differences in the accounting reports is essential if financial statements are to report cost information that can be related to entities' outputs and if the statements are to report other information on the resources over which the entities are accountable. These remaining differences need to be explained in the financial statements to increase the utility of the financial statements.

The Budgetary Process and Its Linkage to Accounting

208. The budget controls obligations and thus ultimately controls expenditures by Government entities. In this sense, it is about their outflows of resources. Conversely, the budget makes inflows of resources available to component entities to finance expenditures. The inflows are reported in the financial statements as revenues and other financing sources (e.g., appropriations).

209. The budgetary process provides a component entity with budgetary resources through appropriations acts. Budget authority may be provided in the form of appropriations, borrowing authority, contract authority, or spending authority from offsetting collections. An appropriation may make funds available from the General Fund, special funds, or trust funds--including amounts received from earmarked taxes--or may authorize the spending of offsetting collections credited to expenditure accounts. Budgetary resources also include unobligated balances remaining from prior reporting periods and a number of adjustments (e.g., recoveries of prior year obligations). Execution of the budget includes the obligation of budgetary resources and the outlays to liquidate the obligations.

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210. Borrowing authority is sometimes used instead of appropriations to incur obligations and make payments to liquidate them out of borrowed money. However, borrowing money under this authority does not change the net position of the entity. The liability created by the borrowing is recorded along with the related asset (the cash borrowed). Repayment of the liability later will normally require the use of an offsetting collection or an appropriation. Assets acquired as a result of borrowing may be later amortized or written off and become part of an entity's costs. When this occurs, or in the unusual event that the borrowing finances expenses rather than assets, the entity's net position will be reduced.

211. Contract authority is not a reportable financing source because it only allows agencies to incur obligations in advance of receiving funds to pay for any resulting liabilities. The funds to liquidate any resulting liabilities will come from an appropriation or offsetting collections. For financial statement purposes, a financing source is recognized in accordance with the appropriate accounting standards for the type of financing received to liquidate the liability. Under past practice the financing was recognized at the time liabilities were incurred, but under the new standard the financing will not be recognized until liquidating appropriations are made available, which may be in the same reporting period as the liability is incurred or a later period.

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212. Appropriations, including permanent indefinite appropriations, are the most widely used form of budget authority. When obligated by orders for, or receipt or provision of, goods, services, or benefits, they are reflected as obligations incurred.[20] When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.

213. From the budgetary perspective, appropriations include dedicated tax receipts, such as Social Security taxes and Highway Trust Fund excise taxes. From a proprietary perspective, on the other hand, unexpended appropriations do not include dedicated tax receipts, because these receipts are accounted for as nonexchange revenue. Therefore, appropriations used do not include dedicated tax receipts, thus avoiding double counting of these amounts as financing sources.

214. The accounting treatment for recognizing "appropriations used" as a financing source parallels the budgetary accounting for expended appropriations. Expended appropriations are recognized when goods and services ordered have been delivered, when benefits are payable to recipients, or when funds available under a grant agreement are payable, and there is an available appropriation to pay these amounts. Under this standard, this is also the time when "appropriations used" is recognized as a financing source in the proprietary accounts.

215. Thus, at the time a liability is established which will be paid by an available appropriation, appropriations are considered used. Liabilities should be established in accordance with SFFAS No. 5. Under that standard, a liability can be established in several ways, and the type of transaction that has occurred governs when a liability has occurred. For example, grants can be provided under different transactions. Some can be provided without any required exchange of service with the federal government, while others may require specific activities to occur before the funds are available.

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216. Providing funds from an appropriation does not necessarily cause the recognition of a financing source if that payment is an advance. For example, an entity may advance funds to a grantee under the grant agreement. This should not cause recognition of a financing source. The recognition of appropriations used would not occur until the grantee meets the requirements that allow it to use the funds in accordance with the grant agreement.

217. The focus on net cost rather than on matching financing with expenses as incurred provided an opportunity to simplify the accounting for appropriations and to eliminate one of the differences between financial and budgetary accounting. Reporting entities will no longer have to defer recognition of appropriations used nor accrue appropriations before they become available.

- Recognition was previously deferred for appropriations used to finance capitalized transactions, such as the purchase of a fixed asset or the making of a loan under pre-credit reform programs which have not converted their accounts to a present value basis. The use of financing was previously recognized at the same time and rate that depreciation of the asset's cost was recognized as an expense or that bad debts expense was recognized on pre-credit reform receivables which had not been converted to present values.

- Accrual of appropriations as amounts receivable was sometimes allowed for costs incurred but not funded until after the period the costs were incurred, such as subsidy reestimates under the Credit Reform Act. Reestimates of subsidy cost for credit programs are made at or after the end of a period for which the reestimate applies and for which an expense is recognized, but the permanent indefinite authority is not available until the following period. When a financing accrual was not used for unfunded expenses, the unfunded expenses were removed from cumulative results of operations and reported separately in net position as future funding requirements.

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218. These changes eliminate reporting invested capital and future financing sources in equity. These two equity accounts did not provide accurate information because invested capital was never expected to be returned and future financing requirements did not cover all future financing needed but only that amount which had been recognized as expenses.

219. An appropriation may provide an agency with the authority to obligate and expend earmarked receipts to which it is legally entitled and its offsetting collections. Most of these inflows of resources are classified and accounted for as either exchange or nonexchange revenue in accord with the accounting standards previously discussed. However, the relationship is not exact between these revenues and related new budget authority. For example, some offsetting collections are neither a revenue nor a financing source. They only change the form of a resource already reported on the Balance Sheet (e.g., funds received from the sale of an asset at book value). Some offsetting collections are credited to receipt accounts instead of expenditure accounts and cannot be obligated without specific appropriation. Some of these revenues are precluded from obligation in a fiscal year by a provision of law, such as a benefit formula that determines obligations, or by a limit on the amount of obligations that can be incurred. Amounts precluded from obligation are not counted as budget authority in that year.

220. By recognizing nonbudgetary resources, e.g., imputed financing and transfers, the financial statements of the entity will show how its recorded costs were financed by the budgetary resources of other entities as well as its own.

(a) "Imputed financing" sources are reported to offset budgeted costs of another entity that applicable accounting standards impute to the reporting entity.[57] The imputing process recognizes these costs in the net cost of operations of the responsible entity. By reflecting "imputed financing" in the changes in net position, the net position of the responsible entity is not affected and there is no double

[57] Imputed financing sources may be reported to recognize imputed costs that have not yet been budgeted for other entities, such as for pensions and retirement health care.

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counting.

(b) "Transfers-in" and "Transfers-out" are necessary to show transfers of assets or revenue from one Government entity to another. In the case of assets, the transferor's budget reflected the original expenditure for the asset, but the budget normally does not reflect the subsequent transfer of the asset. The transfer changes the entity's financial position at the time of transfer but not its net cost of operations. Therefore, it is recognized in determining the net results of operations for the reporting period but not net cost.

221. In the case of earned revenue, the budget may require the earned revenue inflow related to the entity's costs to be paid to the General Fund or another entity. Reporting the transfer-out of such revenue as a reduction in net results of operations lets the responsible entity properly report its earnings in net cost of operations without increasing its net position.

222. Donations are not included as receipts in the budget, except for cash and near-cash items. However, some other kinds of donations are also recognized as revenue. Such revenues are permanent differences between the budget and the financial statements. Donation revenue will increase net results of operations under these standards. Under the standard, accounting for donations is consistent with current practice in the private sector where contributions are recognized as revenue.

223. Costs that are not yet covered by budgetary resources are "permanent" differences until Congress acts to finance them in the budget or until permanent budget authority becomes available. Under the new standards, financing yet to be provided for recorded costs will not be accrued. Accordingly, it will not increase cumulative results of operations.

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Implications of the term "Net Results of Operations"

224. Some of those who commented on the exposure draft expressed concern that some readers might infer that the amount of "net results of operations" reported on the new Statement of Changes in Net Position was a relevant performance measure. Some financial statement users might draw such an inference because, in the private sector, the term "net results of operations" is synonymous with net income and net income is the "bottom line" performance measure. Similarly, the statement of operations used by federal reporting entities prior to implementation of SFFAS No. 7 focused on a similar bottom line, net results of operations. This was the result of showing the flow of all operating activities on a single statement. For most governmental entities, however, no single bottom line can accurately measure performance, and "net results of operations" normally provides little information on either the costs or the benefits of an entity's operations.

225. The new reporting model, illustrated in Entity and Display, focuses on measuring costs and reporting on performance. Both gross and net cost are key financial performance measures that can be related to outputs and outcomes of the entity's programs and activities.

DEDICATED COLLECTIONS

226. The exposure draft proposed disclosure requirements for trust funds that were included within the reporting entity's financial statements in total and for material individual fund. The information was proposed to provide users a basis for understanding these funds and for holding the Government accountable for the use and disposition of earmarked collections. Based on comments received, this standard changes what was proposed

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as follows.

226.1. The proposed standard did not cover funds administered by a federal entity in a fiduciary relationship with beneficiaries that were not included in the entity's financial statement. In addition, it did not cover other funds which are of the same nature as many trust funds. The standard now requires disclosures for these funds also.

226.2. The requirement for a total for all funds was modified. If the fund is not material to the reporting entity, disclosure may be made in a special report to the contributors and beneficiaries (or their representatives) and only disclosure of the total of these funds is required.

227. **User needs.** Funds that account for dedicated collections are of great interest to users of federal financial statements. First and foremost are the contributors and beneficiaries to which the Government needs to be accountable for the receipt and disposition of earmarked collections and for the balances that remain available to pay beneficiaries in the future or serve other purposes determined by law. Other users are interested in the financing of other government operations with these fund balances.

228. External users of federal financial reports sometimes misunderstand the relationship of these funds, especially trust funds, to the Government. Very few Government trust funds are held "in trust" in a fiduciary relationship as is customarily the meaning of this term outside the Government. Also, some of the trust funds currently spend less than the receipts they collect each year. Most of the cash surplus that arises when receipts are greater than outlays is invested in Treasury securities until the amounts are needed for the trust fund to use in accordance with benefit formulas or other provisions of the law.

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229. The Treasury uses these additional receipts to meet the cash needs of general operations, thus reducing the need to borrow from the public, raise taxes, or reduce spending. In the consolidated financial statements of the Government, the investments in Treasury securities held by trust funds and other fund entities and the corresponding debt owed by the Treasury to these funds cancel out. They are eliminated from the amounts reported in the consolidated Balance Sheet but footnote disclosure of these amounts normally has been included.

230. **Funds covered by the standard.** As pointed out by respondents, trust funds are not the only type of fund that collects dedicated moneys. However, the exposure draft did not specifically delineate which funds might be included in the wider scope. The Board decided to limit these disclosures to funds where there was a need to show accountability to contributors and expected beneficiaries. Therefore, the funds that are covered by this standard are all trust funds, all special funds that are similar to trust funds, and all fiduciary funds whether or not in the budget.

231. The federal government does not use a consistent fund designation for these types of collections. Funds classified by law as trust funds are established by specific legislation to carry out activities stipulated by law and frequently are financed by taxes. While the Government's use of the term "trust funds" ordinarily differs from use of the term in the private sector, a few trust funds within the federal universe have the stringent fiduciary characteristics similar to those of trust funds in the private sector. Furthermore, some funds within the budget are classified as special funds and are similar in nature to non-fiduciary trust funds within the budget. Providing precise criteria for which non-trust funds are covered by this requirement is difficult. The Board realized that it will not always be easy for management to

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identify accountability expectations of contributors and beneficiaries.

232. On the other hand, no special accountability of a fund is needed for the sake of those who make voluntary payments in contemporaneous exchange for goods or services. Once goods and services have been rendered for the payment made, the purchaser generally does not expect the fund to provide additional accountability. For this reason the special reporting requirements do not apply to revolving funds or other funds financed similarly. However, special accountability may exist for a revolving fund that collects receipts for goods and services that are expected to be provided at a later period, such as long-term insurance contracts, and preparers are encouraged to provide the needed information in such cases.

233. **Funds not part of the reporting entity's financial statements.** In most cases, the requirement will apply to a fund that is included in the financial statements of the reporting entity. In the case of most fiduciaries, however, the fund is administered by a reporting entity but is not part of the reporting entity itself or included in its own general purpose financial statements. The disclosure requirement applies to such funds as well.

234. **Special reports.** Since the primary purpose of this requirement is accountability to the contributors and expected beneficiaries, all funds that meet the stated criteria are deemed material in this respect. Therefore, information needs to be provided regardless of whether it is material to the reporting entity. However, to minimize the amount of additional information required in financial statements, where the disclosures for dedicated collections are made to the contributors and beneficiaries in special reports and the information required is not material to the reporting entity, minimal disclosures are included in the reporting entity's general purpose financial statements or notes thereto. Special

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reports provided to representatives of contributors or beneficiaries may satisfy this requirement (for example, a report to an Indian tribal government).

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APPENDIX B: GUIDANCE FOR THE CLASSIFICATION OF TRANSACTIONS

INTRODUCTION

235. The Government of the United States has a great many types of transactions that finance its cost of operations, and they must be classified in various ways for revenue accounting in order to achieve the objectives of the standards in this Statement. The type of transaction may be an exchange transaction, a nonexchange transaction, or an other financing source; the transaction may be made between a Government reporting entity and the public or between two reporting entities within the Government (i.e., an intragovernmental transaction). If it is an exchange transaction, it will normally produce revenue but may produce gains and losses. This appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources, and the reasoning behind these standards as explained in the Introduction and the Basis for Conclusions.

236. To serve that purpose, this appendix provides guidance for classifying all major transactions that finance the Government's cost of operations and a significant number of lesser transactions. It is intended that these classifications--together with the explanation of these classifications, interpreted in the light of the Standards, the Basis for Conclusions, and the Introduction--will provide guidance for classifying all the financing transactions of the Government, including those that are not specifically listed. It should be understood that while some classifications are unequivocal, others are the result of balancing

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different considerations.

237. The transactions in this appendix are divided into several groups. Transactions recognized in the financial statements have a two-fold division: first, whether they are with the public or intragovernmental; and second, whether they are nonexchange transactions, exchange transactions that produce revenue, exchange transactions that produce gains or losses, or other financing sources. A separate group consists of gains and losses due to revaluation.

238. Exchange transactions are classified as producing gains or losses if they are likely to be unusual or nonrecurring. If the transactions classified in this appendix as gains or losses are usual and recurring for a particular reporting entity, that entity should classify them as producing exchange revenue or expense instead of gains or losses.

239. The final group of transactions in this appendix consists of transactions that produce amounts not recognized as revenues, gains, or other financing sources. Although in some instances there is overlap with other groups, they are presented together as a convenient reference to amounts not classified in any of the other categories. They include:

- A number of transactions in which there is no net inflow of resources (or the net inflow is less than the full amount of the transaction) because one asset is exchanged for another or there is an increase in both assets and liabilities.

- Certain transfers and donations that do not affect net cost or net position.

- A number of transactions involving direct loans and loan guarantees, which are recognized as expenses or reductions in

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expenses according to the standards in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees.*

- Deposit fund transactions.

240. As a guide to this appendix, the following table lists in order the transactions that are illustrated, group by group, and cites the page. Unless otherwise stated:

- Revenue from nonexchange transactions is included in determining the net operating results and hence the change in net position.

- Revenue from exchange transactions is subtracted from gross cost in determining the net cost of operations. (Gains and losses from exchange transactions also affect net cost.)

- Other financing sources are included in determining the net operating results and hence the change in net position.

241. In addition, the collection and disposition of most nonexchange revenue and a small part of exchange revenue is accounted for as a custodial activity of the collecting entity.

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TABLE OF TRANSACTIONS

TRANSACTIONS WITH THE PUBLIC 97

Nonexchange transactions with the public 97

Individual income taxes, corporation income taxes, social insurance taxes and contributions, excise taxes, estate and gift taxes, and customs duties (97)
Social insurance taxes and contributions paid by Federal employees (99)
Deposits by states for unemployment trust fund (99)
User fees, Harbor Maintenance trust fund (100)
Customs Service fees (101)
Deposits of earnings, Federal Reserve System (102)
Donations: except types of property, plant, and equipment that are expensed (103)
Fines and penalties (104)
Penalties due to delinquent taxes in connection with custodial activity (104)
Forfeitures (105)

Exchange transactions with the public: revenue 107

Sales of goods and services (107)
Sales of goods and services in undercover operations (107)
Interest (unless classified elsewhere), dividends, and rents (except for mineral rights) on Government property (108)
Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights. (108)
Proceeds from the auction of the radio spectrum (109)
Interest on post-1991 direct loans (110)
Interest on delinquent taxes and other receivables that arise as the result of custodial operations (111)
Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees (111)
Diversion fees, Department of Justice (112)
Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance (112)
Federal employee contributions to pension and other retirement benefit plans (112)
Federal employee contributions to health benefits plan for current coverage (113)
Reimbursement for collecting revenue (114)
Reimbursement for cleanup costs (115)

Exchange transactions with the public: gains and losses ..115

Sales of Government assets: other than property, plant, and equipment and forfeited and foreclosed property (115)
Sales of property, plant, and equipment (115)
Acquisition of property, plant, and equipment through exchange (116)
Sales of foreclosed property: associated with pre-1992 direct loans and loan guarantees (117)
Sales of receivables: except direct loans (117)
Sales of direct loans (117)

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

Retirement of debt securities prior to maturity (118)

Other financing sources from the public 118

Seigniorage (118)

INTRAGOVERNMENTAL TRANSACTIONS 119

Nonexchange transactions--intragovernmental: revenue 119

Interest on Treasury securities held by trust funds and special funds (except trust revolving funds) (119)
Interest received by one fund from another (120)
Employer entity contributions to social insurance programs (120)

Nonexchange transactions--intragovernmental: gains and losses 121

Retirement of debt securities prior to maturity: trust funds and special funds (except trust revolving funds) (121)
Cancellation of debt (122)

Exchange transactions--intragovernmental: revenue 122

Intragovernmental sales of goods and services by a revolving fund (122)
Intragovernmental sales of goods and services by a fund other than a revolving fund (122)
Employer entity contributions to pension and other retirement benefit plans for Federal employees (123)
Employer entity contributions to health benefit plans for current coverage of Federal employees (123)
Employer entity payments for unemployment benefits and workers compensation (124)
Interest on Treasury securities held by revolving funds (124)
Interest on Treasury securities held by trust revolving funds (125)
Interest on uninvested funds received by direct loan and guaranteed loan financing accounts (126)
Interest received by Treasury (126)

Exchange transactions--intragovernmental: gains and losses127

Retirement of debt securities prior to maturity: revolving funds and trust revolving funds (127)

Other financing sources--intragovernmental 128

Appropriations (128)
Cost subsidies: difference between internal sales price (reimbursement) and full cost (128)
Cost subsidies: difference between the service cost of pensions (and other retirement benefits), less the employee contributions, if any, and the employer entity contributions (129)

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

Contribution by the General Fund to the SMI trust fund (130)
Transfer by CCC to Federal Crop Insurance Corporation (131)
Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds (131)
Transfer of cash and other capitalized assets without reimbursement (132)
Transfer of property, plant, and equipment without reimbursement: types that are expensed (132)

REVALUATIONS 133

Revaluation of capitalized property, plant, and equipment (133)
Revaluation of inventory and related property (133)

TRANSACTIONS NOT RECOGNIZED AS REVENUES, GAINS, OR OTHER FINANCING SOURCES 134

Borrowing from the public (134)
Borrowing from Treasury, the Federal Financing Bank, or other Government accounts (134)
Disposition of revenue to other entities: custodial transfers (134)
Sales of different types of Government assets (135)
Acquisition of property, plant, and equipment through exchange (135)
Transfer of property, plant, and equipment without reimbursement: types that are expensed (136)
Donation of property, plant, and equipment: types that are expensed (137)
Negative subsidies on post-1991 direct loans and loan guarantees (137)
Downward subsidy reestimates for post-1991 direct loans and loan guarantees (137)
Fees on post-1991 direct loans and loan guarantees.-- (138)
Repayment of post-1991 direct loans (138)
Repayment of pre-1992 direct loans (139)
Repayment of receivables: except direct loans (139)
Sales of direct loans (139)
Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees (140)
Deposit fund transactions (140)

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

TRANSACTIONS WITH THE PUBLIC

Nonexchange transactions with the public

242. Individual income taxes, corporation income taxes, social insurance taxes and contributions,[1] excise taxes, estate and gift taxes, and customs duties.--Taxes (including customs duties) are levied through the exercise of the power of the Government to compel payment. In broad terms, taxes are "the price we pay for civilization." More specifically they finance spending of many types to promote the general welfare, provide for the common defense, and ensure domestic tranquillity: national defense, a judicial system, aid to the elderly, construction of infrastructure, education and training, and so forth. The relationship between the tax paid and the value received is too indirect and disproportionate to relate the revenue that is received from any identifiable taxpayer to the cost that is incurred for providing that identifiable taxpayer with benefits. This is especially the case where the benefits are of a collective or public nature, such as national defense, in which case consumption by one taxpayer does not reduce the consumption available for another; or where the benefits are designed to redistribute income from one group of people to another. Therefore, tax revenue is nonexchange revenue.

243. All excise taxes, like other taxes, are classified as resulting in nonexchange revenue. Some excise taxes (considered to be benefit taxes) are levied on bases that are related to the use of publicly provided goods and services or the public provision of other benefits, such as the gasoline tax; certain other excise taxes are levied on bases related to a cause of some damage and are dedicated to pay down costs, such as the tax on domestically mined coal, which is dedicated to the black lung disability

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trust fund. Even in these cases, however, the relationship between the tax and the benefit received by an identifiable recipient is relatively indirect and disproportionate. Moreover, these excise taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Therefore, like other taxes, they are classified as producing nonexchange revenue.

244. Board members have differing views on whether social insurance programs result in exchange or nonexchange transactions.[21].--Taxes (including customs duties) are levied through the exercise of the power of the Government to compel payment. In broad terms, taxes are "the price we pay for civilization." More specifically they finance spending of many types to promote the general welfare, provide for the common defense, and ensure domestic tranquillity: national defense, a judicial system, aid to the elderly, construction of infrastructure, education and training, and so forth. The relationship between the tax paid and the value received is too indirect and disproportionate to relate the revenue that is received from any identifiable taxpayer to the cost that is incurred for providing that identifiable taxpayer with benefits. This is especially the case where the benefits are of a collective or public nature, such as national defense, in which case consumption by one taxpayer does not reduce the consumption available for another; or where the benefits are designed to redistribute income from one group of people to another. Therefore, tax revenue is nonexchange revenue.

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This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_7.pdf.

Therefore, like other taxes, they are classified as producing nonexchange revenue.

244. Board members have differing views on whether social insurance programs result in exchange or nonexchange transactions.[58] However, they agree that social insurance tax revenue should be reported in the same way as other tax revenue for the purposes of financial reporting. This is because social insurance taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Furthermore, individuals and businesses subject to social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business, so especially for the major, broad-based social insurance programs--Social Security, Medicare (hospital insurance), and unemployment compensation--they have virtually no legal option except to pay.

245. Tax receipts are generally collected from the public by the IRS (Internal Revenue Service) and, to a lesser extent, by the Customs Service and other entities acting as agents for the recipient entities rather than on their own behalf. The collecting entity receives the cash and then transfers it to the General Fund, trust fund, or special fund on whose behalf it was collected. The amount so collected should be accounted for as a custodial activity by the collecting entity. The tax is recognized as a nonexchange revenue by the entity that is legally entitled to the amount. This would be a trust fund or special fund in the case of an earmarked (i.e., dedicated) tax. If collected on behalf of the Government as a whole, it would be recognized in the Government-wide consolidated financial statements.

[58] See discussion of social insurance programs in FASAB, Exposure Draft, *Supplementary Stewardship Reporting* (August 1995).

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246. Social insurance taxes and contributions paid by Federal employees.[22]--Federal employees may be covered by social insurance programs such as Social Security[59] and Medicare under the same terms and conditions as the remainder of the covered population. The payments made by Federal employees are in the nature of taxes, compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to employees of the United States government, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employee contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have obtained similar benefits. For these reasons, the employee contribution should have the same classification as contributions by non-Federal employees, which is nonexchange revenue.

247. Deposits by states for unemployment trust fund.--States deposit the receipts from the state unemployment tax to the U.S. Treasury for the unemployment trust fund in order to finance most of the benefits under the unemployment compensation system. The state unemployment tax differs from state to state in terms of the tax rate, tax base, and certain other characteristics, and unemployment benefits also differ from state to state. Nevertheless, the deposit has long been construed as a Federal budget receipt (a governmental receipt), and the unemployment trust fund has long been included as an account in the Federal budget.

[59] Most Federal civilian employees hired before 1984 are not covered by Social Security.

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248. This is for a combination of reasons taken together: (a) the unemployment compensation system--including the system of taxes, the system of benefits, and the trust fund--was established by the Social Security Act of 1935 and has been amended by Federal law many times; (b) deposits are held in a trust fund operated by the U.S. Government; (c) Federal law specifies extensive requirements for the state unemployment tax and unemployment benefits; (d) the Federal unemployment tax finances grants to states to cover their entire cost of administering the unemployment system; and (e) Federal law effectively coerces states to participate in the system, with participation requiring them to levy the state unemployment tax and deposit the collections in the U.S. Treasury. If a state does not participate (or is not certified by the Department of Labor as meeting Federal requirements): (i) the Federal unemployment tax is levied within the state at its maximum rate, (ii) the system does not pay any unemployment compensation benefits within the state, and (iii) the Federal Government provides no grants to state governments to pay for the costs of administration. The deposits of the state tax are therefore nonexchange revenue of the unemployment trust fund. (The Federal unemployment tax is levied and collected separately from the state unemployment tax.)

249. User fees, Harbor Maintenance trust fund. --This is an example of a tax that is termed a "user fee" by law while classified in the budget as a governmental receipt together with other taxes and duties. It is an ad valorem tax of 0.125 percent imposed on commercial cargo loaded and unloaded at specified U.S. ports open to public navigation. The receipt is earmarked to the Harbor Maintenance trust fund. It is similar in nature to other excise taxes that result from the Government’s power to compel payment and that are dedicated to a trust fund or special fund to be spent for a designated purpose (for example, the gasoline excise tax, which is dedicated to the Highway Trust Fund). It therefore should be recognized as nonexchange revenue by the Harbor Maintenance trust fund.

250. Customs Service fees.--The Customs Service collects revenue primarily from duties on imported merchandise but also from two types of fees: the merchandise processing fee and a group of fees called "user fees."

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251. The merchandise processing fee is primarily an ad valorem charge on formal merchandise entries into the United States (at 0.19 percent) subject to a maximum and minimum charge. It also includes flat fees on informally entered goods. The collections are earmarked by law to a special fund from which receipts are made available to finance Customs Service operations to the extent provided by current appropriations.

252. The merchandise processing fee is associated with the cost of the Customs Service's operations. The fee as originally enacted was modified by the Customs and Trade Act of 1990 to make it consistent with U.S. obligations under GATT (the General Agreement on Tariffs and Trade) after a GATT panel had ruled that the original fee (a straight ad valorem fee) exceeded the cost of services rendered and was a tax on imports that discriminated against imports in favor of domestic production. The maximum and minimum fees and the flat fees were enacted to meet the U.S. obligation.

253. However, the associated cost is primarily some of the costs of assessing and collecting duties on imported merchandise, such as the salaries of import specialists (who classify merchandise) and the costs of processing paperwork. The importer pays duties that are required by law; it does not receive anything of value from the Government in the nature of an exchange. Furthermore, these costs are not likely to depend significantly on the value of the merchandise, and the fee is levied through the power of the Government to compel payment. Therefore, for the purpose of a classification system for financial reporting, the fee is akin to dedicated taxes that are also related in the aggregate to associated costs and that are classified as nonexchange revenue (e.g., the excise tax on gasoline). The merchandise processing fee is therefore classified as a nonexchange revenue.

254. The user fees consist of a group of flat fees charged on passengers and conveyances entering the country.[23] The collections are dedicated by law to a special fund whose receipts are made available by permanent indefinite appropriation to finance Customs Service operations.

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255. These fees are intended to offset certain inspection costs that relate to the processing of passengers and conveyances entering the country. They are levied through the power of the Government to compel payment, and the person or entity that pays these fees does not receive anything of value from the Government in exchange. The inspection activities are for a variety of purposes: to ensure that dutiable merchandise is declared, to seize contraband (such as narcotics and illegal drugs), to detect infringements of patent and copyright laws, and so forth. Some of these purposes are related to the Government's powers to raise taxes, which are nonexchange revenue, and to enforce laws. Only to a limited extent are they like regulatory user fees, based on the Government's power to regulate particular businesses or activities. Therefore, like the merchandise processing fee, the user fees are classified as nonexchange revenue.

256. Deposits of earnings, Federal Reserve System.--The Federal Reserve System consists of the Board of Governors of the Federal Reserve System and twelve regional Federal Reserve Banks. Under Federal accounting concepts, it is not considered to be part of the Government-wide reporting entity. Therefore, payments made to or collections received from the Federal Reserve System would be reported in the financial statements of the Federal Government and its component reporting entities.[24] The Federal Reserve earns large amounts of interest on its portfolio of Treasury securities and deposits to the Treasury all net income after deducting dividends and the amount necessary to bring the surplus of the Federal Reserve Banks to the level of capital paid-in.

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257. The Federal Reserve was established by Act of Congress pursuant to the Government's sovereign power over the nation's money, and its investment in Treasury securities is necessary for carrying out its monetary function. It does not receive anything of value from the Government in exchange for its deposit of earnings, and on occasion it has been required by law to make extra payments. The revenue from the deposits is therefore nonexchange.

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258. Donations: except types of property, plant, and equipment that are expensed.-- Donations are contributions to the Government, i.e., voluntary gifts of resources to a Government entity by a non-Federal entity.[25] The Government does not give anything of value to the donor, and the donor receives only personal satisfaction. The donation of cash, other financial resources, or nonfinancial resources (except stewardship property, plant, and equipment) is therefore a nonexchange revenue.

259. The exception, stewardship PP&E, consists of Federal mission PP&E, heritage assets, and stewardship land. Such PP&E is expensed if purchased, but no amount is recognized if it is received as a donation.[60] Correspondingly, no revenue is recognized for such donations.

260. Fines and penalties.--Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. The person or other entity that pays a fine or penalty does not receive anything of value in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through the exercise of its power to compel payment. Fines and penalties are therefore a nonexchange revenue.

261. Fines from judicial proceedings are collected by the entity acting as an agent for the Government as a whole rather than on its own behalf. They are therefore accounted for as a custodial activity of the collecting entity and recognized as a nonexchange revenue in the Government-wide consolidated financial statements.

262. Fines and penalties produced by an entity's operations--such as inspections to ensure compliance with Federal law and with regulations that are the responsibility of the entity (e.g., inspections by the Office of Surface Mining) or compliance with regulations for the conduct of a Federal program--are recognized as nonexchange revenue by whichever entity is legally entitled by law to the revenue. In some cases, but not all, this would be the collecting entity. If the collecting

[60] SFFAS No.6, Accounting for Property, Plant, and Equipment, pp. 18 and 20.

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entity transfers the nonexchange revenue to the General Fund or another entity, the amount is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.

263. Penalties due to delinquent taxes in connection with custodial activity.--The person or other private entity that pays a penalty on delinquent taxes does not receive anything in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through its power to compel payment. Penalties on delinquent taxes are therefore a nonexchange revenue. The penalties are accounted for as a custodial activity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.

264. Forfeitures.--Property may be seized as a consequence of various laws and regulations and forfeited to the Government. Forfeited property may be acquired through forfeiture proceedings, be acquired to satisfy a tax liability, or consist of unclaimed and abandoned merchandise. Forfeited property is principally managed by the Asset Forfeiture Fund of the Justice Department and the Treasury Forfeiture Fund of the Treasury Department. Revenue is recognized from forfeited property unless the property is distributed to state or local law enforcement agencies or foreign governments or is received in satisfaction of a previously recognized revenue (e.g., accrued tax receivables).[26]

265. The timing of revenue recognition depends on how the property is forfeited and the nature of the property. In the case of unclaimed and abandoned merchandise, revenue is recognized in the amount of the sales proceeds at the time the property is sold. In the case of property acquired through forfeiture proceedings, the timing of recognition depends on the nature and

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disposition of the property. For monetary instruments, the revenue is recognized at the time of obtaining forfeiture judgment; for property that is sold, at the time of sale; and for property that is held for internal use or transferred to another Federal agency, at the time of obtaining approval to use the property internally or transfer it.[61]

266. The method of measuring revenue depends on the nature of the property. The amount of revenue recognized for monetary instruments is the market value when the forfeiture judgment is obtained. For property that is sold, it is the sales proceeds. For property that is held for internal use or transferred to another Federal agency, it is the fair value of the property less a valuation allowance for any liens or third party claims.

267. The revenue from forfeiture is nonexchange revenue, because the Government seizes the property through the exercise of its power. The Government does not sacrifice anything of value in exchange and the entity that forfeits the property does not receive anything of value. More than half of the forfeiture revenue of the two funds mentioned above is from currency and other monetary instruments. Although other types of forfeited property must be sold in order to recognize revenue, or constructively sold (if transferred to another Federal agency or placed into internal use), this is the last step in a process that is inherently nonexchange.

268. The disposition of the revenue from forfeiture is determined by law. Revenue or the

[61] SFFAS No. 3, 15-19. The standard also requires deferred revenue to be recognized when a forfeiture judgment is obtained, but the deferred revenue is reversed when revenue is recognized. The amount of revenue ordinarily differs from the amount of deferred revenue. In some cases, an adjustment subsequent to the original forfeiture judgment may be necessary when it is later determined that a portion of the forfeiture is to be distributed to state or local law enforcement agencies or foreign governments.

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property itself may ultimately be distributed to the seizing entity, state or local law enforcement agencies, foreign governments, or the general fund. Revenue is recognized as nonexchange revenue by the entity that is legally entitled to use the revenue or to use the property itself. If the property is distributed to a state or local law enforcement agency or a foreign government, revenue is not recognized by a Federal Government reporting entity. If the revenue is transferred to the General Fund, it is recognized as nonexchange revenue in the Government-wide consolidated financial statements.

269. Some entities may be involved in the management and liquidation of forfeited property but not themselves be entitled to the revenue or to the use of the property. For example, a central fund created to support the seizure activities of multiple entities may manage forfeited property and the collection and disposition of the revenue from that property. These entities should account for the property as a custodial activity. Revenue is shown when it is recognized, and it is shown as transferred to others when the cash is disbursed or the property is delivered. The disposition of property to an entity outside the Federal Government is also accounted for.

Exchange transactions with the public: revenue

270. Sales of goods and services.--The cost of production for goods and services such as electricity, mail delivery, and maps is defrayed in whole or in part by revenue from selling the goods or services provided. The sales may be made by a public enterprise revolving fund (such as the Bonneville Power Administration), an intragovernmental revolving fund (such as the Government Printing Office), or a fund that is not a revolving fund (such as the Geological Survey). Each party receives and

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sacrifices something of value. The sale is therefore an exchange transaction, and the revenue is exchange revenue for the entity making the sale.

271. Sales of goods and services in undercover operations.--The cost of the Government's undercover operations is defrayed in whole or in part from the proceeds of sales of goods that have been purchased (as opposed to goods that have been forfeited). Each party receives and sacrifices something of value. These characteristics of the transaction are not affected by whether the sale is illegal. The sale is therefore an exchange transactions, and the revenue is exchange revenue of the entity making the sale.

272. Interest (unless classified elsewhere), dividends, and rents (except for mineral rights) on Government property.--Each party receives and sacrifices something of value, so the inflow of resources is an exchange transaction.

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273. Interest is classified as exchange revenue notwithstanding the fact that the entity may not be charged a cost of capital for the assets that yield these inflows; or, if the entity borrowed from Treasury to acquire the assets, it may have been charged a below-market interest rate. The gross cost of the entity is understated in such cases; and to recognize an exchange revenue is to recognize a revenue without some or all of the related costs, and hence to understate the entity's net cost of operations. Nevertheless, in some cases the entity does pay the Treasury at least some interest; and the Government's cost of borrowing to acquire the assets is recognized as a cost of the Government as a whole. Since some cost is recognized, even if not always the full cost of the entity,[27] an exchange revenue is recognized for the entity that receives the inflow of interest.

274. Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights.--Rents, royalties, and bonuses are exchange revenues, because each party receives and sacrifices something of value. The amounts are earned by sales in the market and therefore are exchange revenue. They are collected by the Minerals Management Service (MMS) of the Department of the Interior, which manages the energy and minerals resources on the OCS and collects the amounts due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands.

275. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards natural resources are not recognized as an asset and depletion is not recognized as a cost. As a result, this exchange revenue bears little relationship to the recognized cost of MMS and cannot be matched against its gross cost of operations. Therefore, although the inflows are exchange revenue, they should not be subtracted from MMS's gross cost in determining its net cost of operations.

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276. MMS should instead account for the exchange revenue as a custodial activity. MMS collects rents, royalties, and bonuses acting as an agent on behalf of the recipients designated by law: the General Fund, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. The amounts of revenue should be recognized and measured under the exchange revenue standards when they are due pursuant to the contractual agreement.

277. The rents, royalties, and bonuses transferred to Treasury for the General Fund, or to other Government reporting entities, should be recognized by them as exchange revenue. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, this exchange revenue should not offset their gross cost in determining their net cost of operations. It should instead be a financing source in determining their operating results and change in net position.

278. Proceeds from the auction of the radio spectrum.--The proceeds from auctioning the right to use the radio spectrum are exchange revenues, because each party receives and sacrifices something of value. The amount of revenue is earned by sales in the market at auctions. It bears little relationship to the costs recognized by the Federal Communications Commission (FCC), which collects the revenue, or to the costs recognized by the U.S. Government as a whole. Therefore, it should not be offset against the costs of the FCC in determining its net cost of operations or against the costs of the Government as a whole in Government-wide consolidated financial statements.

279. The FCC should therefore account for this exchange revenue as a custodial activity,
acting as an agent on behalf of the General Fund; and it should be included as exchange revenue in the Government-wide consolidated financial statements.

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280. Interest on post-1991[1] direct loans.[28,62]--Interest on direct loans is an exchange transaction, because it is part of a broader exchange transaction in which the entity makes a loan to the borrower and the entity and borrower each receives and sacrifices something of value. Interest on direct loans that are budgeted according to the provisions of the Federal Credit Reform Act of 1990 consists of two components: the nominal interest (the stated interest rate times the nominal principal) and the amortized interest (change in present value of the loans receivable due to the passage of time). The combined effect of these components equals the effective interest, which is directly defined as the present value of the loans receivable times the Treasury interest rate applicable to the particular loans (i.e., the interest rate used to calculate the present value of the direct loans when the direct loans were disbursed). The effective interest causes an equal increase in the aggregate value of the assets on the balance sheet, and therefore the effective interest is the amount recognized as exchange revenue.[63]

[62]For interest on pre-1992 direct loans, see the preceding section on "interest (unless classified elsewhere) . . ."

[63]See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 11-12, paragraphs 30-31 and 37; for an illustrative case study, also see pp. 50-52 and 59-60.

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281. Interest on delinquent taxes and other receivables that arise as the result of custodial operations.--Receivables that arise as the result of custodial operations are custodial (or non-entity) assets, held by the IRS or another entity as an agent for the Government as a whole rather than on its own behalf (e.g., IRS tax receivables on which the delinquent taxpayer must pay interest). The interest is an exchange revenue, because each party receives and sacrifices something of value, but it is not related to the costs incurred by the collecting entity. The interest is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the interest is recognized as exchange revenue in the Government-wide consolidated financial statements because it is related to the government's cost of borrowing; if transferred to another entity, it is recognized as nonexchange revenue by the entity that receives the transfer.

282. Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees.--Regulatory user fees are charges based on the Government's power to regulate particular businesses or activities. The revenue is related to the cost in one of two ways. Special benefits may be provided to identifiable recipients who pay the fees, beyond the benefits, if any, that accrue to the general public (e.g., passport fees); or the Government may incur costs in order to regulate an identifiable entity for the benefit of the general public or some other group, in which case the user charge compensates the Government for its regulatory costs that were caused by the activity of the party that pays the charge (e.g., SEC and Nuclear Regulatory Commission fees). Because in general the revenue is closely related to the cost of operations, these fees are classified as exchange transactions and the revenue is an exchange revenue of the entity that charges the fee.

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283. Diversion fees, Department of Justice.--Registrants in the Diversion Control Program (e.g., physicians) pay fees to the Drug Enforcement Administration, in exchange for which the DEA provides the registrants with the authority to prescribe controlled substances. The diversion fees are intended to cover the costs of the Diversion Control Program. Because the revenue is related to the cost and the registrants both receive and sacrifice value, the payment of these fees is an exchange revenue of the Diversion Control Program.

284. Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance.--In exchange for a premium and other considerations, the Government promises to make payments to program participants if specified events occur. The premium offsets the cost of the program in whole or in part. The degree to which participation is voluntary differs from program to program. Because the revenue is related to the cost of the providing service, it is an exchange revenue of the insurance program.

285. Federal employee contributions to pension and other retirement benefit plans.[29]--Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary) and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government promises a pension to its employees after they retire. The Government also promises other retirement benefits, notably health benefits. In return, the employee provides services and, under some plans, makes a contribution to the retirement fund out of his or her salary. The financing of these benefits may include contributions paid by the employee to the retirement fund.

286. In broad terms, the employee contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More

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narrowly, it is a payment by the employee as part of an exchange of money and services for a future pension or other retirement benefit. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.[64]

287. Federal employee contributions to health benefits plan for current coverage.--Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of its employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of the employees.

288. In broad terms, the employee contribution out of his or her salary is an inflow of resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage by a health benefits plan. Therefore, it is an exchange revenue of the entity that administers the health benefits plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.

[64] For further discussion of the accounting standards for pensions and other retirement benefits of Federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, pp. 20-36 and 56-63. The standards do not cover accounting for the plan per se as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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289. Reimbursement for collecting revenue.--The Customs Service collects duties on goods imported by Puerto Rico and the Virgin Islands. The Customs Service retains an amount equal to the estimated cost of collecting these duties, including all costs of operations in Puerto Rico and the Virgin Islands and an allocation of overhead; it transfers the remainder to the Treasury, which, in turn, transfers the collections to Puerto Rico or the Virgin Islands.

290. The total amount of duties collected on these goods should be accounted for as a custodial activity by the Customs Service. Notwithstanding that duties are a nonexchange revenue, these particular duties are a nonexchange revenue of an entity other than the United States and therefore are not recognized as a nonexchange revenue of the U.S. Government.

291. The method of disposing of these collections combines two distinct transactions into one. The entire amount of the duties could be transferred to Puerto Rico and the Virgin Islands, and these governments could then pay the Customs Service to reimburse it for its services of collecting duties. The payment to Customs would be exchange revenue of the Customs Service. The actual procedure for reimbursement, whereby Customs retains an amount equal to the estimated cost, is simpler but equivalent in substance. Hence, the custodial transfer to Treasury (for Puerto Rico and the Virgin Islands) and the amount retained by Customs should be shown as separate components of the disposition of the revenue from customs duties. The amount retained by Customs to reimburse itself for its costs is exchange revenue of the Customs Service and is offset against its gross cost in calculating its net cost of operations.

292. Reimbursement for cleanup costs.--The Coast Guard or other Federal entities may incur costs to clean up environmental hazards caused by private parties and, in some cases, require these private parties to reimburse it for the costs incurred. Notwithstanding that the Government demands the revenue under its power to compel payment, the revenue arises from the action of the private parties and is closely related to the cost of operations incurred as a result of that action. Therefore, the revenue is an exchange revenue of the entity that incurs the cost.

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Exchange transactions with the public: gains and losses

293. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.

294. Sales of Government assets: other than property, plant, and equipment and forfeited and foreclosed property.--The sale of Government assets (other than property, plant, and equipment and forfeited and foreclosed property) is an exchange transaction, because each party receives and sacrifices something of value. If the sales price equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than the book value of the property, a gain or loss, respectively, is recognized to the extent of the difference. The amount of the difference between sales price and book value is ordinarily a gain or loss rather than a revenue or expense, because sales of property are ordinarily an unusual or nonrecurring inflow of resources.

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295. Sales of property, plant, and equipment.--The transaction is an exchange transaction, because each party receives and sacrifices something of value. If the sales price[30] equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than book value, a gain or loss, respectively, is recognized to the extent of the difference. The amount of the difference is ordinarily a gain or loss rather than a revenue or an expense, because sales of property, plant, and equipment are ordinarily an unusual or nonrecurring inflow of resources.

296. The entire sales price is a gain if the book value of the asset is zero. The book value is zero (a) if the asset is general property, plant, and equipment (PP&E) that is fully depreciated or written-off or (b) if the asset is stewardship PP&E, for which the entire cost is expensed when the asset is purchased.[65]

297. Acquisition of property, plant, and equipment through exchange.--The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).

[65] SFFAS No. 6, Accounting for Property, Plant, and Equipment, has divided property, plant, and equipment (PP&E) into two basic categories: general PP&E and stewardship PP&E (which consists of federal mission PP&E, heritage assets, and stewardship land). General PP&E is capitalized and recognized on the balance sheet; stewardship PP&E is expensed and thus has no book value. (Stewardship PP&E is presented in a stewardship statement.)

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298. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss.[31] It is a gain or loss rather than a revenue or expense, because ordinarily the amount would be an unusual or nonrecurring inflow of resources.

299. If the fair value of the PP&E acquired is less than the fair value of the PP&E surrendered, the PP&E acquired is recognized at its cost and subsequently reduced to its fair value. The difference between the cost of the PP&E acquired and its fair value is recognized as a loss.[66]

300. Sales of foreclosed property: associated with pre-1992 direct loans and loan guarantees.--Foreclosed property associated with pre-1992 direct loans and loan guarantees is recognized as an asset at net realizable value. The sale is an exchange transaction, and any difference between the sales proceeds and book value is recognized as a gain or loss.[32]

301. Sales of receivables: except direct loans.--The transaction is an exchange transaction, because each party receives and sacrifices something of value. Upon sale, any difference between the sales proceeds and book value is recognized as a gain or loss. If the sales price equals book value, there is no gain or loss, because the exchange of one asset for another of equal value is not a net inflow of resources.

302. Sales of direct loans.--The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990, regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.[33] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[67]

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[66] *Ibid.*, footnote 38.

[67] See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 17 and 66-69.

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303. Retirement of debt securities prior to maturity.--Debt securities may be retired prior to maturity if they have a call feature or if they are eligible for redemption by the holder on demand. Many Treasury bonds issued before 1985 are callable; savings bonds, the Government account series, the foreign series, and the state and local series of Treasury securities are redeemable on demand, although sometimes with a penalty or other adjustment or only after a specified period of time.

304. Each party receives and sacrifices something of value in buying and selling debt securities that may be retired prior to maturity. The sales price reflects such features. Therefore, the transaction is an exchange transaction. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt is recognized as a loss or gain.[34]

Other financing sources from the public

305. Seigniorage.--Seigniorage is the face value of newly minted coins less the cost of production (which includes the cost of the metal, manufacturing, and transportation). It results from the sovereign power of the Government to directly create money and, although not an inflow of resources from the public, does increase the Government's net position in the same manner as an inflow of resources. Because it is not demanded, earned, or donated, it is an other financing source rather than revenue. It should be recognized as an other financing source when coins are delivered to the Federal Reserve Banks in return for deposits.

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INTRAGOVERNMENTAL TRANSACTIONS

Nonexchange transactions-- intragovernmental: revenue

306. Interest on Treasury securities held by trust funds and special funds (except trust revolving funds).--Many trust funds and special funds hold Treasury securities on which they receive interest. In most cases the invested balances of these funds derive predominantly from the funds' earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes), and to a lesser extent from other financing sources received from other government entities (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs a cost.

307. Therefore, in such cases, the interest on Treasury securities should not be deducted from the gross costs of the trust fund (or special fund), or the organization in which it is administered, in determining its net cost of operations. As a result, that interest should not be classified as exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue. The interest received from invested balances of trust funds and special funds (except trust revolving funds) is therefore normally a nonexchange revenue.

308. The source of balances for some trust funds and special funds may not be predominantly nonexchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and

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Disability fund and the Military Retirement fund, consists of exchange revenue and other financing sources. In such exceptional cases, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances--in these cases, as exchange revenue--rather than according to the normal rule.

309. Interest received by one fund from another.--One fund within the Government may borrow from another. For example, in 1983 the Old-Age and Survivors Insurance trust fund borrowed from the Disability Insurance and Hospital Insurance trust funds. When that occurs, the lending fund sacrifices interest from Treasury securities on its invested balances and instead receives interest from the borrowing fund on the amount of the loan. Since the predominant source of balances to the lending fund is the same regardless of whether it invests in Treasury securities or lends to another fund, the interest received from the other fund should be classified in the same way--as nonexchange or exchange revenue--as the interest received on Treasury securities.

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310. Employer entity contributions to social insurance programs.[35] --Federal employees may be covered by social insurance programs such as Social Security[68] and Medicare under the same terms and conditions as the rest of the covered population. Intragovernmental contributions to social insurance programs such as Social Security and Medicare are nonexchange transactions, just as payments made by private employers to these programs are nonexchange transactions. Contributions by private employers are in the nature of taxes; i.e., compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to Federal employees, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employer entity contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have received similar benefits. For these reasons, the employer entity contribution should have the same classification as private employer contributions, which is nonexchange revenue.

Nonexchange transactions--intragovernmental: gains and losses

[68] Most Federal civilian employees hired before 1984 are not covered by Social Security.

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311. Retirement of debt securities prior to maturity: trust funds and special funds (except trust revolving funds).--Treasury securities held by trust funds and special funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other Treasury securities held by these funds may also be callable or redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For trust funds (except trust revolving funds) and special funds, as explained elsewhere, the interest is normally but not always a nonexchange revenue.

312. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the trust fund or special fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.

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313. Cancellation of debt.--The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity's operations and is not directly related to the entity's costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.

Exchange transactions--intragovernmental: revenue

314. Intragovernmental sales of goods and services by a revolving fund.--The cost of providing goods or services by a revolving fund is defrayed in whole or in part by selling the goods or services provided. Intragovernmental sales may be made by an organization that maintains either an intragovernmental revolving fund (such as the Defense Business Operations Fund) or a public enterprise revolving fund (such as the Postal Service). Each party receives and sacrifices something of value. The proceeds are an exchange revenue.

315. Intragovernmental sales of goods and services by a fund other than a revolving fund.--The cost of providing goods or services is defrayed in whole or in part by selling the goods or services provided. Each party receives and sacrifices something of value. The proceeds are an exchange revenue.

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316. Employer entity contributions to pension and other retirement benefit plans for Federal employees.--Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary); and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this transaction, the Government promises a pension and other retirement benefits (especially health benefits) to the employees after they retire. The financing of these benefits may include contributions paid by the employer entity to the retirement fund.

317. In broad terms, the employer entity contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More narrowly, it is a payment by the employer entity in exchange for the future provision of a pension or other retirement benefit to its employees. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.[36]

318. Employer entity contributions to health benefit plans for current coverage of Federal employees.--Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of the employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of its employees.

319. In broad terms, the employer entity contribution is an inflow of

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resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage of the employer entity's employees by a health benefits plan. Therefore, it is an exchange revenue of the entity that operates the health benefits plan and thus is an offset to that entity's gross cost in determining its net cost of operations.

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320. Employer entity payments for unemployment benefits and workers compensation.--The employer entity recognizes a liability and an expense for Federal employees who are laid-off or injured on the job and are entitled under law to unemployment benefits or workers compensation, respectively.[37] The payment to the former or current employee is made by the unemployment trust fund (Department of Labor) in the case of unemployment benefits and by the special benefits fund (Department of Labor) in the case of workers compensation. Unemployment benefits are reimbursed by the former employer entity; and workers compensation costs are mostly charged back to the employer entity.

321. Since the costs are recognized by the employer entity and its payment to the unemployment trust fund or the special benefits fund reimburses these funds for the costs they incur, the amounts these funds receive from the employer entity are exchange revenues.

322. Interest on Treasury securities held by revolving funds.--A revolving fund conducts a cycle of business-type operations in which the expenses are incurred to produce goods and services that generate revenue, and the revenue, in turn, finances expenses. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since their holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on the funds' securities is related to the funds' cost of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue earned from their sales of goods and services, for which the funds incurred costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net cost of operations. For this reason, interest earned by revolving funds should normally be classified as exchange revenue.

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323. The source of balances for some revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.

324. Interest on Treasury securities held by trust revolving funds.--A trust revolving fund is a revolving fund that is also classified by law as a trust fund. Like other revolving funds, it earns exchange revenue, which is an offset to its gross cost. For example, the revenue that the Employees Health Benefit fund earns from contributions by Federal employees, annuitants, employer entities, and the Office of Personnel Management (OPM) is an offset to the insurance premiums that it pays to private firms. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services. Furthermore, the source of the invested balances is predominantly revenue earned from the sales of services, for which they incurred costs of operations when the revenue was earned. The interest they receive should therefore be classified in the same way as the interest received by other revolving funds, which is exchange revenue.

325. The source of balances for some trust revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.

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326. Interest on uninvested funds received by direct loan and guaranteed loan financing accounts.--A guaranteed loan financing account holds uninvested balances as reserves against its loan guarantee liabilities and earns interest on these balances that adds to its resources to pay these liabilities. A direct loan financing account may hold uninvested balances to bridge transactions that are integral to its operations, such as when it borrows from Treasury to disburse direct loans prior to the time of disbursement; it earns interest on these balances to reflect the time value of money and thereby finance the interest it pays on its debt to Treasury. Thus, in both cases, the interest received by the financing account is earned through exchange transactions with Treasury and is an offset to the financing account's related costs of operations. The interest is therefore an exchange revenue of the financing account.

327. Interest received by Treasury.--Accounts or funds (including direct loan and guaranteed loan financing accounts) may be authorized to borrow from the Treasury or from the Federal Financing Bank (an entity within Treasury) or other sources. The interest that the entity pays on its borrowings is a cost to the entity and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the entity borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the entity is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.

Exchange transactions--intragovernmental: gains and losses

328. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.

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329. Retirement of debt securities prior to maturity: revolving funds and trust revolving funds.--Treasury securities held by revolving funds and trust revolving funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other Treasury securities held by these funds may also be callable or redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For revolving funds and trust revolving funds, as explained elsewhere, the interest is normally but not always an exchange revenue.

330. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the revolving fund or trust revolving fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.

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Other financing sources--intragovernmental

331. Appropriations.--Appropriations--a form of budget authority--permit an entity to incur obligations and make payments and thus are a means of financing the entity's cost. They are not otherwise related to the entity's cost and therefore are not an offset to its gross cost in determining its net cost of operations. They are not earned by the entity's activities, demanded by the entity, or donated to the entity. Therefore, appropriations provide an other financing source instead of a revenue.

332. More precisely, "appropriations used" is recognized as an other financing source in determining the entity’s operating results when the entity receives goods and services or provides benefits, grants, or other transfer payments. To avoid double counting, appropriations used are **not** recognized for the appropriation of earmarked revenues or other financing sources, which are already counted in determining the entity’s operating results. Appropriations that have been made available for apportionment but have not been used are recognized as “unexpended appropriations” in the entity’s capital.

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333. Cost subsidies: difference between internal sales price (reimbursement) and full cost.--One entity may receive goods or services from another entity without paying the full cost of the goods or services or without paying any cost at all. Other Federal accounting standards may require the receiving entity to recognize the full cost as an expense (or, if appropriate, as an asset). In these cases the difference between full cost and the internal sales price or reimbursement (sometimes called a "transfer price") is an imputed cost to the receiving entity.[38]

334. The financing of the imputed cost is also imputed to the receiving entity. Imputed financing is necessary so that the imputed cost does not reduce the entity's operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the receiving entity does not earn the amount imputed or demand its payment.

335. Cost subsidies: difference between the service cost of pensions (and other retirement benefits), less the employee contributions, if any, and the employer entity contributions.--The service cost of pensions (and other retirement benefits) to the employer entity, less the employee contributions, if any, is recognized as a cost to the employer entity. The difference between the employer entity's cost and its contributions, if any, is imputed to the employer entity as part of its recognized cost. For pensions, the cost recognized by the employer entity is more than its contribution for employees who are covered by the Civil Service Retirement System and several minor systems (in a few of which the employer entity does not make any contributions toward the service cost). For retirement health care benefits, neither the employees nor the employer entity make any contributions while the employee is working.[39] Therefore, the entire service cost is recognized as a cost to the employer entity and imputed to it.

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336. The financing of the imputed cost is also imputed to the employer entity.[69] The imputed financing is necessary so that the imputed cost does not reduce the employer entity's operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the employer entity does not earn the amount imputed or demand its payment.[70]

337. (This transaction differs from the immediately preceding transaction, in which an entity does not pay the full cost of the goods or services it receives from another entity. In the present case, the employer entity acquires the services of the employees itself, but another entity pays part of their cost.)

338. Contribution by the General Fund to the SMI trust fund.--The General Fund makes a contribution to the SMI (Supplementary Medical Insurance) trust fund. This appropriated payment is separate from the transfer of earmarked premiums and is not a transfer of earmarked taxes or other income. It does not arise from an exchange transaction, because SMI does not sacrifice any value to the General Fund in exchange for the payment, and the General Fund does not receive anything of value from SMI. Instead, the payment constitutes a General Fund subsidy of the SMI trust fund. Since the payment is not demanded or earned, it is an other financing source to SMI rather than a revenue.

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[69] The employer entity's own contribution, if any, is generally financed by an appropriation but could be financed by earned revenue or other sources.

[70] For further discussion of the accounting standards for pensions and other retirement benefits for federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, pp. 20-36 and 56-63. The standards do not cover accounting for the plan per se as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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339. Examples of other payments of a similar nature (and also classified as other financing sources) are the payment by the General Fund to the social security trust funds for military service credits and for certain uninsured persons at least 72 years old; and the payment by the General Fund to the Railroad Retirement Board for the vested dual benefit payments received by certain retirees under both the railroad retirement and the social security systems. The quinquennial military service credit adjustment paid between the General Fund and the social security trust funds is likewise an other financing source to the social security trust funds but one that may be either positive or negative.

340. Transfer by CCC to Federal Crop Insurance Corporation.--The Commodity Credit Corporation (CCC) makes transfers to the Federal Crop Insurance Corporation (FCIC), which it finances by an appropriation. This payment does not arise from an exchange transaction, because FCIC does not sacrifice anything of value to CCC, and CCC does not receive anything of value from FCIC. It differs from the contribution to SMI primarily in that it is paid by another program entity (the CCC) rather than directly by the General Fund. Since the payment is not demanded or earned, it is an other financing source to FCIC rather than a revenue.

341. Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds.--The Railroad Retirement Board pays benefits equivalent to the amounts that would have been paid if railroad workers had been covered under Social Security since its inception, plus additional amounts unique to that program. The railroad retirement program is partly financed by an annual financial interchange that takes place between the Railroad Social Security Equivalent Benefit Account (a trust fund) and the trust funds for old-age and survivors insurance, disability insurance, and hospital insurance (OASDHI). The interchange is designed to place each of the OASDHI trust funds in the same position as it would have been if railroad employment had been covered under Social Security since its inception.

342. The amount of the payment reflects the difference between (a) the benefits that the OASDHI trust funds would have paid to railroad workers and their families if railroad employment had been covered by

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OASDHI and (b) the payroll taxes that the OASDHI trust funds would have received if railroad employment had been covered by OASDHI. If benefits would have exceeded taxes, the OASDHI trust funds make a payment to the Railroad Social Security Equivalent Benefit Account; if benefits would have been less, the OASDHI trust funds receive a payment. Currently OASI and DI make payments to that Account, and HI receives payment. The interchange differs from the examples in the previous cases primarily in that (a) the payment is between two trust funds and (b) the payment may be made in either direction.

343. The financial interchange does not arise from an exchange transaction, because it is a reallocation of resources among funds, all of which are financed primarily from nonexchange revenue. Furthermore, the nature of this reallocation is such that the transferring entity does not receive anything of value and the recipient entity does not sacrifice anything of value. Therefore, the recipient entity recognizes the transfer-in as an other financing source, and the transferring entity recognizes the transfer-out as a negative financing source.

344. Transfer of cash and other capitalized assets without reimbursement.--Cash and other capitalized assets may be transferred without reimbursement from one Government entity to another. Cash may include exchange revenue that is recognized by the transferring entity in determining its net cost of operations but is required to be transferred to the General Fund or another entity; other capitalized assets may include general property, plant, and equipment. The receiving entity does not sacrifice anything of value, and the transferring entity does not acquire anything of value. Therefore, the transfer is not an exchange transaction. The receiving entity recognizes the transfer-in as an other financing source; the transferring entity recognizes the transfer-out as a negative financing source. The amount recorded by both entities is the transferring entity's book value of the asset.

345. Transfer of property, plant, and equipment without reimbursement: types that are expensed.--Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset

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was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.

346. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

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REVALUATIONS

347. Revaluation of capitalized property, plant, and equipment.--Capitalized property, plant, and equipment (PP&E) may be removed from the general PP&E accounts if it no longer provides service in the operations of the entity because it has suffered damage, become obsolete in advance of expectations, or is identified as excess. It is recorded as an asset at its expected net realizable value. Any difference between the book value and the expected net realizable value is recognized as a gain or loss in determining the net cost of operations, because the revaluation results from the entity's operations. The expected net realizable value is adjusted at the end of each period, and any further revaluation is also recognized as a gain or loss in determining the net cost of operations.[40]

348. Since the revaluation does not affect obligations incurred but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.

349. Revaluation of inventory and related property.--Inventory and related property may be revalued for such reasons as determination that the property is excess, obsolete, or unserviceable; that stockpile materials have decayed or been damaged; that a loss is estimated on commodity purchase agreements; or that a change has occurred in the net realizable value of commodities valued at the lower of cost or net realizable value. The amount of revaluation is recognized as a loss or a gain in determining the net cost of operations, because it results from the entity's operations. Assets are correspondingly reduced or increased.[41]

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350. Since the revaluation does not affect obligations incurred, but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.

TRANSACTIONS NOT RECOGNIZED AS REVENUES, GAINS, OR OTHER FINANCING SOURCES

351. Borrowing from the public.--Borrowing from the public is a means of financing the Government's outlays. However, it is not a net inflow of resources to the Treasury or other borrowing entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.

352. Borrowing from Treasury, the Federal Financing Bank, or other Government accounts.-- An entity may be provided the authority to borrow from Treasury, the Federal Financing Bank, or other Government accounts. Intragovernmental borrowing is a means of financing the entity's outlays. However, it is not a net inflow of resources to the entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.

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353. Disposition of revenue to other entities: custodial transfers.--Revenue, primarily nonexchange revenue, may be collected by an entity acting on behalf of the General Fund or another entity within the Government on whose behalf it was collected. The collecting entity accounts for the disposition of revenue as part of its custodial activity. These custodial transfers, by definition, do not affect the collecting entity's net cost of operations or operating results, nor are they part of the reconciliation between its obligations and net cost of operations. (The receiving entity recognizes the revenue as nonexchange or exchange revenue, depending on its nature, according to the applicable revenue standards.)

354. Sales of different types of Government assets.--The sale of Government assets (other than forfeited property) is an exchange transaction, because each party receives and sacrifices something of value. As a general rule, any difference between the sales proceeds and book value is recognized as a gain or loss when the asset is sold. The remainder of the transaction does not provide a net inflow of resources, so no gain, revenue, or other financing source is recognized. If the sales proceeds equal book value, there is no gain or loss, because the exchange of one asset for another of equal recorded value is not a net inflow of resources.

355. This general rule applies to property, plant, and equipment, receivables (other than direct loans), foreclosed property associated with pre-1992 direct loans and loan guarantees, and miscellaneous assets. It does not apply to inventory, nor does it apply to forfeited property (as explained in the previous section on nonexchange revenue). It also does not apply to the sale of direct loans and the sale of foreclosed property associated with post-1991 direct loans and loan guarantees. The latter transactions are discussed in subsequent paragraphs.

356. Acquisition of property, plant, and equipment through exchange.--The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither

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fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).[42]

357. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss. If the cost of the PP&E acquired equals the book value of the PP&E surrendered, there is no gain or loss (nor a revenue or other financing source), because the exchange of one asset for another of equal value does not provide a net inflow of resources. Therefore, the amount of the transaction equal to the book value of the PP&E surrendered is not recognized as a gain, a revenue, or an other financing source.

358. Transfer of property, plant, and equipment without reimbursement: types that are expensed.--Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.

359. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

360. If multi-use heritage assets are transferred and some cost was recognized for them on the books of the transferring entity, that cost is recognized as a transfer-out (a negative other financing source) of capitalized assets. No amount is recognized by the entity that receives the asset.[43]

361. Donation of property, plant, and equipment: types that are

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expensed.--The acquisition cost of stewardship property, plant, and equipment (PP&E) is recognized as a cost when incurred. Such PP&E consists of Federal mission PP&E, heritage assets, and stewardship land. When such PP&E is donated to the Government, however, no amount is recognized as a cost.[44] Since the donation of such PP&E does not affect the net cost or net position of the recipient entity, it is not a revenue, a gain, or an other financing source.

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362. Negative subsidies on post-1991 direct loans and loan guarantees.--A negative subsidy means that the direct loans or loan guarantees are estimated to make a profit, apart from administrative costs (which are excluded from the subsidy calculation by law). The amount of the subsidy cost is recognized as an expense when the direct loan or guaranteed loan is disbursed. A negative subsidy is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.[45]

363. Downward subsidy reestimates for post-1991 direct loans and loan guarantees.--A downward subsidy reestimate means that the subsidy cost of direct loans or loan guarantees is estimated to be less than had previously been estimated. The initial subsidy cost is recognized as an expense; a positive subsidy reestimate is recognized as an expense; and a downward subsidy reestimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.

364. Fees on post-1991 direct loans and loan guarantees.--The present value of estimated fees is included as an offset in calculating the subsidy cost of direct loans and loan guarantees, which is recognized as an expense when the loans are disbursed. The present value of estimated fees is likewise included as one component in calculating the value of loans receivable or loan guarantee liabilities. When cash is received in payment of fees, the loans receivable decrease by an equal amount (or the loan guarantee liabilities increase by an equal amount). The increase in one asset is offset by an equal decrease in another asset (or by an equal increase in liabilities). Therefore, fees are not recognized as a revenue, a gain, or an other financing source.[46]

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365. Repayment of post-1991 direct loans.--The present value of estimated loan repayments is included in the calculation of the subsidy cost of direct loans, and this subsidy cost is recognized as an expense when the loans are disbursed. The present value of estimated loan repayments is likewise included in the value of the loans receivable. When cash is received for the repayment of loans, the loans receivable decrease by an equal amount. The increase in one asset is offset by an equal decrease in another asset. Therefore, cash inflow from the repayment is not recognized as a revenue, a gain, or an other financing source.[47]

366. Repayment of pre-1992 direct loans.--When pre-1992 direct loans are repaid in whole or in part, the entity exchanges one asset (loans receivable) for another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.[48]

367. Repayment of receivables: except direct loans.--When receivables other than direct loans are paid or repaid in whole or in part, the entity exchanges one asset (loans receivable) for another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.[49]

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368. Sales of direct loans.--The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990 regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.[50] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[71] The amount of cash inflow equal to book value is not a net inflow of resources to the entity, because it is an exchange of one asset for another of equal recorded value. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.

369. Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees.--The net present value of the cash flow from the estimated sales of foreclosed property is included in calculating the subsidy cost of post-1991 direct loans and loan guarantees. This subsidy cost is recognized as an expense when the loans are disbursed. When property is foreclosed, the property is recognized as an asset at the net present value of its estimated net cash flows. When the foreclosed property is sold, any difference between the sales proceeds and the book value (i.e., the net present value as of the time of sale) requires a reestimate of the subsidy expense, which is recognized as a subsidy expense or a reduction in subsidy expense. The amount of cash flow equal to book value is an exchange of one asset for another of equal recorded value and therefore is not recognized as a gain, a revenue, or an other financing source.[51]

[71] SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 17 and 66-69.

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370. Deposit fund transactions.--Deposit funds are accounts outside the budget that record amounts that the Government (a) holds temporarily until ownership is determined or (b) holds as an agent for others. The standards and guidance in this Statement do not apply to deposit funds except insofar as a particular deposit fund may be classified as part of a Federal reporting entity or a disclosure may be required due to a fiduciary relationship on the part of a Federal reporting entity toward a deposit fund.

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APPENDIX C: GLOSSARY

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This glossary provides definitions for many terms used in this Statement. The definitions may be modified or superseded when relevant terms are considered or defined by the Board in future projects.

Abatement

A reduction or cancellation of an assessed tax. (Cooper W, Ijiri Y, Kohler's Dictionary for Accountants, 6th ed., Englewood Cliffs, NJ: Prentice-Hall, 1983)

Apportionment

A distribution made by OMB of amounts available for obligation in an appropriation or fund account into amounts available for specified time periods, programs, activities, projects, objects, or combinations thereof. The apportioned amount limits the obligations that may be incurred. (OMB Circular A-34)

Assessments

Enforceable claims for nonexchange revenue for which specific amounts due have been determined and the person from whom the tax or duty is due has been identified. They include both self- assessments made by persons filing tax returns and assessments made by the collecting entities as a result of audits, investigations, and litigation. Although the term is normally used in connection with taxes, as used in this Statement assessments also include determinations of amounts due for any other kind of nonexchange revenue. Specifically excluded from the definition of assessments, as used in this Statement, are compliance assessments. Compliance assessments, as defined by IRS and Customs, do not represent financial receivables.

Basic Financial Statements

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As used in this Statement, the basic financial statements are those on which an auditor would normally be engaged to express an opinion. The term "basic" does not necessarily mean that other financial information not covered by the auditor's opinion is less important to users than that contained in the basic statements; it merely connotes the expected nature of the auditor's review of, and association with, the information.

The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the "principal financial statements." The Form and Content of these statements are determined by OMB.

Budget Authority

The authority provided by Federal law to incur financial obligations that will result in immediate or future outlays. Specific forms of budget authority include:

- appropriations, which may be provided in appropriations acts or other laws and which permit obligations to be incurred and payments to be made;

- borrowing authority, which permits obligations to be incurred but requires funds to be borrowed to liquidate the obligation;

- contract authority, which permits obligations to be incurred but requires a subsequent appropriation or offsetting collections to liquidate the obligations; and

- spending authority from offsetting collections, which permits offsetting collections to be credited to an expenditure account and permits obligations and payments to be made using the offsetting collections (the offsetting collections credited to an account are deducted from gross budget authority of the account.)

Budget authority may be classified by period of availability (one year, multiple-year, or no year), by nature of the authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or as gross (without reduction of offsetting

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collections) and net (with reductions of offsetting collections). (OMB Circular A-11; OMB, The Budget System and Concepts, 1996; and GAO, A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, January 1993)

Budgetary Accounting

Budgetary accounting is the system that measures and controls the use of resources according to the purposes for which budget authority was enacted; and that records receipts and other collections by source. It tracks the use of each appropriation for specified purposes in separate budget accounts through the various stages of budget execution from appropriation to apportionment and allotment to obligation and eventual outlay. This system is used by the Congress and the Executive Branch to set priorities, to allocate resources among alternative uses, to finance these resources, and to assess the economic implications of federal financial activity at an aggregate level. Budgetary accounting is used to comply with the Constitutional requirement that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations Made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time." (See Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting, September 1993:15, 35-36, and 61-62.)

Cost

Defined in SFFAC No. 1, Objectives of Federal Financial Reporting as the monetary value of resources used (para. 195). Defined more specifically in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, as the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service (page 105). Depending on the nature of the transaction, cost may be charged to operations immediately, i.e., recognized as an expense of the period, or to an asset account for recognition as an expense of subsequent periods. In most contexts within Accounting for Revenue and Other Financing Sources, "cost" is used synonymously with expense. See also "Full Cost."

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Dedicated Collections (or Taxes)

See "earmarked taxes."

Directed Flows of Resources

Expenses to nonfederal entities imposed by federal laws or regulations without providing federal financing. In the case of state and local governments, directed flows are known as "unfunded mandates." The costs and financing of federal regulations do not flow through the Government, but their effects are similar to direct federal expenditures and revenue.

Drawbacks

Refunds of all or part of duties on imported goods that are subsequently exported or destroyed. Typically these arise when imported materials are used to manufacture a product that is later exported. In such cases, most of the duties originally paid are refundable when the finished product is exported.

Earmarked Taxes

Taxes levied by the Government that are dedicated by law to finance a specific federal program. (SFFAS No. 5, Accounting for Liabilities of the Federal Government, page 71.)

Exchange Revenue

Inflows of resources to a governmental entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return.

Expended Appropriations

The dollar amount of appropriations used to fund goods and services received or benefits or grants provided.

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Full Cost

The total amount of resources used to produce the output. More specifically, the full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities. (SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, p. 36) All direct and indirect costs to any part of the Federal Government of providing goods, resources, or services. (OMB Circular A-25).

General Fund

Accounts for receipts not earmarked by law for a specific purposes, the proceeds of general borrowing, and the expenditure of these moneys. (OMB, The Budget System and Concepts)

General Purpose Financial Reports

Reports intended to meet the common needs of diverse users who typically do not have the ability to specify the basis, form, and content of the reports they receive.

Governmental Receipts

Collections from the public that result primarily from the exercise of the Government's sovereign or governmental powers. Governmental receipts consist mostly of individual and corporation income taxes and social insurance taxes but also include excise taxes, compulsory user charges, customs duties, court fines, certain license fees, gifts and donations, and deposits of earnings by the Federal Reserve System. They are compared to outlays in calculating a surplus or deficit. (OMB, The Budget System and Concepts)

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Nonexchange Revenue

Inflows of resources to the Government that the Government demands or that it receives by donations. The inflows that it demands include taxes, duties, fines, and penalties.

Offsetting Collections

Collections from the public that result from business-type or market-oriented activities and collections from other Government accounts. These collections are deducted from gross disbursements in calculating outlays, rather than counted in governmental receipts. Some offsetting collections are credited directly to appropriation or fund accounts; others, called offsetting receipts, are credited to receipt accounts. The authority to spend offsetting collections is a form of budget authority. (OMB, The Budget System and Concepts)

Other Financing Sources

Inflows of resources that increase net position of a reporting entity but that are not revenues or gains. Borrowing is not included as other financing sources, since it does not increase the net resources of the reporting entities.

Proprietary Accounting

Also known as financial accounting, a process that supports accrual accounting and financial reporting that attempts to show actual financial position and results of operations by accounting for assets, liabilities, net position, revenues, and expenses. (See Tierney, Cornelius E., Handbook of Federal Accounting Practices, Reading Massachusetts: Addison-Wesley, 1982:122).

Revenue Adjustment

A contra revenue account that is used to report reduction in revenue when realization is not probable (less likely than not). It includes , returns, allowances, and price redeterminations but not credit losses (due to the inability of the debtor to pay the established or negotiated price).

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Revolving Fund

A fund consisting of permanent appropriation and expenditures of collections, from both the public and other Governmental agencies and accounts, that are earmarked to finance a continuing cycle of business-type operations. (OMB Circular A-34)

Special Fund

Federal fund accounts for receipts earmarked for specific purposes and the associated expenditure of those receipts. (OMB, The Budget System and Concepts)

Tax Expenditure

A revenue forgone attributable to a provision of the federal tax laws that allows a special exclusion, exemption, or deduction from gross income or provides a special credit, preferential tax rate, or deferral of tax liability. (see GAO, A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, February 1993)

Tax Gap

An estimate of taxes (including duties) that are unpaid because of non-compliance with existing laws and regulations.

Treasury Warrant

An official document that the Secretary of the Treasury issues pursuant to law and that establishes the amount of monies authorized to be withdrawn from the central accounts that Treasury maintains. Warrants for currently unavailable special and trust fund receipts are issued when requirements for their availability have been met. (GAO, A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, February 1993)

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Trust Funds

Accounts that are designated by law as trust funds, for receipts earmarked for specific purposes and the associated expenditure of those receipts (OMB, Budget System and Concepts).

Trust Revolving Funds

Accounts that record permanent appropriation and expenditure of collections used to carry out a cycle of business type operations in accordance with a statute that designates the fund as a trust fund. (OMB Circular A-34)

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INDEX OF TRANSACTIONS CLASSIFIED IN APPENDIX B

Acquisition of property, plant, and equipment (116)
Acquisition of property, plant, and equipment through exchange (135)
Appropriations (128)
Borrowing from the public (134)
Borrowing from Treasury, the Federal Financing Bank, or other Government accounts (134)
Cancellation of debt (122), (127)
Contribution by the general fund to the SMI trust fund (130)
Cost subsidies: difference between internal sales price (reimbursement) and full cost (128)
Cost Subsidies: difference between the service cost of pensions and employer entity contributions (129)
Customs Service fees (101)
Deposit fund transactions (140)
Deposits by states for unemployment trust fund (99)
Deposits of earnings, Federal Reserve System (102)
Disposition of revenue to other entities: custodial transfers (134)
Diversion fees, Department of Justice (112)
Donation of property, plant, and equipment: types that are expensed (137)
Donations: except types of property, plant, and equipment that are expensed (103)
Downward subsidy reestimates for direct loans and loan guarantees (137)
Employer entity contributions to health benefit plans for current coverage of Federal employees (123)
Employer entity contributions to retirement plans for Federal employees (123)
Employer entity contributions to social insurance programs (120)
Employer entity payments for unemployment benefits and workers compensation (124)
Federal employee contributions to health benefits plan for current coverage (113)
Federal employee contributions to retirement plans (112)
Fees on post-1991 direct loans and loan guarantees (138)
Fines and penalties (104)
Forfeitures (105)
Individual income taxes, corporation income taxes, social insurance taxes and contributions, excise taxes, estate and gift taxes,and customs duties (97)
Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds (131)
Interest (unless classified elsewhere) (108)
Interest on delinquent taxes and other receivables that arise as a result of custodial operations (111)
Interest on post-1991 direct loans (110)
Interest on Treasury securities held by revolving funds (124)
Interest on Treasury securities held by trust funds and special funds except trust revolving funds (119)
Interest on Treasury securities held by trust revolving funds

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(125)
Interest on uninvested funds held by direct loan and guaranteed loan financing accounts (126)
Interest received by one fund from another (120)
Interest received by Treasury (126)
Intragovernmental sales of goods and services by a fund other than a revolving fund (122)
Intragovernmental sales of goods and services by a revolving fund (122)

Negative subsidies on direct loans and loan guarantees under credit reform (137)
Penalties due to delinquent taxes in connection with custodial activity (104)
Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance (112)
Proceeds from the auction of the radio spectrum (109)
Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees (111)
Reimbursement for cleanup costs (115)
Reimbursement for collecting revenue (114)
Rents, royalties, and bonuses on Outer Continental Shelf (OCS) (108)
Repayment of post-1991 direct loans (138)
Repayment of pre-1992 direct loans (138)
Repayment of receivables: except direct loans (139)
Retirement of debt securities prior to maturity (118)
Retirement of debt securities prior to maturity: revolving funds and trust revolving funds (127)
Retirement of debt securities prior to maturity: trust funds and special funds except trust revolving funds (121)
Revaluation of capitalized property, plant, and equipment (133)
Revaluation of inventory and related property (133)
Sales of different types of Government assets (135)
Sales of direct loans (117), (139)
Sales of foreclosed property associated with post-1991 direct loans and loan guarantees (140)
Sales of foreclosed property associated with pre-1992 direct loans and loan guarantees (117)
Sales of goods and services (107)
Sales of goods and services in undercover operations (107)
Sales of government property: other than property, plant, and equipment (115)
Sales of property, plant, and equipment: types that are capitalized (115)
Sales of receivables: except direct loans (117)
Seigniorage (118)
Social insurance taxes and contributions paid by Federal employees (99)
Transfer by CCC to Federal Crop Insurance Corporation (131)
Transfer of cash and other capitalized assets without

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reimbursement (132)
Transfer of property, plant, and equipment (132), (136)
User fees, Harbor Maintenance trust fund (100)

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LIST OF ABBREVIATIONS

CFS--Consolidated Financial Statements
FASAB--Federal Accounting Standards Advisory Board
FASB--Financial Accounting Standards Board
GAO--General Accounting Office
GASB--Governmental Accounting Standards Board
GPRA--Government Performance and Results Act
IRS--Internal Revenue Service
MMS--Minerals Management Service
OCS--Outer Continental Shelf
OMB--Office of Management and Budget
PP&E--Property, Plant, and Equipment
RSI--Required Supplementary Information
SEC--Securities and Exchange Commission
SFFAC--Statement of Federal Financial Accounting Concepts
SFFAS--Statement of Federal Financial Accounting Standards
SGL--Standard General Ledger

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FASAB TASKFORCE ON REVENUE AND OTHER FINANCING SOURCES

Donald H. Chapin, Taskforce Chair--FASAB Member/GAO*
Peter BenEzra--Agriculture
Christine Bonham--GAO
Debra Carey--Interior
Christine Chang--Treasury
Robert Dacey--GAO*
Lowell Dworin--Treasury
Robert Hamilton--Customs Service
Gregory Holloway--GAO
Linda Hoogeveen--OMB
Martin Ives--FASAB Member/New York University
Robert Kilpatrick--OMB*
Allan Lund--Treasury
Thomas Luter--Treasury*
JoEllen McCormack--GAO*
Dennis Mitchell--Treasury
Richard Nieman--Energy Department
Marvin Phaup--CBO
Joel Platt--Treasury
Darlene Schongalla--Interior
Charles Sims--Interior
Deborah Taylor--GAO
Dana Thiebeau--Treasury
William Truitt--Justice
Ellen Waterhouse--IRS

*working group member

Individual members of the task force do not necessarily agree with all aspects of the Board's recommendations.

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The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board") in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The Board's sponsors, i.e., the officials who established the Board, then decide whether to adopt the recommendations. If they do, the standard is published by the OMB and the GAO and then becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board
Ronald S. Young, Executive Director
750 First Street, NE, Room 1001
Washington, DC 20002
Telephone (202) 512-7350
Fax (202) 512-7366

[1]As explained in para. 44 of SFFAS Number 1, Accounting for Selected Assets and Liabilities, "more likely than not" means more than a 50 percent chance. "Not probable" means the converse, i.e., less than a 50 percent chance.

[2]Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting.

standard is an exception to the general principle of SFFAS No. 5, Accounting for es of the Federal Government, which, but for this exception, would require a loss on a to be recognized at the time when expected costs exceeded expected revenue. However, the loss must be disclosed: see the disclosure requirement in paragraph 0 (d) below.

pricing guidance in OMB Circular No. A-25 does not apply to prices set by law or order.

[5]SFFAS No. 1, Accounting for Selected Assets and Liabilities, para. 41, states that "a receivable should be recognized . . . based on legal provisions, such as a payment due

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date (e.g., taxes not received by the date they are due) . . ." Under the revenue standard, past due taxes are not recognized on the date they are due, but rather on the date when tax returns are received without sufficient payment or legally enforceable claims against non-compliant taxpayers are established through enforcement processes.

[6] SFFAS No. 1, para. 44-51.

[7] For the recognition criteria for donated property, plant and equipment, see SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 30, 62, and 71.

accounting standards will determine the criteria for the imputation of costs and how sts shall be measured. This standard provides guidance for accounting for the ding financing source that is reported in such cases.

explained in the Basis for Conclusions, in the private sector, the term "net results of s" is synonymous with net income and net income is the "bottom line" measure of ce for profit-seeking businesses. For most Government reporting entities, on the other s is not the "bottom line" for performance measurement. See para. 0 and following.

e transfers are distinguished from custodial transfers in that transfers involve assets e been earned or in use by the entity in carrying out its programs whereas custodial involve funds that have been collected on behalf of another entity. Accounting for transfers is described in the section covering nonexchange revenue.

information on funds is reported separately and the basis of accounting is not in e with applicable accounting standards, the report should state that it is prepared on of legal requirements.

category includes representational organizations, retired federal employees, federal responding as individuals, and federal contractors, as well as academics and other

revolving funds that are self-financing do not recover full cost from their customers if not charged for all of their own costs, such as pension and retirement health benefits employees.

C No. 1, Objectives of Federal Financial Reporting, p. 39, paragraphs 126 and 128.

ods of calculating depletion based on the economic cost of extraction, such as ed here, should be distinguished from depletion methods allowed under the Internal ode.

ular No. A-25, *User Charges*, as revised July 8, 1993, establishes Federal policy fees assessed for government services and for the sale or use of government goods or . It implements the provisions of Title V of the Independent Offices Appropriations Act 31 U.S.C. 9701), which generally calls for "each service or thing of value provided by . . . to a person . . . to be self-sustaining to the extent possible" and says that hall be based on a number of specified criteria including "the costs to the Government." dance of Circular A-25 also applies to the assessment of user charges under other However, Circular A-25 is intended to be applied only to the extent permitted by law or order; it does not apply to the legislative and judicial branches or to mixed-ownership t corporations; and its requirements are deemed to be met by other OMB circulars that uidance concerning a specific user charge area.

if all taxpayers filed returns, the underlying event criteria for most taxpayers is come for the calendar year, whereas the government's fiscal year ends September 30. required estimated tax payments do not eliminate the problem of measuring taxes based rtificial" nine months period ending September 30 for calendar year taxpayers whose r the following three month "stub" period ending December 31 could be disproportionate.

uant to law, Customs establishes legal assessments for fines in amounts which frequently y exceed the value of the goods, then subsequently abates the fine to a fraction of that lso in accordance with applicable law. Full disclosure and explanation of practice d better understanding of the significance of assessments, abatements, and uncollectible

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eported by Customs in its disclosures required by para. 0.
details see Net Tax Gap and Remittance Gap Estimates (Supplement to Publication 7285), on 1415 (4-90), Internal Revenue Service; and Tax Gap: Many Actions Taken, But a Compliance Strategy Needed, GAO/GGD-94-123, May 1994.
nts appropriated to liquidate contract authority or repay debt are not available to incur ations and hence are not considered budget authority.
al insurance" does not include programs established solely or primarily for Federal , such as pension and other retirement plans. "Social insurance" taxes and contributions do, include payments made by or on behalf of Federal employees to social insurance plans, such Security and Medicare.
al insurance" does not include programs established solely or primarily for Federal , such as pension and other retirement plans.
e fees are sometimes called the "COBRA user fees." This term comes from the Consolidated udget Reconciliation Act of 1985, which established these fees.
C No. 2, Entity and Display, pp. 14-15.
term "donations" includes wills disposing of property and judicial proceedings other than es.
amends SFFAS No. 3, Accounting for Inventory and Related Property, with respect to es related to satisfying tax liabilities.
partial recognition of associated cost distinguishes interest from rents, royalties, and on the Outer Continental Shelf and the auction of the radio spectrum. For the latter ons, see the subsequent paragraphs.
-1991 direct loans consist of direct loans that were obligated after September 30, 1991, re-1992 direct loans consist of direct loans that were obligated before October 1, 1991. The unting that is used for post-1991 direct loans is also used for pre-1992 direct loans that fied and transferred to financing accounts; loans receivable arising from defaulted post- ranteed loans; and loans receivable arising from defaulted pre-1992 guaranteed loans that fied and transferred to financing accounts.
ral employee retirement plans do not include social insurance, such as Social Security and

ales price may include the fair value of items received in exchange.
SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, pp. 10-11.
FFAS No. 3, Accounting for Inventory and Related Property, pp. 20-23.
difference is due to the different interest rates used to discount future cash flows for ng the subsidy cost (and subsidy allowance) when the loan is made and for calculating the modification at a later time. If the sale is with recourse, the present value of the loss from the recourse is also recognized as an expense.
S No. 5, Accounting for Liabilities of the Federal Government, p. 17.
ial insurance" does not include programs established solely or primarily for Federal , such as pension and other retirement plans.
further discussion of the accounting standards for pensions and other retirement benefits al employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, pp. 20- 6-63. The standards do not cover accounting for the plan per se as distinct from the ring entity. Nor do they cover defined contribution plans, or administrative entities that ederal reporting entities.
SFFAS No. 6, Accounting for Liabilities of the Federal Government, p. 37 and p. 64, footnote

SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, .
red employees do pay premiums, however, and the service cost to the employer entity is et of the actuarial present value of those future premiums.

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S No. 6, *Accounting for Property, Plant, and Equipment*, pp. 12-13.
SFFAS No. 3, Accounting for Inventory and Related Property, pp. 6-7, 11, 13, 24, and 26.
FFAS No. 6, *Accounting for Property, Plant, and Equipment*, pp. 10-11.
No. 6, *Accounting for Property, Plant, and Equipment*, pp. 17-18, 20.

standards on direct loans and loan guarantees, see SFFAS No. 2, Accounting for Direct Loans Guarantees. The accounting for negative subsidy costs is symmetrical to the accounting for subsidy costs.
ee component of the subsidy cost is required to be disclosed separately.
he actual repayment is different from the previous estimate, the present value of the e between cash inflows and outflows over the term of the loan--calculated as of the date of ent--is reestimated and is recognized as a subsidy expense or a reduction in subsidy

he loan is not repaid, the unpaid amount is recognized as an adjustment to the bad debt and does not affect revenue, gains, or other financing sources.
he receivable is not repaid, the unpaid amount is recognized as an adjustment to the bad wance and does not affect revenue, gains, or other financing sources.
difference is due to the different interest rates used to discount future cash flows for ng the subsidy cost (and subsidy allowance) when the loan is disbursed and for calculating of modification at a later time. If the sale is with recourse, the present value of the loss from the recourse is also recognized as an expense.
SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 18 and 79-82; and SFFAS counting for Inventory and Related Property, pp. 20-23 and 37-38.

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This is the final approved Statement of Federal Financial Accounting Standards (SFFAS) 8, Supplementary Stewardship Reporting.

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FASAB -- Federal Accounting Standards Advisory Board
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Supplementary Stewardship Reporting, Statement of Federal Financial Accounting Standards 8

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[From Inside Front Cover]

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD (FASAB)

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard is published by OMB and GAO and then becomes effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

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-- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

-- "Mission Statement: Federal Accounting Standards Advisory Board"

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a The purpose of this Statement is to establish standards for reporting on the Federal Government's stewardship over 1) certain resources entrusted to it, identified as stewardship property, plant, and equipment and stewardship investments, and 2) certain responsibilities assumed by it, identified as the current service assessment. The resources and responsibilities do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but are, nonetheless, important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they should be recognized in the financial reports of the Federal Government and of its component entities. This determination was made to more fully satisfy the stewardship objective defined in the concepts statement, Objectives of Federal Financial Reporting.[FN1-Objectives of Federal Financial Reporting, SFFAC No. 1, September 1993.]

b The stewardship objective requires that the Federal Government "report on the broad outcomes of its actions." Such reporting will provide information that could help report users assess the impact of the Government's operations and activities for the period on its financial condition.[FN2-Ibid., pp. 41-42.]

c Stewardship resources involve substantial investment by the Federal Government for the benefit of the Nation. When made, they are treated as expenses in the financial statements. These expenses, however, are intended to provide long-term benefits to the public. Therefore, this Statement requires that information on these resources be reported to highlight their long-term-benefit nature and to demonstrate accountability over them. Depending on the nature of the resources, stewardship reporting could consist of financial and nonfinancial data.

d This Statement also establishes a standard for reporting

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projections that will aid in assessing the sufficiency of future budgetary resources to sustain public services and meet obligations as they come due.

e Given the above purpose, this Statement establishes standards for supplementary stewardship reporting that are on the basis of categories defined in the paragraphs that follow.

f Stewardship Property, Plant, and Equipment (PP&E) - property owned by the Federal Government and meeting the definition of one of the following three categories:

-- Heritage Assets - property, plant, and equipment of historical, natural, cultural, educational, or artistic significance.

-- Federal Mission PP&E - property, plant, and equipment integral to certain unique Federal missions.

-- Stewardship Land - land other than that acquired for or in connection with general PP&E.

g Stewardship Investments - items treated as expenses in calculating net cost but meriting special treatment to highlight their substantial investment and long-term-benefit nature. This includes:

-- Nonfederal Physical Property - grants provided for properties financed by the Federal Government, but owned by the state and local governments.

-- Costs incurred for education and training programs that are designed to increase or maintain national economic productive capacity and research efforts to provide future benefits or returns. These include:

- Human Capital - education and training programs financed by the Federal Government for the benefit of the public.

- Research and Development - basic and

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applied
research and development.

h Stewardship Responsibilities - the projected financial impact on the Government of sustaining current services that it provides. Projections of current services provided by the Government aid in assessing the sufficiency of future budgetary resources to sustain public services and meet obligations as they come due. This assessment, termed a Current Services Assessment, provides receipt and outlay data on the basis of projections of future activities.

j All stewardship information is deemed "required supplemental
stewardship information" (RSSI). Audit requirements for RSSI will be established in a collaborative effort by the Office of Management and Budget (OMB) and the General Accounting Office (GAO).

k The introduction and background chapter of this standard provides information on the approaches used to develop the standards for supplementary stewardship reporting. Appendices include a basis for the Board's conclusions, sample stewardship reports, and a glossary of terms used in the Statement. First-time use of glossary terms within the body of this document appear in boldface.

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Executive Summary - para. i

Chapter 1: Introduction and Background - para.1

Chapter 2: Standard - Heritage Assets - para. 43

Chapter 3: Standard - Federal Mission Property, Plant, and Equipment - para. 52

Chapter 4: Standard - Stewardship Land - para. 71

Chapter 5: Standard - Nonfederal Physical Property - para. 83

Chapter 6: Standard - Human Capital - para. 89

Chapter 7: Standard - Research and Development - para. 96

Chapter 8: Standard - Current Services Assessment - para. 102

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Appendix A: Basis for Conclusions - para. 109

Appendix B: Sample Stewardship Reporting - not included

Appendix C: Glossary - follows para. 135

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Purpose

1 The purpose of this Statement is to establish standards for reporting on the Federal Government's stewardship over certain resources entrusted to it, and certain responsibilities assumed by it. The resources and responsibilities relate to those which do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but that are important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Costs of these stewardship-type resources are treated as expenses in the financial statements in the year the costs are incurred. However, these costs and resultant resources are intended to provide long-term benefits to the public and are included in stewardship reporting to highlight for the reader their long-term-benefit nature and to demonstrate accountability over them.

2 Specific descriptions of these stewardship-type resources are addressed later in this chapter and in the individual standards (chapters 2-7) in this Statement. Generally, stewardship reporting on these resources includes:

-- Information on investment in physical capital other
than that used to support Federal operations to provide goods and services to the public, that is, investment in other than general property, plant, and equipment (PP&E)[FN3-Physical assets supporting Federal operations to provide goods and services to the public, referred to as general property, plant and equipment (PP&E), are addressed in Accounting for Property, Plant and Equipment, SFFAS No. 6.].

-- Information on investment in other than physical capital. Such information, as well as the information called for in the paragraph above, will be reported for stewardship purposes on an investment basis (that is, as benefitting more than the

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current reporting period) rather than a consumption basis (that is, as benefitting only the current reporting period). Such a presentation could help users analyze all Federal investment on an equal basis, and make decisions among competing investments, such as when allocating Federal resources or deciding whether to authorize new programs or modify ongoing programs.

-- Information that could assist in measuring the success of certain programs. The measurement of the benefits received for the dollars invested and the evaluation of program performance could appear with other stewardship information as part of the financial statements, or in other financial reports, for example, in a report on program performance.

3 This Statement also establishes standards for providing information on stewardship responsibilities (chapter 8) through projections for the Government as a whole. The projections will aid in assessing the Government's financial condition and the sufficiency of future budgetary resources to sustain public services and meet obligations as they come due.

4 Each standard is summarized briefly in a box followed by a detailed explanation of the standard. However, the standards comprise the summaries in the boxes and the entire text of the explanations.

Background and Rationale

5 The Concepts Statement, Objectives of Federal Financial Reporting was developed on the basis of an in-depth assessment of user needs and is used to guide the Board in developing Federal accounting and reporting standards. The objectives cover four areas: budgetary integrity, operating performance, stewardship, and systems and control.

6 This Statement of accounting standards addresses the objective of reporting on stewardship over certain resources entrusted to the Federal Government and responsibilities assumed by it. The need for a report on the Federal Government's stewardship over the resources entrusted to it and the responsibilities it has assumed, arises because of the unique nature of the Federal Government, as described in the following section.

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Stewardship and the Reporting Objectives

7 "Financial position" is a representation of an entity's economic resources and the claims on those resources as of a particular date. In the private sector, the principal objective of reporting on financial position is to assess the viability of the entity, the business firm, and its potential profitability.

8 Assessing the overall performance of the Federal Government is not exclusively a matter of comparing revenue and expense, or its accumulated assets and liabilities.

9 The Federal Government's viability and perpetuity are assumed. It has unique access to financial resources and financing, and the power to tax, to borrow, and to create money. For the Federal Government, financial performance is a vital issue, but traditional financial measures provide data that are appropriate for assessing only some, not all, of the responsibilities for which the Government should be held accountable. Since it exists not to make a profit but to serve the needs of the citizens and to promote the general welfare of the Nation, other measures of accountability need to be used. Measures of accountability are to be reported for elements that are defined as stewardship property, plant, and equipment (PP&E); stewardship investments; and stewardship responsibilities. These elements of stewardship exist because the Federal Government is dissimilar to industrial and commercial entities.

Financial Condition

10 The measures of accountability mentioned above help to portray the Government's "financial condition." Financial condition is a broader and more forward-looking concept than is financial position. Financial condition allows an assessment of an entity on the basis of additional data that could include financial and nonfinancial information about current conditions. These additional data provide a more complete indication of performance. In some cases, it may be necessary to present and characterize financial data in ways that differ from traditional financial reporting and to supplement traditional data with nonfinancial data. In other cases, it may be necessary to rely almost entirely on nonfinancial data to provide a more complete

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presentation of entity performance. Moreover, assessment of financial condition could include analysis of trends, demands, commitments, events, and uncertainties.[FN4-Chapter 7 of the Objectives of Federal Financial Reporting provides a full discussion of financial position and financial condition.]

Stewardship PP&E

11 "Stewardship PP&E" consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differ from general PP&E in that their values may be indeterminable or may have little meaning (for example, museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (for example, military weapons systems and space exploration hardware) to accounting periods that benefit from the ownership of such assets is meaningless. However, the Federal Government should be able to demonstrate accountability for stewardship PP&E by reporting on its existence and on its condition by a reference to deferred maintenance reported in the financial statements. Stewardship PP&E would include stewardship land (that is, land not acquired for or in connection with general property, plant, and equipment); heritage assets (for example, Federal monuments and memorials and historically or culturally significant property); and Federal mission property, plant, and equipment (for example, space exploration and military weapons systems).

Stewardship
Investments

12 "Stewardship investments" are substantial investments made by the Federal Government for the benefit of the nation. When incurred, they are treated as expenses in determining the net costs of operations. However, these items merit special treatment so that readers of Government financial reports know the extent of these investments that are made for long-term benefit. Such investments will be measured in terms of expenses incurred for certain education and training programs; federally financed research and development; and federally financed but not federally owned property, such as bridges and roads.

13 Because the Government has been entrusted with and made accountable for these resources, they should be reported in the financial reports of the Government and of its component

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entities. This will help satisfy the stewardship objective defined in the concepts statement, Objectives of Federal Financial Reporting, SFFAC No. 1. The goal of the stewardship objective is that the Federal Government "report on the broad outcomes of its actions." Such reporting may provide information that could help report users assess the impact of the Government's operations and investments for the period.[FN5-See SFFAC No. 1, pp. 41-42.]

Stewardship Responsibilities

14 A key aspect of the stewardship objective requires that Federal reporting provide information that helps users determine (1) whether the Government's financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.[FN6-Ibid., pp. 42-44.]

15 Information on "stewardship responsibilities" will aid in these determinations. It will provide an essential perspective on the Government's commitment to discretionary and mandatory programs.

16 Reporting on this stewardship responsibility may be accomplished in a stewardship section in the consolidated financial report of the Federal Government.

Stewardship Categories or Elements

17 In defining the specific categories of items, or elements, that would appear as stewardship information, the Board decided on the following:

-- Property owned by the Federal Government and meeting the definition of one of the following three categories:

- Property, plant, and equipment of historical, natural, cultural, educational or artistic significance, referred to as heritage assets, for example, the Washington Monument and the Lincoln Memorial;

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- Property, plant, and equipment that are integral to meeting a unique Federal mission, referred to as Federal mission[FN7-The term "Federal mission" refers to activities that are typically Federal, such as National defense. In addition, Federal mission PP&E is limited to PP&E that would not typically be used by non-federal entities. Clearly, any functions performed by a Federal entity could be broadly labeled "Federal mission." The definition of this category, however, clarifies the characteristics of PP&E appropriately included in this category--a much narrower group than inferred by the category's title.] property, plant, and equipment (PP&E), and

- Investments in stewardship land,[FN8-The Board is including only surface land as supplementary stewardship information because the issues associated with other than surface land, i.e., the natural resources on and under that land, are complex. The Board is researching these complex issues and will publish a separate exposure draft on a proposed accounting standard for natural resources at a later date.] that is, land not acquired for or in connection with general property, plant, and equipment, for example, national forests, parks, and historic sites. Some investments in stewardship land, for example national parks, will be reported by both 1) the number of acres used as a park or an historic site in the stewardship land category, and 2) by the number of physical units identified as national parks in the heritage assets category. Such reporting would not be considered duplication, as the type of information reported on an item would be different for each category of stewardship asset.

-- Properties financed by the Federal Government but owned by state and local governments, referred to as nonfederal physical property, for example, highways and bridges.

-- Expenses that are incurred for education and training that are intended to increase national economic productive capacity or for research and development that are intended to provide future benefits or returns. This includes:

- Investments in human capital, that is, education and training programs provided by the Federal Government, for example, job training programs, and grants for higher education.

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- Investments in research and development, for example, research on the effects of early medical intervention in delaying the onset of AIDs symptoms in HIV-positive individuals, and Federal investment in genetic code research to advance national medical research.

-- Information on the projected financial impact on the Government of providing current services, assuming a continuation of current programs. This information will be in the form of a current services assessment providing future receipt and outlay data on the basis of projections of future activities for the Government as a whole and will include both discretionary and mandatory programs and interest on debt.

18 The previous categories of items or elements result from or exist largely because of the Federal Government's role as a sovereign power. The components that they include are defined and discussed in detail in their respective chapters of this standard.

The Nature of Stewardship Reporting

19 The Board, recognizing the Federal Government's size, complexity, diversity, and impact on others, has determined that the aforementioned information is needed in addition to that included in financial statements.

20 Such information may not link directly with the basic financial statements because the data to be reported may be other than financial, for example, physical units or projections. It will supplement the basic financial statements.

21 This information, as indicated in each of the standards, will be designated as required supplementary stewardship information (RSSI) for the consolidated financial statements of the Federal Government and of the entities who have stewardship responsibilities over resources identified earlier in this document. The Board has chosen to call this RSSI to distinguish it from "required supplementary information" (RSI), for which audit responsibilities are prescribed in existing professional literature. The Board believes that OMB and GAO should establish and cause the implementation of the audit responsibilities for

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RSSI.

Stewardship Information

22 Stewardship information may be presented in varying formats depending on the nature of the Federal investments or claims to Federal resources controlled by an entity. Such information is required for those entities (1) that control stewardship resources and (2) whose financial statements purport to be in accordance with Federal accounting principles as recommended by FASAB, and approved by the Secretary of the Treasury, the Director of OMB and the Comptroller General.

23 Examples of selected portions of stewardship report sections
are included at Appendix B.

Measurement

24 The separate standards for each stewardship element contain specific guidance for that element. In general, however, stewardship investments shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and a share of the cost of facilities (for example, depreciation).[FN9-See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, for a discussion of Federal cost accounting principles and standards.]

25 For investments that are intended to maintain or increase the economic productive capacity of the Nation, that is, investments in human capital, research and development, and nonfederal physical property, trend data shall be presented. Trend data should reflect the full cost (including allocation of facility and administrative costs) of the investment.

26 For stewardship land and heritage assets, measurement will be done on other than a financial basis. For example, measurement may be on the basis of physical units, such as acres of land. Specific data requirements are addressed in the individual stewardship standards.

27 Generally, amounts shall be reported in nominal dollars. If trend data that span many years are reported and the entity

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believes that constant dollar information would be meaningful for data interpretation, constant dollar data may be provided in addition to nominal dollar data.

28 Split Grants. Frequently, stewardship elements are financed by grants. In some cases, the grants may have more than one purpose.[FN10-An example of a grant with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.] For such grants, the investment shall be allocated among stewardship elements on the basis of an estimate of the proportionate funding of the various grant objectives. If allocation is not feasible, the investment shall be reported on the basis of the predominant use of the grant.

29 Performance Indicators. For some stewardship elements, categorization of these elements as investments is predicated on producing outputs and outcomes. The specific procedures, including a phasing-in process for requiring such justification, is contained in the individual respective standards.

30 Reporting Program Expenses. Trend data reported on stewardship investment elements should reflect the full cost[FN11-See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, for a discussion of Federal cost accounting principles and standards.] of the investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would better indicate the investment nature of an item.

31 In some cases, before the issuance of Federal accounting standards, entities have maintained records on the basis of outlays rather than expenses. It may be impracticable for such entities to reconstruct their accounts on the basis of expense. In such cases, entities may report data on an outlay basis for any years for which expense data are not available. At the end of 5 years, entities should have sufficient expense data to be able to report expenses rather than outlays.

32 Reporting Deferred Maintenance. Many state and local governments, members of Congressional oversight committees, and national groups, have raised the issue of the deteriorating condition of federally-owned PP&E because of deferred maintenance associated with these assets. The issue was addressed in association with PP&E. As a result, a deferred maintenance standard in Accounting for Property, Plant, and Equipment, SFFAS No. 6, establishes reporting requirements related to the

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condition and future maintenance requirements for PP&E.

33 These requirements are flexible since different conditions may be considered acceptable by different entities, as well as for different items of PP&E held by the same entity. The deferred maintenance standard is applicable to all PP&E whether the PP&E is reported as general PP&E or stewardship PP&E.

Reporting Requirements

34 Within each of the standards, minimum required and, in some cases, recommended reporting is described. These requirements and recommendations, including a phasing-in process for entities who may not have required data available at the implementation of the standards, are contained in the individual standards. These requirements describe the nature of items to be reported by Federal entities; guidance on the form and content of agency financial reports, including the specific guidance on the format in which items addressed in this Statement will be reported, will be prescribed by OMB.

35 Reporting should be at the major program or category level; individual transactions need not be reported unless significant. Additional reporting is encouraged when preparers believe such information would make the financial report more meaningful or understandable.

Social Insurance

36 The Board first considered accounting and reporting for social insurance programs while considering SFFAS No. 5, Accounting for Liabilities of the Federal Government. The Board concluded, at that time, that the topic should be made part of the Supplementary Stewardship Reporting project.

37 Research and deliberations regarding social insurance have continued as part of the Supplementary Stewardship Reporting project. However, the Board, recognizing the magnitude and complexity of these programs, the strength of the views on the accounting and reporting issues, the significant attention being focused on these programs at the present time, and the potential for change to the programs, has again concluded that additional consideration is appropriate before issuing final guidance. Accordingly, the Board has not included guidance on social

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insurance in this Statement and has added a Social Insurance Accounting project to its agenda.

Applicability

38 This standard requires that the consolidated financial reports[FN12-The terms "financial statements" and "consolidated financial statements" are used throughout this document to refer to the basic financial statements of a reporting entity; the basic financial statements normally include: the balance sheet, the statements of net cost, changes in financial position, financing, budgetary resources, and custodial activities and the notes to the financial statements. The terms "financial reports" and "consolidated financial reports" are used to refer to a document which would include the financial statements but which would also include items such as: a management discussion and analysis section, a statement of program performance measures, required supplemental information or required supplementary stewardship information not included in the financial statements or other supplemental financial and management information.] of the Federal Government and the financial reports12 of its component units contain RSSI relating to:

-- amounts invested in human capital, research and development, and nonfederal physical property; and

-- quantities (stated in terms of physical units or dollars) of land, heritage assets, and Federal mission property.

Although FASAB's sponsors do not set accounting standards for the legislative or judicial branches, Federal accounting standards would be appropriate for them.

39 Because the financial reports of the Federal Government present the aggregation of information about stewardship investments and assets related to varied agencies and programs, further deliberations by the Board are needed to reach a decision on the amount and nature of information to be required under this standard for reporting in the consolidated financial report. Accordingly, except for the standard described in Chapter 8, "Current Service Assessment," the effective date of the stewardship standards as they apply to the consolidated financial report, is deferred pending that decision. The effective date of the standard in Chapter 8 is for fiscal periods beginning after

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September 30, 1997. In the interim, the consolidated financial reports should include such summary or selected information as is feasible. Experimentation is encouraged, as is the reporting of such additional information as will enhance the financial report.

40 Some Federal entities, including those government corporations listed in the Government Corporation Control Act and certain others, such as the US Postal Service, are required by law or policy to publish financial statements pursuant to the standards issued by the Financial Accounting Standards Board (FASB). (Some entities also may be required to prepare statements pursuant to standards set by a regulatory agency. That practice would not be affected by this statement of standards.) For such entities, this standard provides the following general principles:

-- Applying Applicable Accounting Principles - Separately issued (stand-alone) general-purpose financial statements on such entities should apply applicable accounting principles that will best meet user needs and comply with any relevant statutory requirements. This principle would continue to be true for separately issued statements even if, pursuant to the provisions below, other information about these entities might need to be presented when their financial statements are included within reports of a larger Federal entity.

-- Reporting Additional or Supplementary Information - When financial information on such entities is included in general-purpose financial reports of a larger Federal reporting entity (including Treasury's consolidated financial report), any applicable standards recommended by the FASAB and issued by OMB and the General Accounting Office (GAO) that call for additional reporting or supplementary information should be applied.

-- Applying Applicable Standards When Differences Arise - When financial information on such entities is included in general purpose financial reports of a larger Federal reporting entity (including Treasury's consolidated financial report), standards recommended by FASAB and issued by OMB and GAO should be used if the difference arising from differences between Federal accounting standards and FASB's would be material to users of the report of the larger entity.

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Materiality

41 The provision of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

42 The accounting standards in this statement, except for the standards described in Chapters 2-7 to the extent that they relate to the consolidated financial report of the Federal Government, are effective for fiscal periods beginning after September 30, 1997. Earlier implementation is encouraged. See paragraph 39 for the effective date of standards in Chapters 2-7 relating to the consolidated financial report.

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CHAPTER 2: STANDARD - HERITAGE ASSETS

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Heritage Assets - Heritage assets shall be reported as required supplementary stewardship information accompanying the financial statements of the Federal Government and the component units of the Federal Government responsible for such assets. Heritage assets shall be reported in terms of physical units rather than cost, fair value, or other monetary values.

Definition

43 "Heritage assets" are PP&E that are unique for one or more of the following reasons:

-- historical or natural significance;

-- cultural, educational or artistic (for example, aesthetic) importance; or

-- significant architectural characteristics.

44 Heritage assets are generally expected to be preserved indefinitely. One example of evidence that a particular asset is heritage in nature is that it is listed on the National Register of Historic Places.

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45 Some investments in heritage assets, for example national parks, will be reported by both 1) the number of physical units identified as national parks in the heritage assets category, and by 2) the number of acres used as a park or an historic site in the stewardship land category (see Chapter 4 of this document). Such reporting would not be considered duplication, as the type of information reported on an item would be different for each category of stewardship asset.

Measurement

46 Heritage assets shall be quantified in terms of physical units (for example, number of items in collections or the number of national parks). No asset amount shall be shown on the balance sheet of the Federal financial statements for heritage assets.

47 The costs of acquiring, constructing, improving, reconstructing, or renovating heritage assets shall be considered an expense in the period incurred when determining the net cost of operations.[FN13-For guidance in measuring and reporting the cost of heritage assets transferred from other federal entities, and heritage assets acquired through donation or devise, see the general PP&E standard contained in Accounting for Property, Plant, and Equipment SFFAS No. 6.] The cost shall include all costs incurred to bring the heritage asset to its current condition and location.

Multi-use Heritage Assets

48 Not all heritage assets are used solely for heritage purposes--some serve two purposes by providing reminders of our heritage and by being used in day-to-day government operations unrelated to the assets themselves. The cost of renovating, improving, or reconstructing operating components of heritage assets used in Government operations shall be included in general PP&E. The renovation, improvement, or reconstruction costs to facilitate Government operations (for example, installation of communication wiring or redesign of office space) would be capitalized and depreciated over its expected useful life. The cost should not be depreciated over an unrealistically long life.

49 Costs of renovating or reconstructing the heritage asset that cannot be associated directly with operations shall be considered heritage asset costs and included as expense in

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calculating net costs.

Minimum
Reporting

50 The determination of the most relevant information to be presented should be made by the preparer; however, reporting at the entity level shall be more specific than at the governmentwide level. The following are examples of information that should be considered for presentation:

-- Description of each major category of heritage asset.

-- The number of physical units added and withdrawn from the heritage asset records during the year and the end-of-year number of physical units for each type of heritage asset. Heritage assets consist of (1) collection-type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections; and (2) noncollection-type heritage assets, such as, parks, memorials, monuments, and buildings.

-- Description of the methods of acquisition and withdrawal of heritage assets.

-- Condition[FN14-Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.] of the assets unless it is already reported in a note to the financial statements in which case a reference to the note will suffice.

-- A reference to a note to the financial statements if deferred maintenance is reported for the assets.FN15-For guidance relating to deferred maintenance reporting, see the Deferred Maintenance standard in Accounting for Property, Plant, and Equipment SFFAS No. 6.]

Implementation
Guidance

51 For guidance on heritage assets that were previously recognized as assets for balance sheet reporting, see Statement

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of Federal Financial Accounting Standards (SFFAS) No. 6, Accounting for Property, Plant and Equipment, page 18, paragraphs 63, 64, and 65.

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CHAPTER 3: STANDARD - FEDERAL MISSION PROPERTY, PLANT, AND EQUIPMENT

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Federal Mission Property, Plant, and Equipment - Federal mission property, plant, and equipment (PP&E) shall be reported as required supplementary stewardship information accompanying the financial statements of the Federal Government and the component units of the Federal Government responsible for such PP&E. Federal mission PP&E shall be valued and reported using either the total cost or the latest acquisition cost valuation method.

Definition

52 Federal mission PP&E includes items used to meet a Federal Government mission in which the specific PP&E used is an integral part of the output of the mission.[FN16-The name "Federal mission PP&E" may cause readers to erroneously assume that this category should include any PP&E supporting a Federal mission. Federal mission PP&E is limited to those items specifically identified herein as well as any other items exhibiting at least one characteristic from each of the two groups listed.] PP&E should be considered Federal mission PP&E if it possesses at least one of each of the two types of characteristics presented below. One type of characteristic relates to the use of Federal mission PP&E, and the other relates to its useful life.

53 Characteristics related to the use of the Federal mission PP&E are that it

-- has no expected nongovernmental alternative uses; or

-- is held for use in the event of emergency, war or natural disaster; or

-- is specifically designed for use in a program for which there is no other program or entity (Federal or nonfederal) using similar PP&E with which to compare costs.

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54 Characteristics related to the useful life are that it

-- has an indeterminate or an unpredictable useful life[FN17-This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.] because of the unusual manner in which it is used, improved, retired, modified or maintained, or

-- is at a very high risk of being destroyed during use or
of premature obsolescence.

55 Federal mission PP&E excludes land whether the land is general PP&E land or stewardship land.

56 Federal mission PP&E, however, specifically includes (1) weapons systems PP&E (for example, fighter or attack aircraft, submarines, and tracked combat vehicles) and (2) space exploration equipment (for example, space hardware and launch, tracking, and recovery facilities). Weapons systems and space exploration equipment are defined in the following paragraphs.

57 Weapons Systems. Weapons systems are a combination of one or more weapons[FN18-Weapons are instruments of combat used to destroy, injure, defeat or threaten an enemy. (adapted from Dictionary of Weapons and Military Terms)] with all related equipment, materials, services, personnel, and means of delivery and deployment required for self-sufficiency.[FN19-Joint Chiefs of Staff, Department of Defense Dictionary of Military and Associated Terms, Joint Publication 1-02, March 23, 1994.] This standard addresses only the PP&E component of weapons systems. PP&E included in weapons systems are distinguished from general property, plant, and equipment held by defense agencies and defense support agencies in that they are intended to be used directly by the armed forces to carry out combat missions, when necessary, and to train in peacetime.

58 Weapons systems include only those assets owned by defense agencies and defense support agencies that would otherwise meet the property, plant, and equipment definition. Items meeting other than the PP&E asset category definitions are excluded from Federal mission PP&E, such as items of inventory or operating materials and supplies.

59 Space Exploration Equipment. Space exploration equipment

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includes

-- items that are intended to operate above the atmosphere for space exploration purposes, and

-- any specially designed equipment to aid, service, or operate other equipment engaged in exploring space.

Measurement

60 Federal mission PP&E shall be valued using either the total cost or the latest acquisition cost valuation method.

61 There is a presumption that the valuation method previously used by the entity was appropriate for the circumstances and, therefore, should be applied on a consistent basis. Accordingly, the preparer shall justify any changes in the use of a valuation method.

62 For purposes of this standard, the "total cost method" is defined to include the actual acquisition cost of each item held plus the costs of any additions, improvements, alterations, rehabilitations, or replacements that extend the useful life of the Federal mission PP&E.

63 Under the latest acquisition cost method, all like units that are held are valued at the invoice price of the most recent like item purchased, less any discounts, plus additional costs described in the following paragraphs.

64 Using either cost valuation method, the cost assigned to an item of PP&E shall include all costs incurred to bring the Federal mission PP&E to a form and location suitable for its intended use. For example, the cost of acquiring Federal mission PP&E may include

-- amounts paid to vendors;

-- transportation charges to the point of initial use;

-- handling and storage costs;

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-- labor and other direct or indirect production costs (for assets produced or constructed);

-- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;

-- acquisition and preparation costs of buildings and other facilities;

-- an appropriate share of the cost of the equipment and the facilities used in construction work;

-- fixed equipment and related installation costs required for activities in a building or a facility;

-- direct costs of inspection, supervision, and administration of construction contracts and construction work;

-- legal and recording fees and damage claims;

-- fair value of facilities and equipment donated to the government; and

-- material amounts of interest costs paid.[FN20-"Interest costs" include any reimbursable interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of Federal mission PP&E. It excludes any interest costs paid by a reporting entity in financing its own debt.]

65 No asset amount shall be shown on the balance sheet for Federal mission PP&E.

66 The acquisition cost of Federal mission PP&E shall be considered an expense in determining the net costs of operations in the period acquired. The cost of constructing, improving, reconstructing, or renovating Federal mission PP&E also shall be considered an expense in determining net costs in the period incurred.

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67 For acquisitions of Federal mission PP&E where costs are incurred over a number of years, the portion of the cost incurred during the reporting period shall be considered an expense in the period incurred in determining the net cost of operations and the total cost to date considered an acquisition-in-process cost in the required supplementary stewardship information.

Minimum Reporting

68 Federal Mission PP&E shall be reported as required supplementary stewardship information. Reporting at the entity level for Federal mission PP&E shall be more specific than at the governmentwide level. At a minimum, the following information shall be reported:

-- A description of major types of Federal mission PP&E by the holding entity and the values assigned under the valuation method used.

-- The value of Federal mission PP&E added and withdrawn during the year, the increase or the decrease in value resulting from revaluations of assets held to latest acquisition cost, and the end-of-year value for each major type of property using the entity's valuation method.

-- A description of the methods of acquisition and withdrawal of Federal mission PP&E. This should be reported at the major program or category level; individual transactions, unless significant, need not be reported.

-- Condition[FN21-Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.] of the assets unless it is already reported in a note to the financial statements in which case a reference to the note will suffice.

-- A reference to the applicable note to the financial statements if deferred maintenance is reported for the assets.

Implementation Guidance

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69 For guidance on Federal mission PP&E previously recognized as assets for balance sheet reporting, see SFFAS No. 6, Accounting for Property, Plant, and Equipment, page 16, paragraphs 55 and 56.

70 For guidance on deferred maintenance reporting, see SFFAS No. 6, Accounting for Property, Plant, and Equipment, page 23, paragraphs 77 through 84.

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CHAPTER 4: STANDARD - STEWARDSHIP LAND

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Stewardship Land - Land not acquired for or in connection with[FN22-"Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.] items of general PP&E, that is, stewardship land, shall be reported as required supplementary stewardship information accompanying the financial statements of the Federal Government and the separate reports of component units of the Federal Government responsible for such land. Stewardship land shall be reported in terms of physical units rather than cost, fair value, or other monetary values.

Definition

71 "Land" is defined as the solid part of the surface of the earth. Excluded from the definition are the natural resources (that is, depletable resources, such as mineral deposits and petroleum; renewable resources, such as timber; and the outer-continental shelf resources) related to land.

72 Although the Federal Government holds vast amounts of "proven" and "inferred" natural resources, the major reasons for addressing only surface land in this project were (1) the allotted time frame within which to complete this standard; (2) existing studies that point out the difficulties and the complexities of accurately estimating and valuing natural resources; and (3) disputes regarding the boundaries of the outer-continental shelf.[FN23-The Board presently has an active project to address standards for natural resources.]

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73 Land and land rights[FN24-"Land rights" are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land.] owned by the Federal Government and acquired for or in connection with items of general PP&E shall be accounted for and reported as general PP&E.

74 Land and land rights owned by the Federal Government and not acquired for or in connection with items of general PP&E will be reported as stewardship land. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.

Measurement

75 Stewardship land shall be quantified in terms of physical units (for example, acres) rather than in monetary terms.

76 No asset amount shall be shown on the balance sheet of the Federal financial statements for stewardship land.

77 The acquisition cost of stewardship land shall be considered an expense in the period acquired when determining the net cost of operations.

78 In some cases, land may be acquired along with existing structures. The following treatments may apply:

-- if the structure, which would be deemed a heritage asset, is significant in and of itself, the entity shall use its judgement as to whether the acquisition cost shall be treated as the cost of stewardship land, heritage asset, or both;

-- if the structure is to be used in operations (for example, as general PP&E) but 1) the value of the structure is insignificant, or 2) its acquisition is merely a byproduct of the acquisition of the land, the cost in its entirety shall be treated as an acquisition of stewardship land; or

-- only significant structures that have an operating use (such as, a recently constructed hotel or employee housing block)

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shall be treated as general PP&E by identifying the cost attributable to general PP&E and segregating it from the cost of the stewardship land acquired.

79 However, no amounts for stewardship land acquired through donation or devise[FN25-A will or clause of a will disposing of property.] shall be recognized as a cost in calculating net cost. The fair value of the property, if known and material, shall be disclosed in notes to the financial statements. If fair value is not estimable, information related to the type and quantity of assets received shall be disclosed in the year received.

80 Any costs to prepare stewardship land for its intended use (for example, razing a building) shall be expensed as a part of the cost of stewardship land.

Minimum Reporting

81 Reporting at the entity level for stewardship land shall be more specific than at the governmentwide level. Minimum reporting shall include the following:

-- The number of physical units of stewardship land by category of major use, broken down within that category by principal holding agency.

-- Where parcels of stewardship land have more than one use, the predominant use of the land shall be considered the major use. Examples of major uses of stewardship land include forests and wildlife, grazing, parks, recreation, and historic sites. In cases where land has multiple uses, none of which is predominant, a description of the multiple uses shall be presented.

-- Acquisitions, withdrawals, and ending balance should be shown by major categories of use, and methods of acquisition and withdrawal identified. Reporting should be at the major category level; individual transactions, unless significant, need not be reported.

-- The condition[FN26-Examples of condition information

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include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.] of the stewardship land, unless it is already reported in a note to the financial statement, in which case a reference to the note will suffice.

-- A reference to the note to the financial statements if deferred maintenance is reported for the assets.[FN27-For guidance on deferred maintenance reporting, see the Deferred Maintenance standard Accounting for Property, Plant, and Equipment, SFFAS No. 6.]

Implementation Guidance

82 For guidance relating to stewardship land that was previously recognized as assets for balance sheet reporting, see SFFAS No. 6, Accounting for Property, Plant and Equipment, page 21, paragraphs 75, and 76.

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CHAPTER 5: STANDARD - NONFEDERAL PHYSICAL PROPERTY

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Nonfederal Physical Property - Expenses included in calculating net cost for nonfederal physical property programs shall be reported as investments in required supplementary stewardship information accompanying the financial statements of the Federal Government and the separate reports of component units of the Federal Government responsible for such investments. Reporting will include data, in nominal dollars, on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the nature of the investment.

Definition

83 "Investment in nonfederal physical property" refers to those expenses incurred by the Federal Government for the purchase, the construction, or the major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements; the purchase of major equipment; and the purchase or improvement of other physical assets. Grants

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for maintenance and operations are not considered investments.

Measurement

84 "Expenses incurred" - The financial investment shall be measured on the same basis of accounting as used for financial statement purposes, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.[FN28-See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.] Amounts shall be reported in nominal dollars.

85 Cash grants related to nonfederal physical property programs
are recognized and reported as expenses in arriving at the net cost of operations.

86 Expenses incurred for program costs, contracts, or grants with split purposes[FN29-An example of an investment with a split purpose is a grant issued to a state to construct segments of the National Highway System and to conduct highway research.] shall be reported on the basis of an allocation of the expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expense or transfer.

Minimum
Reporting

87 Minimum reporting shall include the following:

-- Annual investment[FN30-As defined in this standard,
"annual investment" includes more than the annual expenditure reported by character class for budget execution. "Annual investment" is the full cost of the investment. Full cost shall be measured and accounted for in accordance with Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4.] shall be reported, including a description of Federally-owned physical property transferred to state and local governments. This information will be provided for the year ended on the balance sheet date as well as for each of the 4 years preceding that year. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no

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historical data, only current reporting year data need be reported.

-- Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major investments at the entity level shall be more specific than at the governmentwide level.

-- In some cases, the information called for above is not available because entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report only expense data for the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be categorized as investments for nonfederal physical property rather than the outlays for each of the preceding 5 years.

-- Reporting shall include a description of major programs involving Federal investments in nonfederal physical property including a description of programs or policies under which non-cash assets are transferred to state and local governments.

Recommended Reporting

88 Reporting of the amount of significant state and local total contributions to shared or joint programs is encouraged but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the total program) shall be reported even if the exact amount of the contribution is not known.

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CHAPTER 6: STANDARD - HUMAN CAPITAL

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Human Capital - Expenses included in calculating net cost for education and training programs that are intended to increase or

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maintain national economic productive capacity shall be reported as investments in human capital as required supplementary stewardship information accompanying the financial statements of the Federal Government and its component units. Continued categorization of expenses as investments for stewardship purposes is predicated on demonstrated outputs and outcomes consistent with the intent of the program. Reporting will ordinarily include data in nominal dollars on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the investment.

Definition

89 "Investment in human capital" refers to those expenses incurred for programs for education and training of the public that are intended to maintain or increase national productive capacity and that produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity.

90 The definition excludes education and training expenses for Federal civilian and military personnel. It also excludes education and training expenses whose purpose is not maintaining or enhancing national productive capacity.

Measurement

91 "Expenses incurred" - The investment shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.[FN31-See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.] Amounts shall be reported in nominal dollars.

92 Expenses incurred for programs, contracts, or grants with split purposes[FN32-An example of an investment with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.] shall be reported on the basis of an allocation of the investment expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expenses incurred.

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93 By no later than the third year after the effective date of this standard, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported. If outcome data are not available (for example, the agency has not agreed on outcome measures for the program, the agency is unable to collect reliable outcome data or the outcomes will not occur for several years), output data that best provide indications of the intended program outcomes shall be used to justify continued treatment of expenses as investments until outcome data are available. Definitions and characteristics of outputs and outcomes are provided in the paragraphs that follow.[FN33-The human capital outputs and outcomes should be the same as those measured for the Government Performance and Results Act (GPRA) and the budget and could be reported in a Statement of Program Performance Measures as described in Appendix 1-F to the concepts statement entitled, Entity and Display, SFFAC No. 2.]

-- "Output" - A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. Outputs shall have two key characteristics: (1) they shall be systematically or periodically captured through an accounting or management information system, and (2) there shall be a logical connection between the reported measures and the program's purpose. Examples of human capital output are high school and college graduates as a percentage of population over 25.

-- "Outcome" - An assessment of the results of a program compared to its intended purpose. Outcomes shall: (1) be capable of being described in financial, economic, or quantitative terms and (2) provide a plausible basis for concluding that the program has had or will have its intended effect. Examples of human capital outcomes are program graduates obtaining jobs within 2 months of program completion or program graduates obtaining jobs making more money than they previously received on Federal aid.

Minimum Reporting

94 Minimum reporting shall consist of:

The annual investment[FN34-As defined in this

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standard,
"annual investment" includes more than the annual expenditure reported by character class for budget execution. "Annual investment" is the full cost of the investment. Full cost shall be measured and accounted for in accordance with Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4.] made in the year ended on the balance sheet date as well as in each of the 4 years preceding that year shall be reported. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported. Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major efforts at the entity level shall be more specific than at the governmentwide level.

-- In some cases, the information called for above will
not be available because entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report expense data for only the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be categorized as investments for human capital rather than the outlays for each of the preceding 5 years.

-- A narrative description of major education and training
programs considered Federal investments in human capital shall be included.

Recommended
Reporting

95 Reporting of the amount of significant state, local, private, or foreign total contributions to shared or joint programs is encouraged, but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the

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total program) may be reported even if the exact amount of the contribution is not known.

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CHAPTER 7: STANDARD - RESEARCH AND DEVELOPMENT
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Research and Development - Expenses included in calculating net cost for research and development programs that are intended to increase or maintain national economic productive capacity or yield other future benefits shall be reported as investments in research and development in required supplementary stewardship information accompanying the financial statements of the Federal Government and its component units. Continued categorization of program expenses as investment is predicated on output and outcome data consistent with the program's intent. Reporting ordinarily will include data in nominal dollars on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the investment.

Definition

96 "Investment in research and development" refers to those expenses incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of

-- Basic research: systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind;

-- Applied research: systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met; and

-- Development: systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.[FN35-See OMB Circular A-

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11, section 44.]

Measurement

97 "Expenses incurred" - The investment shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.[FN36-See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.] Amounts shall be reported in nominal dollars.

98 Expenses incurred for programs, contracts, or grants with split purposes[FN37-An example of an investment with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.] shall be reported on the basis of an allocation of the investment expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expenses incurred.

99 By no later than the third year after the effective date of this standard, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported.[FN38-The research and development outputs and outcomes should be the same as those measured for the Government Performance and Results Act (GPRA) and the budget and will be reported in a Statement of Program Performance Measures as described in Appendix 1-F to Entity and Display, SFFAC No. 2.] If outcome data are not available (for example, the agency has not agreed on outcome measures for the program, the agency is unable to collect reliable outcome data, or the outcomes will not occur for several years), the outputs that best provide indications of the intended program outcomes shall be used to justify continued treatment of expenses as investments until outcome data are available. Definitions and characteristics of outputs and outcomes follow.

-- "Output" - A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. They shall have two key characteristics: (1) they shall be systematically or periodically captured through an accounting or management information system, and (2) there shall be a logical connection between the reported measures and the program's purpose. In research and development programs, this

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might consist of data for the year concerning the number of new projects initiated, the number continued from the prior year, the number completed and the number terminated. It also might consist of such quantitative measures as bibliometrics (for example, publication counts, citation counts and analysis, and peer evaluation); patent counts and analysis; and science "indicators" that assess the ongoing vitality of the research (for example, statistics on scientific and engineering personnel, graduate students and degree recipients by field and sector).[FN39-Research Funding as an Investment: Can We Measure the Returns?, A Technical Memorandum, Congress of the United States, Office of Technology Assessment (Apr. 1986).]

-- "Outcome" - An assessment of the results of a program compared to its intended purpose. Because of the difficulty of measuring such results for research and development programs in financial, economic, or quantitative terms, outcome data for such programs are expected to consist typically of a narrative discussion of the major results achieved by the program during the year, along the following lines:

- Basic Research - an identification of any major new discoveries that were made during the year;

- Applied Research - an identification of any major new applications that were developed during the year; or

- Development - the progress of major developmental projects including the results with respect to projects completed or otherwise terminated during the year and the status of projects that will continue.

The information provided concerning outcomes should be chosen to provide, in concise form, a plausible basis for judging the extent to which the program is achieving its purpose.

Minimum Reporting

100 Minimum reporting shall consist of the following:

-- The annual investment[FN40-As defined in this standard, "annual investment" includes more than the annual expenditure reported by character class for budget execution. "Annual investment" is the full cost of the investment. Full cost shall

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be measured and accounted for in accordance with Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4.] made in the year ended on the balance sheet date as well as in each of the 4 years preceding that year shall be reported. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported. Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major investments at the entity level shall be more specific than at the governmentwide level.

-- In some cases, the information called for above will not be available because certain entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report expense data for only the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be categorized as research and development rather than the outlays for each of the preceding 5 years.

-- A narrative description of major research and development programs shall be included.

Recommended Reporting

101 Reporting of the amount of significant state, local, private, or foreign total contributions to shared or joint programs is encouraged, but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the total program) may be reported even if the exact amount of the contribution is not known.

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CHAPTER 8: STANDARD - CURRENT SERVICES ASSESSMENT

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Current Services Assessment - A Current Services Assessment (CSA) on the basis of receipt and outlay data as published in the President's Budget will be reported for all programs for the base

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year and 6 years subsequent to the base year. "Base year" data will be actual receipt and outlay data for the last completed fiscal year; projected data will be receipt and outlay data that are included in the current services estimates in the President's Budget published after the close of the base year. The data would be presented as required supplementary stewardship information accompanying the consolidated financial statements of the Federal Government but not in individual reports of its component units. Reporting of projected data for additional years is encouraged where it would be useful and relevant.

102 "A Current Services Assessment" provides receipt and outlay data on the basis of projections of future activities. It is relevant for assessing the sustainability of programs established by current law, that is, the sufficiency of future resources to sustain public services and to meet obligations as they come due. The CSA focuses on the totality of government operations rather than on individual programs. It provides an analytical perspective on the Government because it shows the short- and long-term direction of current programs.

Measurement

103 CSA will present receipt and outlay data published in the President's Budget. Data will be presented for all programs for the base year and at least 6 years subsequent to the base year, summarized in sufficient detail to identify, at least, (1) receipts by major source (e.g., individual income taxes, social insurance taxes, etc.); (2) outlays for the defense, Social Security, Medicare, and net interest functions; (3) all other receipts and outlays; and (4) the deficit or surplus. The "base year" is the year for which the financial statements are being prepared. Reporting of projected data for additional years is encouraged where it would be useful and relevant.

104 CSA data for the 6-year projection will be identical to projected data published in the President's Budget for the same period. "Base year" data will be actual receipt and outlay data for the last completed fiscal year; projected data will be the current services estimates of receipt and outlay data that are included in the President's Budget published after the close of the base year.

Minimum

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Reporting

Governmentwide Report of the Federal Government

105 The CSA shall present flow data as described in the two preceeding paragraphs for inclusion in the consolidated financial report of the US Government.

106 Preparers of financial reports are encouraged to experiment with the presentation of the CSA data in order to make it more understandable.

107 In some cases, summary data will be more effective than detailed data. There may be situations, too, where graphic presentations will be more effective than tabular presentations.

Reporting Entities of the Federal Government

108 None.

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APPENDIX A

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109 This appendix provides a discussion of the more significant comments that the Board received from respondents to the exposure draft, Supplementary Stewardship Reporting, dated August 1995 and from testimony at a public hearing on the exposure draft that was held December 5, 1995.

110 Responses overall were generally favorable to the concept of reporting stewardship information. In some cases, respondents had questions about the specific reporting requirements or requested clarification on particular items. Where feasible, these areas were addressed or clarified in the final standards in this Statement. In the case of issues raised by the respondents, this appendix explains the basis of the Board's conclusions.

The Nature of Stewardship Reporting

111 The exposure draft presented the Board's approach to reporting in a manner other than is done in the basic financial statements for those items that it has categorized as stewardship items. As the Board stated in the Introduction and Background chapter of this Statement, it believes that these stewardship items warrant specialized reporting to highlight their importance and to portray them in additional ways than provided by financial

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accounting. The Board designated a new category of reporting to highlight the unique nature of stewardship reporting, Required Supplemental Stewardship Information (RSSI).

112 Some respondents believed that, although reporting on stewardship items might be warranted, a separate manner of reporting might not. They believed that stewardship reporting could be accommodated either within the basic financial statements, for example, as a note, or as Required Supplemental Information (RSI). They did not see the need for the separate category of RSSI.

113 The Board, however, believes that a new category for reporting on stewardship items is more appropriate. If stewardship information were required to be reported in a note to the basic financial statements, it would be subject to the same level of audit scrutiny as that of the basic financial statements. Since some of the stewardship information is non-financial, for example, physical units, and other data is based on projections or assumptions, the same degree of audit coverage as that of the basic financial statements for these items may not be appropriate. Such data is not drawn directly from the financial records. Thus reliance on financial records for audit backup would not be feasible.

114 On the other hand, the Board believes that certain stewardship information should receive more audit scrutiny than it would if it were RSI. For RSI, the auditor reviews the data for overall compliance with associated guidance and for consonance with the basic financial statements. The auditor usually provides in-depth review of the RSI only if there appears to be some problem with the data. If he or she believes that the data is not fairly presented, the auditor still may issue a clean opinion on the basic financial statements while noting that there are problems with the RSI.

115 Therefore, the Board has proposed that a new category, RSSI, be designated to cover stewardship reporting. By developing this new category, it is anticipated that audit standards will be developed to address the specific items in that category. Although the Board does not have authority to set audit standards, it established RSSI with the expectation that OMB and GAO will, in collaboration, determine appropriate audit procedures for this information.

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Social Insurance

116 Consideration of guidance for the recognition, measurement and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The Board notes the strength of feelings of respondents and commentators, some of whom believe a liability should be recognized for amounts that will be paid in future periods to or on behalf of current or future program beneficiaries and others who believe that there is no obligation associated with these programs that meets the definition of a liability, other than amounts due and payable at the end of an accounting period; additionally, some favor disclosure of projected data relating to the magnitude of the present value of future net benefit payments at a particular date while others favor cash flow information for a long period of time. The Board notes too the magnitude and complexity of these programs and the extreme sensitivity of projections relating to the programs to assumptions whose range of possibilities is large. More importantly, the Board notes that social insurance programs are presently being studied and discussed frequently and seriously within government and by the public; a report and recommendations are expected shortly from the 1994-95 Quadrennial Advisory Council on Social Security. The prospects of significant changes to the programs are reasonably high.

117 After deliberating the issue, the Board has concluded that additional investigation and further deliberation is required and has directed the FASAB staff to continue to research social insurance issues focusing especially on: identifying the characteristics of programs which should cause them to be subject to the guidance provided in a Statement on Social Insurance; the appropriate display of information in the financial statements; the identification of additional information, if any, which should be required for social insurance programs; the means for measurement of financial data included in such additional information; and, the desirability of nonfinancial indicators (ratios of data to GDP or "covered payroll") to describe the status of programs or the implications of potential changes to or needs of the programs.The Board has instructed the staff to be mindful of all current developments in structuring its research and its recommendations.

Expensing
Stewardship
PP&E

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118 Echoing their earlier comments to the Board's Exposure Draft, Accounting for Property, Plant, and Equipment, some respondents expressed concern that expensing rather than capitalizing costs associated with stewardship PP&E would lessen the value of the operating statement as a tool for performance measurement since it would overstate the cost in the year an asset is acquired.

119 The Board, however, believes that capitalizing and depreciating stewardship PP&E provides information that is of little usefulness. Stewardship PP&E includes heritage assets, Federal mission PP&E, and stewardship land. Period costs related to stewardship PP&E are of diminished usefulness because of uncertain useful life (e.g., heritage assets, Federal mission PP&E), uncertain historical cost basis (e.g., stewardship land), or probability of being destroyed in use (e.g., Federal mission PP&E). Therefore, the Board believes that attempting to capitalize and depreciate stewardship PP&E is not warranted. It believes that reporting on information related to the existence and the condition of the stewardship PP&E has more relevance to decision-makers and other users of the financial report.

Costing of Federal
Mission PP&E

120 Respondents to the Board's question on whether the alternatives of presenting costs of Federal mission PP&E in terms of either total (historical) or latest acquisition cost generally believed that both options should not be allowed. Some believed that use of alternative methods would not ensure consistency in reporting. Others believed that only total (historical) costs should be used. Still others believed that total (historical) cost should be the long-term goal, with the use of latest acquisition cost allowed only until such historical cost data would be available.

121 The Board, however, recognizes that significant practical problems may arise if an agency is compelled to adopt a specified costing approach for reporting stewardship assets, and that such cost approach would not be used for computing the net cost of operations. Therefore, it believes that its decision to accept either the historical cost or latest acquisition cost method is appropriate. However, it also emphasizes that once a method is chosen, an entity should switch to the other method only with appropriate justification.

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Reporting Expense or Outlay Data

122 The standards require that expense data be reported for investments in human capital, research and development, and nonfederal physical property. The standards also provide for a period of 5 years to transition to reporting expense data for those agencies that currently maintain only outlay data. Some Board members suggested that since some agencies currently maintain only outlay data, requiring that only outlay data be reported might be more practical. However, the responses reflected a clear consensus for reporting expenses, with little or no support for reporting outlays only, and a minority preferring to report both expenses and outlays. Therefore, the standards, as proposed, remain unchanged.

Request for More Specificity In Reporting Requirements

123 When the Board developed the standards for stewardship reporting, its intention was to provide overall guidance on definitions, recognition, measurement, and minimum and recommended reporting. This broad guidance was intended to provide the basic reporting requirements while allowing each entity maximum flexibility in such areas as determining what constitutes the individual stewardship items for that entity, which costs are directly attributable to the stewardship item, and how best to report on multi-use items so that users will gain the best picture of the entity's financial and performance information.

124 The Board believes that the desire for more specific guidance expressed by several respondents stems from the belief that without such guidance, an entity's determination of how to apply the standards could be questioned. Nevertheless, the Board reiterates its position that entities should be provided maximum flexibility when applying the stewardship standards. However, entities should make the determination of how best to apply the stewardship standards based on a thorough analysis of their individual entity, including its mission, financial practices, and the impact of its mission and operation on financial report users and on the Nation. Finally, all entity determinations of the applicability of stewardship standards should be thoroughly documented.

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Issues for Which Changes
Were Made to the
Proposed Standards

125 Multiple Category Reporting. Some respondents were concerned that there would be double counting if, as proposed by the standards, some stewardship items would be reported in two separate categories; for example, Yellowstone National Park would be reported as a heritage asset and as stewardship land.

126 Reporting supplementary stewardship information in two categories will not be deemed double counting. This is because where multiple reporting is required, the units of measure are different for each of the stewardship categories. In the example above, Yellowstone National Park would be reported under a category, such as "National Parks," as one of the total number of heritage assets under the auspices of the Department of the Interior; it also would be reported by the number of acres that it occupies under the stewardship land category for the Department. To clarify this point, the discussion of the process of multiple reporting was expanded in the statement to explain that the Board does not consider this reporting as double counting.

127 Reporting the Fair Value for Stewardship PP&E Transferred to State or Local Governments. Many respondents questioned the need for, and the cost/benefit of, requiring that the fair value of stewardship PP&E transferred to state and local governments be reported. They stated that monetary values for stewardship PP&E are not required to be reported because such values are either difficult to obtain (e.g., lack of historical cost data on land acquired at the birth of the Nation) or not meaningful (e.g., the historical cost to build the Washington Monument). Therefore, they questioned the cost/benefit of requiring that the fair value of stewardship
property transferred to state and local governments be determined and reported.

128 The Board agreed that the fair value of stewardship property transferred to state and local governments need not be determined and reported. The standards have been revised to require a description of the property transfer transaction; if the fair value is known, nothing would preclude reporting it.

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Effective Date for Consolidated Financial Statements

129 In considering required reporting of stewardship information, the Board became increasingly aware of the need to be highly selective in proposing requirements for the consolidated financial report of the Federal Government. It recognized the potential for implementation problems in the first few years after the effective date of this statement. In addition to the normal problems associated with adapting to new standards, several of these standards provide for a transition period during which agencies may or, in some cases, may not report investments in human capital, research and development and nonfederal physical property; if investments are reported for each of five years as called for in this statement, they may be reported for earlier years during the transition period on the basis of either outlays or expense. The merit of reporting the aggregate of information prepared on different bases is questionable.

130 Further, the information required to be reported by these standards goes beyond that customarily accompanying financial reports of governments or commercial enterprises. Standards related to heritage assets and stewardship land call for reporting in terms of physical units (e.g., number of parks or acres of land) rather than in terms of historical cost. Implementation problems are foreseen at the consolidated report level because of differing measures. Also, the Board is concerned with the possibility of establishing requirements so detailed as to render the consolidated financial report unwieldy, unfriendly to the potential user and obfuscating of important information.

131 Because of these possible implementation problems and the need to consider other disclosures or presentations, the Board expressed a desire for further deliberations relative to the consolidated financial report of the Federal Government.

132 Accordingly, the effective date of this statement will be for fiscal years beginning after September 30, 1997 as it relates to financial statements of component units of the Federal Government; this same effective date applies to chapter 8 as it relates to the consolidated financial statements of the Federal Government. The effective date of the statement as it applies to the consolidated financial statements, except for chapter 8, is deferred pending further deliberations of the Board. In the interim, the consolidated financial reports should include such

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summary or selected information as is feasible. Experimentation is encouraged, as is the reporting of such additional information as will enhance the financial report.

Reporting of Information
Not Specifically Addressed
in the Standards

133 Some respondents requested that the standards provide for reporting additional information, such as transfers of stewardship property to foreign governments, stewardship land sold to the private sector, the Federal Government's interest in such things as property held by nonfederal entities or patents generated through Federal research and development funds, and foreign contributions to Federal programs.

134 In developing the standards for stewardship reporting, the Board concentrated on providing guidance in the principal areas of stewardship resources that have materiality for the majority of Federal entities and for the consolidated financial reporting for the Nation. The Board's intent was to ensure that these significant areas, if material for an entity, would be reported regularly and in a consistent manner.

135 In some cases, an entity may have other resources or obligations that were not specifically addressed in the stewardship standards, but that the entity believes may be material to the presentation of its stewardship information. In such cases, if the reporting of such additional data would be useful and relevant to readers, and would provide a better indication of the resources and obligations of the entity, the Board encourages such reporting.

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APPENDIX B: SAMPLE STEWARDSHIP REPORTING
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**** NOTICE !!! ****

APPENDIX B CONTAINS SAMPLE ILLUSTRATIONS OF ALL THE REPORTING ELEMENTS ADDRESSED IN THE SUPPLEMENTARY STEWARDSHIP REPORTING STANDARD. HOWEVER, THE DETAILED GRAPHICS IN THE SAMPLE REPORTING FORMATS ARE NOT REPRODUCIBLE IN ASCII FORMAT FOR THIS ELECTRONIC POSTING OF STANDARD ON

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FINANCENET. THEREFORE, READERS INTERESTED IN EXAMINING THE SAMPLE REPORTING FORMATS SHOULD CONTACT THE FASAB AT 202-512-7350, OR FAX 202-512-7366 AND REQUEST:

APPENDIX B OF THE SUPPLEMENTARY STEWARDSHIP REPORTING STANDARD

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APPENDIX C: GLOSSARY

Applied research
Systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.

Basic research
Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.

Budgetary resources
The forms of authority given to an agency allowing it to incur obligations. Budgetary resources include the following: new budget authority, unobligated balances, direct spending authority, and obligation limitations. (A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, January 1993)

Condition
The condition of an asset is based on an evaluation of the physical condition of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence.

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Constant dollar
A dollar value adjusted for changes in the average price level. A constant dollar is derived by dividing a current dollar amount by a price index. The resulting constant dollar value is that which would exist if prices had remained at the same average level as in the base period. Any changes in such constant dollar values would therefore reflect only changes in the real volume of goods and services, not changes in the price level. Constant dollar figures are commonly used to compute the real value of the gross domestic product and its components and to estimate the real level of Federal receipts and outlays. (A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, January 1993)

Current services
assessment
Projections of future receipts and outlays from future activities based on the programs established by current law. The CSA focuses on the totality of Government operations rather than on individual programs, and shows the short- and long-term direction of current programs.

Development
Systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

Disclosure
Reporting information in notes or narrative regarded as an integral part of the basic financial statement. (Revenue and Other Financing Sources, SFFAS No. 7)

Expenditure
With respect to provisions of the Antideficiency Act (31 U.S.C. 1513-1514) and the Congressional Budget and Impoundment Control Act of 1974 (2 U.S.C.622(i)), a term that has the same definition as outlay. (A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, January 1993)

Expense

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Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period. (Accounting for Selected Assets and Liabilities, SFFAS No. 1)

Federal mission property, plant, & equipment (PP&E)
Items used to meet a Federal Government mission in which the specific PP&E used is an integral part of the output of the mission.

General PP&E land
Land and land rights owned by the Federal Government that are acquired for or in connection with items of general PP&E.

Heritage assets
Property, plant, and equipment that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic (e.g., aesthetic) importance; or,
significant architectural characteristics.

Human Capital
Expenses incurred for education and training programs financed by the Federal Government for the benefit of the public and designed to increase or maintain national economic productive capacity.

Land
Land is the solid part of the surface of the earth. Excluded from the definition of land are the natural resources (that is, depletable resources such as mineral deposits and petroleum; renewable resources such as timber, and the outer-continental shelf resources related to land).

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Latest acquisition
cost (LAC) method
A method that provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use.

Maintenance
The act of keeping fixed assets in useable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it in order to serve needs different than, or significantly greater than, those originally intended. (Accounting for Property, Plant, and Equipment, SFFAS No. 6)

Nonfederal Physical
Property
Physical properties financed by grants from the Federal Government, but owned by state and local governments.

Nominal dollar
The dollar value assigned to a good or service in terms of prices current at the time of the good or service is required. This contrasts with the value assigned to a good or service measured in constant dollars.

Outcome
An assessment of the results of a program compared to its intended purpose. They shall: 1) be capable of being described in financial, economic, or quantitative terms; and 2) provide a plausible basis for concluding that the program has had or will have this intended effect. For measuring outcomes for research and development programs, results may be reported by a narrative discussion of the major results achieved by the program during the year. (See para. 99 for further discussion.)

Output
A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner.

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They shall have two key characteristics: 1) they shall be systematically or periodically captured through an accounting or management information system, and 2) there shall be a logical connection between the reported measures and the program's purpose.

Outlay
The issuance of checks, disbursement of cash, or electronic transfer of funds made to liquidate a Federal obligation. Outlays also occur when interest on the Treasury debt held by the public accrues and when the Government issues bonds, notes, debentures, monetary credits, or other cash-equivalent instruments in order to liquidate obligations. Also, under credit reform, the credit subsidy cost is recorded as an outlay when a direct or guaranteed loan is disbursed. (A Glossary of Terms Used in the Federal Budget Process, Exposure Draft, January 1993)

Research and
Development
Federal investment in research and development refers to those expenses incurred in support of the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of basic research, applied research, and development.

Required
Supplementary Stewardship
Information (RSSI)
The category defined by the Board for reporting information required by the stewardship standards. Stewardship information may be presented as RSSI, in the financial statements, or in the notes to them. Stewardship information will be necessary for a fair presentation of financial position and results of operations.

Space Exploration
Equipment
Items that are intended to operate above the atmosphere to explore space and any specially designed equipment to aid, service or operate other equipment engaged in exploring space.

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State and Local Governments

State and local governments generally include:

the 50 States and the District of Columbia

cities, counties, townships, school districts, specia districts, public authorities, and other local governmental units as defined by the Bureau of the Census; and

Puerto Rico, the Virgin Islands, and other US territories

Stewardship

The Federal Government's responsibility for the general welfare of the nation in perpetuity. (FASAB Concepts Statement No. 1, Objectives of Federal Financial Reporting)

Stewardship investments

Items recognized as expense in calculating net cost, but meriting special treatment to highlight the substantial investment and long-term benefit of the expenses. This would include nonfederal physical property, human capital, and research and development.

Stewardship land

Land and land rights owned by the Federal Government that are not acquired for or in connection with items of general PP&E.

Stewardship responsibilities

The projected financial impact on the Government of sustaining the current services that it provides pursuant to laws already enacted. The commitments and constraints reflected in "current services" are inherent in the tax and spending policies contained in current law.

Total cost method

An accounting method that includes the actual acquisition cost of each item held plus the costs of any additions, improvements, alterations, rehabilitations, or replacements that extend the useful life of an asset.

Weapons

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Instruments of combat used to destroy, injure, defeat or threaten an enemy. (adapted from Dictionary of Weapons and Military Terms)

Weapons Systems
A combination of one or more weapons with all related equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency. (Joint Chiefs of Staff, Department of Defense Dictionary of Military and Associated Terms, Joint Publication 1-02, Mar. 23, 1994.)

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Federal Accounting Standards Advisory Board

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750 First Street, NE
Suite 1001
Washington, DC 20002

Telephone (202) 512-7350
FAX (202) 512-7366

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Federal Accounting Standards Advisory Board

DEFERRAL OF THE EFFECTIVE DATE OF MANAGERIAL COST ACCOUNTING STANDARDS FOR THE FEDERAL GOVERNMENT IN SFFAS NO. 4

Statement of Recommended Accounting Standards
Number 9

October 1997

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The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board") in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The officials who established the Board then decide whether to adopt the recommendations. If they do, the standard is published by OMB and the General Accounting Office and then becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 3B18
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366

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EXECUTIVE SUMMARY

I. This statement is issued to amend the effective date of the standards in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, issued in July 1995. The original effective date was for reporting periods beginning after September 30, 1996. The amended effective date is for periods beginning after September 30, 1997.

II. In July 1997, the Federal Accounting Standards Advisory Board (the Board) received a request from the CFO Council for a two year deferral of the effect date of the managerial cost accounting standards to fiscal year 1999. The CFO Council representatives stated that many agencies have not been able to implement the managerial cost accounting standards during the two years since SFFAS No. 4 was issued, due to the following reasons: (a) the Joint Financial Management Improvement Program (JFMIP) has not issued its Managerial Cost Accounting System Requirements, (b) the CFO Council has not issued its managerial cost accounting guide, and (c) most agencies do not have adequate cost accounting systems in place. After considering the CFO Council's request, the Board reluctantly agreed to propose deferring the effective date of the managerial cost accounting standards for one year to fiscal year 1998 and issued an Exposure Draft (ED) for public comments. Most responses to the ED were in favor of the proposal.

III. After reviewing the comments to the ED, the Board decided to recommend the one year deferral. At the same time, it reemphasizes the importance of managerial cost accounting to Federal program and financial management. The Chief Financial Officers Act of 1990 requires the development of cost information and the systematic measurement of performance. Reliable and relevant cost information is indispensable for implementing the requirements of the Government Performance and Results Act of 1993. The Board urges Federal entities and their CFOs to give priority to implementing the requirements in SFFAS No. 4.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION 1

THE AMENDED EFFECTIVE DATE 2

BASIS FOR CONCLUSIONS 3
- **Reasons for the delay** 3
- **The Status of Interpretation No. 2** 5
- **The Status of SFFAS No. 7** 6

ATTACHMENT: LETTER FROM CFO COUNCIL 7

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INTRODUCTION

1 This statement is issued to amend the effective date of the managerial cost accounting standards prescribed in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government,[1] which was issued in July 1995. The standards in SFFAS No. 4 were effective for reporting periods beginning after September 30, 1996. The amended effective date is for reporting periods beginning after September 30, 1997.

2 In August 1997, the Board issued an exposure draft (ED)[2] in which it proposed a deferral of the effective date of managerial cost accounting standards. The ED was issued after considering a request presented to the Board by the CFO Council. (See Attachment: Letter from the CFO Council, dated June 26, 1997.) In their request, the CFO Council representatives stated that most agencies were having difficulties in implementing the cost accounting standards because (a) the Managerial Cost Accounting System Requirements have not yet been issued,[3] (b) the CFO Council has yet to issue a managerial cost accounting guide,[4] and (c) most agencies do not have adequate cost systems in place. The CFO Council representatives requested that the effective date of SFFAS No. 4 be deferred for two years to reporting periods that begin after September 30, 1998. They also requested that "relevant portions" of SFFAS 7, Accounting for Revenue and Other Financing Sources, be delayed to that same date.

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[1]In addition to managerial cost accounting standards, SFFAS No. 4 also contains managerial cost accounting concepts which provide general guidance for managerial cost accounting but do not constitute specific requirements. The effective date does not apply to those concepts.

[2]The ED was published in FASAB News issue No. 45, August 1997.

[3]In April 1997, JFMIP issued an Exposure Draft on Managerial Cost Accounting System Requirements, which is yet to be finalized as of this date.

[4]The CFO Council's Governmentwide Cost Accounting Work Group issued an Exposure Draft of the Managerial Cost Accounting Implementation Guide on June 30, 1997, which has not been finalized as of this date.

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3 After considering the reasons presented by the CFO Council, the Board reluctantly proposed a one year delay for SFFAS No. 4, to reporting periods beginning after September 30, 1997, and issued the ED for that proposal. No delay was proposed for any part of SFFAS No. 7, which is effective for reporting periods beginning after September 30, 1997. The Board noted that cost accounting is required by the Chief Financial Officers Act of 1990 (the CFO Act), and reliable cost information is necessary for implementing the Government Performance and Results Act (GPRA) of 1993. The Board also observed that the cost accounting standards allow Federal entities without a sophisticated cost accounting system to use cost studies or cost finding techniques to meet the requirements of the cost accounting standards. The Board further observed that during the past two years since SFFAS No. 4 was issued, most agencies should have had sufficient time to develop at least the basic cost accounting processes as described in paragraph 71, SFFAS No. 4.

4 The Board received 26 responses to the ED. Most respondents supported the Board's proposal for a one year deferral of the cost accounting standards in SFFAS No. 4 to fiscal year 1998. After considering the comments, including those opposed to any delay and those favoring a two year delay, the Board decided to recommend the one year deferral to the FASAB principals.

THE AMENDED EFFECTIVE DATE

5 The effective date of the managerial cost accounting standards provided in paragraph 30, SFFAS No. 4, is amended as follows:

"The managerial cost accounting standards prescribed in SFFAS No. 4 shall be effective for fiscal periods beginning after September 30, 1997. Earlier implementation is encouraged."

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BASIS FOR CONCLUSIONS

Reasons for the delay

6 After considering the CFO Council's presentation and the responses to the ED, the Board is convinced that as of the end of fiscal year 1997, most agencies were not ready to produce cost information as required in the cost accounting standards. As described in CFO Council's request and in the responses to FASAB's ED, many agencies need more time and guidance to define responsibility segments and to develop procedures for accumulating and assigning costs. They also said that they need more time to upgrade or expand their accounting systems, and to promote the use of cost measures among program and financial managers.

7 Most respondents stated that the one year delay should not significantly affect implementation of the Government Performance and Results Act of 1993 (GPRA). With regard to the GPRA requirement that Federal agencies measure and report outputs, outcomes, and related costs by segments for fiscal year 1999 and thereafter, the respondents stated that with the one year deferral of the cost accounting standards, agencies will have time to align their cost accounting structures with the GPRA measures.

8 Under these circumstances, the Board concluded that a one year deferral would be appropriate. The deferral would provide the Federal entities with an opportunity to engage top-level agency officials, budget analysts, and program and financial managers in the processes of developing, collecting and using cost information.

9 Several respondents reiterated the CFO Council's original request for a two year delay to fiscal year 1999, on the grounds that their systems would not be ready within fiscal year 1998. The Board cannot agree with this request. It believes that cost accounting capability must be developed in time to fully support the GPRA reporting. The Board thus urges Federal entities to give implementation of SFFAS No. 4 a high priority and take immediate actions to define and

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structure responsibility segments and develop costing methodologies.

10 Several respondents said that, after the effective date, Federal entities should be given a transitional period in which they could have flexibility to develop and improve their cost accounting systems and procedures gradually. The Board disagrees with this approach for two reasons: (a) such a transitional period would add uncertainty to the required implementation, (b) a degree of flexibility for developing cost accounting systems and procedures is already built in the standards, and thus a transitional provision is not necessary.

11 The Board notes that the standards already provide a sufficient degree of flexibility to Federal entities. For example, paragraph 70, SFFAS No. 4, provides that managerial cost accounting processes can be accomplished through the use of a cost accounting system or the use of cost finding techniques or other cost studies and analyses. Paragraph 266 further provides that "Federal agencies can take a gradual approach to the development of cost systems, if necessary, while developing basic cost information through other means in the short run." Federal agencies are expected to refine and improve their costing procedures, methods, and systems, as they gain experience in using cost information (paragraph 24, SFFAS No. 4). Those who are not familiar with the criteria of implementation should review the standard on "Requirement for Cost Accounting" in paragraphs 67 through 76, SFFAS No. 4.

12 Several respondents were opposed to any deferral. They pointed out that the original effective date was more than two years after SFFAS No. 4 was issued, and it provided enough lead time for agencies to implement the cost accounting standards. They stated that if the delay in implementing the standards was caused by a lack of action, a mere deferral could only cause continued inaction. The Board recognizes that many agencies have made significant progress in improving general accounting and financial reporting. The Board anticipates that the one year deferral will bring similar progress in implementing the cost accounting standards.

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The Status of Interpretation No. 2

13 In January 1997, FASAB issued Interpretation No. 2, Accounting for Treasury Judgment Fund Transactions. The Treasury Judgment Fund was established by Congress to pay, in whole or part, the court judgments or settlements negotiated by the Justice Department on behalf of Federal agencies. Interpretation No. 2 requires that if a loss in litigation is probable and estimable, the reporting entity in the litigation should recognize an expense and liability for the full amount of the estimated loss, although the loss may be paid by the Treasury Judgment Fund. The Interpretation reflects the cost principle in SFFAS No. 4, and is based on the principle of recognizing contingent liabilities in SFFAS No. 5, Accounting for Liabilities of the Federal Government. The Interpretation was made effective for reporting periods beginning after September 30, 1996, the same as SFFAS No. 4 and No. 5.

14 The ED raised a question: If SFFAS No. 4 were deferred as proposed, should Interpretation No. 2 be deferred as well? Some respondents believed that Interpretation No. 2 should be deferred to fiscal year 1998. They were concerned with difficulties in collecting reliable information to estimate the probable litigation losses. Other respondents, however, did not believe that Interpretation No. 2 should be delayed for the following reasons: (1) the recognition of litigation losses and liabilities is not dependent on cost accounting capabilities, and (2) the recognition of contingent liabilities and losses is required by SFFAS No. 5, which is not deferred.

15 The Board agrees with the view that Interpretation No. 2 is based on the principle provided in SFFAS No. 5 of recognizing contingent liabilities, and that its implementation should not be deferred. As with all matters in litigation, the data should come from agencies' management and their legal offices and the Department of Justice. Deferring the Interpretation is not a positive solution to the data gathering problem.

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The Status of SFFAS No. 7

16 Those respondents who preferred a two year delay for SFFAS No. 4 also reiterated the CFO Council's original request to defer certain cost-related portions of SFFAS No. 7, Accounting for Revenue and Other Financing Sources to fiscal year 1999. While no specific paragraphs were mentioned, they were concerned with the requirements for matching costs with revenues by sub-organizations (equivalent to responsibility segments). (See, for example, paragraphs 116 through 126, SFFAS No. 7.) They stated that they are modifying their systems to accommodate those requirements, but their systems work could not be completed in fiscal year 1998.

17 With the effective date of SFFAS No. 4 deferred to fiscal year 1998, the cost accounting standards should be implemented and the necessary cost information should be accumulated to support implementation of SFFAS No. 7 for that year. Thus, the Board is not convinced that SFFAS No. 7 needs to be deferred. The Board believes that it is highly important to relate SFFAS No. 4 and No. 7 to measuring program performance and results. While the standards in SFFAS No. 4 provide more detail in cost concepts, procedures, and methodologies, SFFAS No. 7 brings cost information into focus in measuring the net results of programs and activities. The integrated implementation of those two statements is crucial for meeting the objectives of financial reporting by Federal entities and for implementing the GPRA requirements.

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ATTACHMENT: LETTER FROM CFO COUNCIL

The CFO Council's letter is reprinted on the next two pages.

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United States Government
Chief Financial Officers Council

JUN 26, 1997

Mr. Dave Mosso, Chairman
Financial Accounting Standards Advisory Board
441 G Street, N. W.
Washington, D.C. 20548

Dear Mr. Mosso:

The Chief Financial Officers Council (CFOC) recognizes the importance for Federal agencies to move forward and implement the Statement of Federal Financial Accounting Standards (SFFAS) No.4, Managerial Cost Accounting Concepts and Standards for the Federal Government. We believe this standard, effective for reporting periods after September 30,1996, is essential to support the cost effectiveness of mission performance and to provide full accountability to taxpayers over our resources.

The Council is concerned, however, over the impediments and difficulties most agencies are having in implementing this standard. These difficulties exist due to the following:

- The Managerial Cost Accounting System Requirements have not yet been issued;

- The Managerial Cost Accounting Guidance, which will help agencies in implementing SFFAS No.4, will not be issued until later this Summer;

- Adequate cost Systems are not in place to meet the requirements of the Results Act to provide program cost and performance information in an agency's annual performance report. Agency Performance Reports required under the Results Act are not due until March 2000. It will be several years before agencies will have the necessary cost systems in place.

For the above reasons, the Council requests FASAB to change the effective date for SFFAS No.4, and in relevant portions of its companion, SFFAS No. 7, Accounting for Revenue and Other Financial Sources (effective for reporting periods after September 30,1997), to the "revised effective date" for reporting periods after September 30, 1998. Given that the systems and cost accounting guidance needed by agencies have not been issued and only 4 months remain in this fiscal year, we feel this request is justified. Additionally, this request is further supported by the fact that the Results Act Performance Report requirements are not statutorily required until FY 1999.

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While we recommend a change in the effective implementation date, we fully acknowledge and support the critical importance of the cost and revenue standards. Based on the importance and usefulness of anticipated cost information for internal agency management and other purpose, in addition to the significant benefits that are often derived from early implementation of Federal accounting standards, we nevertheless encourage Federal agencies to implement these standards as soon as practicable based on the capabilities of agency systems and the maturity of agency cost accounting practices. While such early, voluntary implementation is encouraged, the Council requests that the Board change the mandatory implementation date to fiscal periods after September 30, 1998.

Specific questions regarding this request may be directed to Frank M. Sullivan, Chair, CFOC Cost Accounting Committee, at (202) 273-5504 or via E-Mail at 'fs@mail.va.gov".

Sincerely,

Arnold G. Holz
Executive Vice-Chair
Chief Financial Officers Council

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FASAB

Federal Accounting Standards Advisory Board

Accounting for Internal Use Software

Statement of Federal Financial Accounting Standards
Number 10

June 1998

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB, or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the federal government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." After considering oral and written comments, the standards may be recommended by the Board. The Board's sponsors then decide whether to adopt the recommendations. If adopted, the standards are published by OMB and the General Accounting Office and become authoritative.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- *"Memorandum of Understanding Between the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

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Table of Contents

Executive Summary i

Introduction 1
- Purpose 1
- Scope 1
- Background 2
- Materiality 2
- Effective Date 2

Accounting Standard 3
- Definitions 3
- Software Development Phases 4
- Recognition, Measurement, and Disclosure 7
  - Software Used as General PP&E 7
  - Capitalizable Cost 7
  - Data Conversion Cost 8
  - Cutoff for Capitalization 8
  - Multiuse Software 8
  - Integrated Software 9
  - Bundled Products and Services 9
  - Capitalization Thresholds 9
  - Enhancements 9
  - Impairment 10
  - Amortization 12
  - Disclosures 13
- Implementation 13

APPENDIX A: Basis for Conclusions 14

APPENDIX B: Glossary 29

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_10.pdf.

Executive Summary

This statement provides recommended accounting standards for internal use software. Under the provisions of this statement, internal use software is classified as "general property, plant, and equipment" (PP&E) as defined in Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment.* This statement includes software used to operate a federal entity's programs (e.g., financial and administrative software, including that used for project management) and software used to produce the entity's goods and services (e.g., air traffic control and loan servicing).

Internal use software can be purchased off-the-shelf from commercial vendors and can be developed by contractors with little technical supervision by the federal entity or developed internally by the federal entity. SFFAS No. 6 specified treatment for internally developed software different from that for commercial off-the-shelf (COTS) software and contractor-developed software. SFFAS No. 6 addressed COTS and contractor-developed software generally, providing that they were "subject to its provisions." On the other hand, specific provision was made for internally developed software.

SFFAS No. 6 prohibited the capitalization of the cost of internally developed software unless management intended to recover the cost through user charges, and the software was to be used as general PP&E. For capitalizable software, capitalization would begin after the entity completed all planning, designing, coding, and testing activities that are necessary to establish that the software can meet the design specifications.

At the conclusion of the PP&E project the Federal Accounting Standards Advisory Board discussed whether the standard for internally developed software should also apply to contractor-developed software. Also, some users of SFFAS No. 6 were unsure how to apply it to COTS and contractor-developed software. The Board decided, in December 1996, to review the issue and develop a separate standard for internal use software.

This standard requires the capitalization of the cost of internal use software whether it is COTS, contractor-developed, or internally developed. Such software serves the same purposes as other general PP&E and functions as a long-lived operating asset. This standard provides guidance regarding the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

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Introduction

Purpose

1. This statement provides accounting standards for **internal use software**[1] used by federal entities. Federal entities purchase **commercial "off-the-shelf" (COTS) software**, hire contractors to develop substantially all of the desired **software** (**contractor-developed**), or develop software internally using their own employees, with or without a contractor's assistance (**internally developed**).

Scope

2. This statement establishes accounting standards for the **cost** of software developed or obtained for internal use. These include the cost of

- **software** used to operate an **entity's** programs (e.g., financial and administrative software, including that used for project management),
- software used to produce the entity's goods and to provide services (e.g., air traffic control and loan servicing), and
- software that is developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement.

3. This statement provides standards on accounting for software consisting of one or more components or modules. For example, an entity may develop an accounting software system containing three elements: a general ledger, an accounts payable subledger, and an accounts receivable subledger. Each element might be viewed as a component or module of the entire accounting software system. This standard may be applied to the total cost of the software or, when appropriate, to individual components or modules. For example, one software module may be implemented before others, in which case, the provisions of this standard for capitalization, **amortization**, etc., would apply to it separately.

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Background 4. At the conclusion of the general property, plant, and equipment (PP&E) project, the Federal Accounting Standards Advisory Board (Board) discussed whether the standard for **internally developed software** should also apply to contractor-developed software. Also, some users of Statement of Federal Financial Accounting Standards (SFFAS) No. 6 were unsure of how to apply it to COTS and contractor-developed software. The Board decided in December 1996 to review the issue and develop a separate standard for internal use software.

5. In June 1997, the Board issued an exposure draft entitled *Accounting for Internal Use Software*. The Board received comments from 26 respondents and held a public hearing on December 18, 1997.

Materiality 6. The provisions of this statement need not be applied to immaterial items.

Effective Date 7. The provisions of this statement are effective for reporting periods that begin after September 30, 2000. Paragraphs 27 and 28 of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, which pertain to internally developed software, are rescinded upon this standard's issuance. Federal entities may continue their current accounting practices for internal use software for accounting periods beginning before October 1, 2000. Early implementation of this statement is encouraged.

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Accounting Standard

Definitions

8. Software includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program. "Internal use software" means software that is purchased from commercial vendors "off-the-shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs. Normally software is an integral part of an overall system(s) having interrelationships between software, hardware, personnel, procedures, controls, and data.

9. This definition of internal use software encompasses the following:

    a. **Commercial off-the-shelf** (COTS) software: COTS software refers to software that is purchased from a vendor and is ready for use with little or no changes.

    b. Developed software

        (1) Internally developed software refers to software that employees of the entity are actively developing, including new software and existing or purchased software that are being modified with or without a contractor's assistance.

        (2) **Contractor-developed software** refers to software that a federal entity is paying a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

Software Development Phases [2]

10. Software's life-cycle phases include planning, development, and operations. This standard provides a framework for identifying software development phases and processes to help isolate the capitalization period for internal

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use software that the federal entity is developing.

11. The following table illustrates the various software phases and related processes. The steps within each phase of internal use software development may not follow the exact order shown below. This standard should be applied on the basis of the nature of the cost incurred, not the exact sequence of the work within each phase.

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Preliminary design phase	Software development phase`	Post-Implementation / operational phase
Conceptual formulation of alternatives[1] Evaluation and testing of alternatives Determination of existence of needed technology Final selection of alternatives	Design of chosen path, including software configuration and software interfaces[2] Coding Installation to hardware Testing, including parallel processing phase	Data conversion Application **maintenance**

12. In the *preliminary design phase*, federal entities will likely do the following:

    a. Make strategic decisions to allocate resources between alternative projects at a given time. For example, should programmers develop new software or direct their efforts toward correcting problems in existing software?

    b. Determine performance requirements (i.e., what it is that they need the software to do).

    c. Invite vendors to perform demonstrations of how their software will fulfill a federal entity's needs.

[1] See OMB Circular A-11, *Planning, Budgeting, and Acquisition of Capital Assets;* Supplement to Circular A-11, *Capital Programming Guide* (July 1997); and Circular A-109, *Major Systems Acquisitions*, par. 11, "Alternative Systems."

[2] See OMB Circular A-109, *Major Systems Acquisitions*, par. 13, "Full-Scale Development and Production."

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d. Explore alternative means of achieving specified performance requirements. For example, should a federal entity make or buy the software? Should the software run on a mainframe or a client server system?

e. Determine that the technology needed to achieve performance requirements exists.

f. Select a vendor if a federal entity chooses to obtain COTS software.

g. Select a consultant to assist in the software's development or installation.

13. In the *software development phase*, federal entities will likely do the following:

a. Use a system to manage the project.

b. Track and accumulate life-cycle cost and compare it with performance indicators.

c. Determine the reasons for any deviations from the performance plan and take corrective action.

d. Test the deliverables to verify that they meet the specifications.

14. In the *post-implementation/operational phase*, federal entities will likely do the following:

a. Operate the software, undertake preventive maintenance, and provide ongoing training for users.

b. Convert data from the old to the new system.

c. Undertake post-implementation review comparing asset usage with

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the original plan.

d. Track and accumulate life-cycle cost and compare it with the original plan.

Recognition, Measurement, and Disclosure

Software Used as General PP&E

15. Entities should **capitalize** the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services.[3]

Capitalizable Cost

16. For internally developed software, capitalized cost should include the **full cost** (**direct** and **indirect cost**) incurred during the software development stage.[4] Such cost should be limited to cost incurred after

    a. management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function with an estimated service life of 2 years or more and

    b. the completion of conceptual formulation, design, and testing of possible software project alternatives (the preliminary design stage).

17. Such costs include those for new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation manuals.

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18. For COTS software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized.

Data Conversion Cost

19. All data conversion costs incurred for internally developed, contractor-developed, or COTS software should be **expensed** as incurred, including the cost to develop or obtain software that allows for access or conversion of existing data to the new software. Such cost may include the purging or cleansing of existing data, reconciliation or balancing of data, and the creation of new/additional data.

Cutoff for Capitalization

20. Costs incurred after final acceptance testing has been successfully completed should be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site.

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Multiuse Software

21. The cost of software that serves both internal uses and stewardship purposes ("multiuse software") should be accounted for as internal use software (e.g., a global positioning system used in connection with national defense activities and general operating activities and services).

Integrated Software

22. Computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly (e.g., airport radar and computer-operated lathes). The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.

Bundled Products and Services

23. Federal entities may purchase software as part of a package of products and services (e.g., training, maintenance, data conversion, reengineering, site licenses and rights to future upgrades and enhancements). Federal entities should allocate the capitalizable and noncapitalizable cost of the package among individual elements on the basis of a reasonable estimate of their relative fair values. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements should be expensed.

Capitalization Thresholds

24. Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system. That guidance should consider whether period cost would be distorted or asset values understated by expensing the purchase of numerous copies of a software application or numerous components of a software system and, if so, provide that the

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collective cost should be capitalized.

Enhancements

25. The acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities. For example, in an instance where the federal entity adds a capability or function to existing software for making ad hoc queries, the cost would be capitalized.

26. Enhancements normally require new software specifications and may require a change of all or part of the existing software specifications as well. The cost of minor enhancements resulting from ongoing systems maintenance should be expensed in the period incurred. Also, the purchase of enhanced versions of software for a nominal charge are properly expensed in the period incurred.

27. Cost incurred solely to repair a design flaw or to perform minor upgrades that may extend the **useful life** of the software without adding capabilities should be expensed.[5]

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Impairment

Post-implementation/Operational Software

28. Impairment should be recognized and measured when one of the following occurs and is related to post-implementation/operational software and/or modules thereof:

    - the software is no longer expected to provide substantive service potential and will be removed from service or

    - a significant reduction occurs in the capabilities, functions, or uses of the software (or a module thereof).

29. If the impaired software is to remain in use, the loss due to impairment should be measured as the difference between the **book value** and either (1) the cost to acquire software that would perform similar remaining functions (i.e., the unimpaired functions) or, if that is not feasible, (2) the portion of book value attributable to the remaining functional elements of the software. The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. If neither (1) nor (2) above can be determined, the book value should continue to be amortized over the remaining useful life of the software.

30. If the impaired software is to be removed from use, the loss due to impairment should be measured as the difference between the book value and the **net realizable value** (NRV), if any.[6] The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. The NRV, if any, should be transferred to an appropriate asset account until such time as the software is disposed of and the amount is realized.

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Developmental Software

31. In instances where the managers of a federal entity conclude that it is no longer more likely than not that developmental software (or a module thereof) will be completed and placed in service, the related book value accumulated for the software (or the balance in a work in process account, if applicable) should be reduced to reflect the expected NRV, if any, and the loss recognized. The following are indications of this:

    - Expenditures are neither budgeted nor incurred for the project.
    - Programming difficulties cannot be resolved on a timely basis.
    - Major cost overruns occur.
    - Information has been obtained indicating that the cost of developing the software will significantly exceed the cost of COTS software available from third party vendors; hence, management intends to obtain the product from those vendors instead of completing the project.
    - Technologies that supersede the developing software product are introduced.
    - The responsibility unit for which the product was being created is being discontinued.

Amortization

32. Software that is capitalized pursuant to this standard should be amortized in a systematic and rational manner over the estimated useful life of the software. The estimated useful life used for amortization should be

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consistent with that used for planning the software's acquisition.[7]

33. For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing.

34. Any additions to the book value or changes in useful life should be treated prospectively. The change should be accounted for during the period of the change and future periods. No adjustments should be made to previously recorded amortization. When an entity replaces existing internal use software with new software, the unamortized cost of the old software should be expensed when the new software has successfully completed testing.

Disclosures

35. The **disclosures** required by SFFAS No. 6, paragraph 45, for general PP&E are applicable to general PP&E software. Thus, for material amounts, the following should be disclosed in the financial statements regarding the software:

- The cost, associated amortization, and book value.
- The estimated useful life for each major class of software.
- The method(s) of amortization.

Implementation

36. Cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been

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capitalized, had this statement been in effect when those costs were incurred. However, the provisions of this statement concerning amortization and impairment should be applied to any unamortized cost capitalized prior to the initial application of this statement that continue to be reported as assets after the effective date.

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APPENDIX A: Basis for Conclusions

General Property, Plant, and Equipment

37. As stated in Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 10, the Federal Accounting Standards Advisory Board (Board) believes that measuring the cost associated with using general property, plant, and equipment (PP&E), and including that cost in a federal entity's operating results will help to achieve the operating performance objective. To meet the operating performance objective, the Board seeks to provide accounting standards that will result in

- relevant and reliable cost information for decision-making by internal users,
- comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
- information to help assess the efficiency and effectiveness of asset management.

38. The Board believes that the cost of software acquired or developed for internal use that meets the SFFAS No. 6 criterion for general PP&E should be capitalized. Internal use software is specifically identifiable, can have determinate lives of 2 years or more, is not intended for sale in the ordinary course of operations, and has been acquired or constructed with the intention of being used by the entity.[8]

39. This standard does not apply to software that is an integral part of stewardship property, plant, and equipment. For example, if software is a part of a weapons systems, it would not be capitalized but included in the cost of investing in that weapons system. On the other hand, software used to accumulate the cost of acquiring that weapons system or to manage and account for that item

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would meet the criteria for general PP&E and should be capitalized.

40. Regarding any costs of internal use software acquired or developed for stewardship PP&E or stewardship investments, the Board chose to follow SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and SFFAS No. 8, *Supplementary Stewardship Reporting*, and expense them as incurred. For example, a research project may involve new software applications for computer simulation or modeling and meet the definition of a stewardship investment in research and development. In such cases, that software should be expensed as part of that research and development stewardship investment. However, software used to manage, account for, and report on research and development projects and activities would meet the criteria for general PP&E and should be capitalized.

Comparison With SFFAS No. 6

41. As explained in the following paragraphs and in subsequent sections of the Basis for Conclusions, the accounting standard for internal use software required some tailoring of the provisions in SFFAS No. 6. First, the criteria in this standard for determining when to start amortizing/depreciating differs from SFFAS No. 6. SFFAS No. 6 provides that for constructed PP&E, depreciation begins when the PP&E is "placed in service." However, this standard defines the start of amortization for internal use software as the point when final acceptance testing is successfully completed. This additional criteria is necessary, especially for internally developed software--but also for contractor-developed and commercial off-the-shelf (COTS) software--because (1) testing plays a major role for software assets by demonstrating that the software product can meet the requirements and (2) of the need for clear point for ending the

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developmental phase.

42. A second area of tailoring involves "enhancements" and other potentially capitalizable expenditures incurred after the software and/or other general PP&E is in service. SFFAS No. 6 provides a criterion for capitalizable cost for general PP&E that is different from that required here for software enhancements. SFFAS No. 6 provides that cost incurred to either extend the useful life of existing general PP&E or to enlarge or improve its capacity should be capitalized.[3]

43. By contrast, this standard, as explained below, takes a different tack for software. It provides that material expenditures to add capability/functionality would be capitalized but expenditures that result in extending useful life or capacity would be expensed.

44. Finally, it should be noted that this standard provides additional procedures for recognizing and measuring impairment. The provisions in this standard and in SFFAS No. 6 are the same regarding situations where the software/general PP&E is impaired and will be removed from service in its entirety. Both provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, as explained below, this standard also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

Respondent's Comments

45. The respondents to the exposure draft (ED), *Accounting for Internal Use Software*, generally agreed with the principles presented therein. Most of the respondents agreed that the cost of internal use software and enhancements thereto should be capitalized, that capitalized amounts should be written down or off when the software is impaired, and that the guidance in the ED was sufficient to identify capitalizable cost and to

[3] Par. 37.

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recognize impairment. Two-thirds of the respondents agreed with the capitalization point in the ED--after (1) management authorizes and commits to funding a project and believes that it is more likely than not that the project will be successful and (2) the preliminary design stage is complete.

46. Some respondents raised objections and concerns, similar to those expressed in response to the original PP&E exposure draft, about capitalizing software, especially internally developed software. They were concerned that distinguishing between the cost of new and/or enhanced software on the one hand and maintenance and routine improvements that do not benefit future periods on the other hand would be difficult. Other respondents noted the rapidity with which technology changes and current software becomes obsolete, and said that the risky and uncertain nature of software development makes write-off much more likely for software than for general PP&E.

47. Notwithstanding these objections, the Board continues to believe that internal use software is similar to other general PP&E and should be accounted for accordingly. Internal use software and other **information technology** products and services are important resources for government operations. They are subject to similar risks of impairment and write-off and, otherwise, have general PP&E characteristics. Moreover, some respondents said they were already capitalizing their COTS software, which represents a large and growing percentage of their software portfolio.

48. The Board believes that the difference between internal use software and other general PP&E is not sufficient to justify different accounting treatment. This standard provides guidance for determining when capitalization starts and stops, how to amortize the software, how to determine and measure impairment, and other guidance.

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Cost-Benefit

49. Several of the respondents opposed the capitalization of internal use software because they do not believe that the benefits of doing so are worth the cost. The respondents are concerned about the difficulty and cost of evaluating, measuring, and tracking such information. Some respondents point especially to the difficulty of allocating federal employees' salaries and contractors' cost in multiuse contracts (e.g., systems development and maintenance).

50. Some argue (1) that capitalized internal cost related to developing internal use software is often unrelated to the software's actual value or is irrelevant, (2) that capitalization would result in arbitrary values and amortization periods, and (3) that such cost is frequently written-off, causing readers to be misled by the initial capitalization and subsequent write-off.

51. In Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, the Board points out that recommending accounting standards necessarily involves judgments about the cost and benefits of producing information and that standards can have different effects on different users. The Board is concerned that the benefits from standards should exceed the cost of complying with them but realizes that the benefits from standards are very hard to quantify.[4]

52. The Board is persuaded that the benefits from this standard exceed the cost. The Board believes that internal use software meets the definition of general PP&E and that general PP&E ought to be capitalized as an asset and amortized to the future periods benefited.

53. Capitalizing software contributes to the effective management of federal entities' resources. The careful measurement of the cost to construct capital assets, the matching of such cost to periods and programs benefitted on the federal

[4] Also, see OMB Circular A-130, *Management of Federal Information Resources*, par. 7d, which establishes the goal of having benefits exceed cost but notes that "the benefits to be derived from government information may not always be quantifiable."

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entity's statement of net cost, and the comparison of cost with other alternatives for achieving the entity's goal comprise good management. Moreover, the regular review of software assets for impairment provides an early warning of problems. In short, such information provides periodic feedback about the quality and competitiveness of software products and services.[5]

54. The Board believes that expensing software costs incurred (1) in the preliminary design stage, (2) for software repairs and improvements that increase efficiency and useful life (see discussion of enhancements below), and (3) under materiality considerations will ease the burden of complying with this standard. Federal entities incur cost in the preliminary design stage exploring design and technical possibilities. Expensing this cost will limit the risk of "over-capitalization."

55. The Board realizes that software--in general--and internally developed internal use software--in particular--present difficult materiality considerations. However, the Board believes that federal entities will be able to use their discretion under the materiality provisions of federal accounting standards to set reasonable limits to capitalization and avoid incurring excessive cost in tracking de minimis items.

56. SFFAS No. 4 calls for the full cost of resources that directly and indirectly contribute to the production of outputs to be assigned to outputs through appropriate costing methodologies. Cost effectiveness is a key consideration in selecting a cost assignment method. As a general rule, directly tracing costs and assigning costs on a cause-and-effect basis are more expensive than cost allocations, because they require detailed analyses and record-keeping for costs and activities. However, they are preferable because they produce more reliable cost information than cost allocations.[6] In any case, the method used to trace, assign or allocate costs

[5] See OMB Circular A-130, par. 8a, "Information Management Policy," and par. 9b, as well as OMB's *Capital Programming Guide*, for detailed guidance on analyzing information technology through the planning, acquisition, and management-in-use phases.

[6] SFFAS No. 4, par. 143.

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must produce materially correct and complete costs.

57. The Board acknowledges that the service life of software is less predictable than that for other general PP&E. However, the Board is not persuaded that the difficulties of estimation and adjustment justify an accounting treatment different from that for other general PP&E. The Board believes that the additional guidance in the standard versus that in the ED will address the concerns raised by respondents and will be sufficient for federal entities to comply with the standard.

Cost to Be Capitalized--Direct and Indirect Cost

58. Many respondents agreed with the ED position that indirect cost should be expensed. The ED provided that such cost should be expensed because of cost-benefit considerations and the risk of over-capitalization.

59. Several respondents objected to the failure of the ED to require indirect as well as direct costs to be capitalized. Most of these respondents based their objection on the full-cost requirements in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, believing that the Board would not be consistent with this standard unless full cost accounting were adopted.

60. The Board had reserved final judgment on the issue of capitalizing indirect cost at the time the ED was published. Several of the Board's members had argued that capitalizing only direct cost was inconsistent with SFFAS No. 4. Also, some Board members felt that, if the standard not did require indirect cost to be capitalized, the cost of internally developed internal use software would not be comparable with COTS and contractor-developed software, which would include indirect cost.

61. After reconsidering the issue, the Board is persuaded that SFFAS No. 4 requires both direct and indirect costs to be capitalized. Moreover, the new federal capital programming guidelines[7] require full life-cycle cost to be tracked,

[7] The Office of Management and Budget's (OMB) *Capital Programming Guide*, Supplement to OMB Circular A-

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which is a more extensive requirement than that required by this standard, since it includes cost that would be expensed for accounting purposes.[8] Also, software asset values will be comparable among internally developed, COTS and contractor-developed software.

Commencing Capitalization

62. Two-thirds of the respondents agreed that capitalization should begin as described in par. 21 of the ED (and par. 16 of this standard): that is, when (1) management authorizes and commits to a software project and believes that it is more likely than not that the software will be completed and (2) the preliminary design stage is complete. Two of these respondents noted that the standard was consistent in this regard with the American Institute of Certified Public Accountant's (AICPA) draft Statement of Position(SOP).[9] Six other respondents would begin to capitalize only when "technological feasibility" is demonstrated.[10] Other respondents either would not capitalize internal use software under any circumstances or only COTS software.

63. The Board has added a framework for identifying the stages of a software project. Also, the standard now draws a sharper distinction between internally developed software on the one hand and COTS and contractor-developed software on the other. However, the Board believes that flexibility is needed so that the standard can be applied governmentwide.

11, Part 3 (July 1997), integrates the various executive branch and statutory asset management initiatives, including the Government Performance and Results Act, the Clinger-Cohen Act, and the Federal Acquisition Streamlining Act, into a single, integrated capital-programming guide.

8 "Capital assets are land, structures, equipment, and intellectual property (including software) that ... have an estimated life of two years or more... The cost of a capital asset is its full life-cycle cost, including all direct and indirect cost for planning, procurement ... operations and maintenance, including service contracts and disposal." *Capital Programming Guide*, version 1.0, definition of capital asset, p. i (July 1997).

9 Published March 4, 1998 as SOP No. 98-1.

10 "Technological feasibility" is the criteria that the Financial Accounting Standards Board (FASB) used in Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*.

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64. One respondent asked for clarification regarding management's commitment to the software project. This is critical, since it is the starting point for the capitalization of software cost. The Board believes that management's authorization and commitment are a recognizable point for major software projects. A "go/no go" decision should be a visible milestone. Management should use its best judgment to identify when its commitment to a major software project takes place.

65. The Board decided that the "technological feasibility" test in SFFAS No. 6, which follows the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 86, should be changed. The Board believes that that test is appropriate for software developed for sale or lease or otherwise marketed but is not applicable to internal use software. Federal software should be capitalized because it is a long-lived operating asset rather than inventory to be sold. However, federal entities normally do not develop software for sale. If, in a rare instance, an entity should engage to develop software for another federal entity, SFAS No. 86 would be applicable.

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Software Licenses

66. One respondent asked for guidance on accounting for licenses for COTS software. The Board had not discussed software licenses during its deliberations leading up to the publication of the ED. Software licenses can cover periods ranging from the entire estimated service life of the software (a "perpetual" license) to annual or more frequent periods and are similar to leases of general PP&E.

67. The Board believes that it would be appropriate for the federal entity to apply lease accounting concepts[11] and the entity's existing policy for capitalization thresholds and for bulk purchases to licenses. Immaterial costs would be expensed, but the entity should consider whether period costs would be distorted by expensing the license.

Capitalization Thresholds

68. In SFFAS No. 6, the Board carefully considered whether to take a prescriptive approach regarding capitalization thresholds or to permit each entity to set its threshold in light of its own particular operating environment. The Board decided that federal entities were too diverse to require one threshold for all entities; hence, the Board adopted a materiality approach whereby each entity establishes its own threshold as well as the guidance for bulk purchases. The Board continues to believe that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

[11] See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, "Capital Leases," pars. 43-46, and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, par. 20, for federal accounting standards for leases.

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Data Conversion Cost

69. The issue of whether to capitalize all, some, or no data conversion cost is a difficult one. Some argue that the cost of converting existing data to a new software system is analogous to the types of cost that the Accounting Principles Board Opinion (APB) No. 17, *Intangible Assets*, requires to be expensed as incurred because they are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole--such as goodwill (APB 17, par. 24). The Board is persuaded that data conversion costs are operating costs and should be expensed.

Amortization Period

70. Most respondents said that no maximum period for amortization should be set in the standard. One respondent asked for clarification regarding the meaning of the general requirement that the amortization period be "consistent with management's plan for use." Another respondent asked whether the amortization period should begin when capitalization stops or when the system is put into use, saying that, often, there can be a significant time lag between these two events. One respondent asked for clarification regarding incremental implementation.

71. The Board has added additional guidance regarding the cessation of capitalization and commencement of amortization. The standard now focuses on the point when testing is complete. The term "operational," which some respondents found vague, is no longer used as a definitive point for cessation of capitalization. Also, provision has been made to treat each location and/or module separately.

Enhancements

72. Several respondents requested additional guidance for distinguishing maintenance from enhancements. The exposure draft proposed capitalizing the cost of changes to the existing system as an enhancement if it is more likely than not that the changes add capabilities or useful life. One respondent asked

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whether the cost of changes that make the software or system easier to use and users more efficient, but do not significantly change the capability/functionality (i.e., the system does not do any additional tasks), should be expensed or capitalized. Also, the ED proposed that year 2000 (Y2K) cost be expensed as incurred, even though they extend useful life. Several respondents asked whether Y2K cost were "enhancements."

73. The Board believes that an "enhancement" should be limited to instances where significant new capabilities are being added to the software. Merely making the software more efficient and/or extending its service life should not constitute a capitalizable cost. Software is more fluid and malleable than other PP&E and the Board concludes that a higher threshold for additional capitalization is reasonable.

Impairment

74. Two-thirds of the respondents said that the guidance on impairment was sufficient. Several respondents had questions about how the impairment provisions would apply to particular situations.

75. A respondent asked whether the availability of a new, updated version of COTS software with significantly improved functionality, efficiency, or effectiveness means that the older version is impaired even if the older version is still performing the functions for which it was designed. He asked whether the availability of new technology, whether adapted or not, render existing software "impaired." He asked about the affect of modernizing existing software to take advantage of the new technology. This respondent was concerned that if modernization is included in the definition of "impairment," there will be constant write-downs.

76. The Board believes that none of the situations cited by the respondent would meet the criteria of this standard in paragraphs 28-31. According to the criteria, in order for software to be considered impaired, it would have to have lost its service potential such that the federal entity would plan to remove it from service or the software would have had its capabilities reduced.

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77. One respondent asked about the ED's proposal for expensing Y2K cost. Since the implementation date for this standard has been moved back to FY 2001, the issue is largely moot. However, the Board's rationale for recommending that the Y2K cost be expensed is that such cost is incurred to repair a design flaw rather than to add to the software's capabilities or useful life, although the latter would be affected.

Working Capital Funds

78. At least one respondent was concerned about the impact of capitalizing non-COTS internal use software on the cash flows, billing rates, and performance measurement of working capital funds (WCFs). This respondent said that developing software internally and through contractors could require long lead times during which WCFs would have to finance the project because WCFs could not start to recover the cost from customers until the software project was complete and amortization commences. Also, this respondent said that write-downs or write-offs due to impairment by rapidly changing technology would be difficult to recapture from customers who expect and budget for consistent billing rates. This respondent believes that the capitalization of internally developed or contractor-developed software could result in fluctuating rates depending on when new projects come "on line" and on write-downs or write-offs due to impairment.

79. This respondent said that if write-downs or write-offs cannot be recovered from customers, then capital funds would be unavailable for investment, the WCFs' equity could be seriously impaired, and the WCFs would rapidly become unable to effectively provide the services for which they were established. The respondent said that WCFs are vulnerable to capital shortages because they operate on a break-even basis rather than generate retained earnings, and because they do not have access to private capital markets. This respondent's WCF currently capitalizes COTS software because it is a proven commodity; it becomes operational immediately and the WCF can begin chargingback the cost to customers.

80. Fixed assets usually provide important future benefits but require large amounts of resources up-front and extended periods for planning and acquisition.

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Making capital planning decisions is often difficult for agencies because full budget authority is required before the acquisition can commence and the entire acquisition has an immediate budgetary impact. This makes capital assets look expensive relative to, for example, annual lease payments even though the latter may be more expensive in the longrun.[12]

81. Notwithstanding these very real concerns, the Board concludes that the WCFs problem is one of budgetary control and program finance rather than of accounting. Congress has instituted various alternatives for WCFs to acquire capital. The Board's responsibility is to recommend what it considers the best accounting treatment considering all the circumstances and the Board's objectives.

Implementation Date

82. The 23 respondents who addressed the question of the implementation date were almost evenly divided as to the feasibility of an FY 1999 implementation date. Most respondents opposing the FY 1999 date said that federal agencies do not have the cost accounting systems as yet to account for capitalized cost but are developing such capabilities. Some respondents said that most federal agencies have a great deal "on their plate" now, when one considers the many recent initiatives. They said that an FY 2000 or FY 2001 implementation date would be better.

83. One respondent said that the AICPA's SOP is effective for periods beginning after December 15, 1998, and that there is no reason for the federal government to adapt such a standard before the private sector does. The respondent said that federal implementation after the private sector implements its standard would allow the federal government to learn from the private sector's experience.

84. The Board believes that federal entities are striving to meet deadlines for audited financial statements, performance reports, cost accounting, technology

[12] See GAO, *Budget Issues: Budgeting for Federal Capital* (GAO/AIMD-97-5 Nov. 1996), for (1) an analysis of capital budgeting problems experienced by WCFs and federal agencies generally and (2) possible solutions.

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management, and other initiatives. Entities resources are under stress to meet these deadlines. Thus, the Board believes that moving the implementation to FY 2001 is reasonable.

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APPENDIX B: Glossary

Amortization--The gradual extinguishment of any amount over a period of time through a systematic allocation of the amount over a number of consecutive accounting periods.

Book value--The net amount at which an asset or group of assets is carried on the books of account (also referred to as carrying value or amount). It equals the gross amount of any asset minus any allowance or valuation amount.

Capitalize--To record and carry forward into one or more future periods all or any part of expenditures from which the benefits or proceeds will then be realized.

Commercial off-the-shelf (COTS) item--Any item, other than real property, that is of a type customarily used by the general public for nongovernmental purposes and that (1) has been sold, leased, or licensed to the general public; (2) is sold, leased, or licensed in substantial quantities in the commercial marketplace; and (3) is offered to the federal government, without modification, in the same form in which it is sold, leased, or licensed in the commercial marketplace.

Contractor-developed software--Software that the federal entity is employing a contractor to design, program, install, and implement--including new software and existing or purchased software that have been modified--without substantive employee involvement beyond contract monitoring.

Cost--The monetary value of resources used or liabilities incurred to achieve an objective. Cost may be charged to operations immediately or, in cases where the cost relates to goods or services that will benefit future periods, to an asset account for recognition as an expense of subsequent periods.

Disclosure--Reporting information in notes or narrative regarded as an integral part of the basic financial statements.

Direct cost--The cost of resources directly consumed by and specifically identified with an activity. Direct cost is assigned to activities by the direct tracing of units of resources consumed by individual activities.

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Entity--A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with the Office of Management and Budget's annual guidance of Form and Content of Financial Statements.

Expense--Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period.

Full cost--The sum of all costs required by a cost object including the costs of activities performed by other entities regardless of funding sources.

Indirect cost--The cost of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs, e.g., general administrative services, general research and technical support, security, rent, employer health and recreation facilities, and operating and maintenance cost for buildings, equipment, and utilities. Such cost can be assigned to the output on a cause and effect basis or allocated on a reasonable and consistent basis.

Information system--A discrete set of information resources organized for the collection, processing, maintenance, transmission, and dissemination of information in accordance with defined procedures, whether automated or manual.

Information technology--Any equipment or interconnected system or subsystem of equipment used in the automatic acquisition, storage, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information. The term includes computers, ancillary equipment, software, firmware and similar procedures, services (including support services), and related resources.

Internal use software--Software that is purchased off-the-shelf, internally

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developed, or contractor-developed solely to meet the entity's internal needs.

Internally developed software--Software that employees of the entity are actively developing, including new software and existing or purchased software that is being modified with or without the assistance of contractors.

Life cycle--The phases through which a software application or an information system passes, typically characterized as initiation, development, operation, and termination.

Maintenance--The act of keeping internal use software and other assets in usable condition, including preventative maintenance, normal repairs, the replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide services and achieves its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from or significantly greater than those originally intended.

Net realizable value--The estimated amount that can be recovered from selling, or any other method of disposing of an item, less the estimated cost of completion, holding, and disposal.

Recognize--Having determined the amount, timing, classification, and other conditions precedent to the acceptance and entry of a transaction, the recording of an amount on the books of account and the reporting, other than parenthetically, of that amount on the face of the financial statements either individually or aggregated with other amounts.

Research and development--Federal research and development refers to those expenses incurred in support of the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes, with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits.

Software--The application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system.

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Stewardship PP&E--Items whose physical properties resemble general PP&E but whose value in terms of dollars (1) may be indeterminate or (2) would have little meaning (e.g., museum collections and monuments), or whose cost cannot be allocated meaningfully to accounting periods (e.g., military avionics and weapons systems and space exploration assets). Stewardship PP&E includes stewardship land, heritage assets, and federal mission PP&E (e.g., military and space exploration equipment).

Stewardship investments--Items treated as expenses in calculating net cost but meriting special treatment to highlight the substantial investment and long-term benefit of the expenses. This would include nonfederal physical property, human capital, and research and development.

Useful life--The normal operating life in terms of utility to the owner.

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APPENDIX B: Glossary

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FASAB Board Members

David Mosso, Chairman

Linda Blessing

James L. Blum

Philip T. Calder

Donald H. Chapin

Norwood Jackson

Gerald Murphy

James E. Reid

Nelson Toye

- -

Wendy M. Comes, Executive Director

Project Staff:

Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street NW

Suite 3B18

Washington, DC 20548

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Telephone (202) 512-7350

FAX (202) 512-7366

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APPENDIX B: Glossary

The terms defined in the glossary will be in **boldface** when they first appear in the body of this document.

There are no federal requirements regarding the phases that each software project must follow. The **life-cycle** phases of a software applicatio ribed here are compatible with and generally reflect those in the Office of Management and Budget's (OMB) Circular A-130, *Management of rmation Resources*, and *Capital Programming Guidance*; the General Accounting Office's (GAO), *Measuring Performance and Demonstratin ılts of Information Technology Investments (*GAO/AIMD-98-89, Mar. 1998); and the American Institute of CPA's Statement of Position No. 9 ɔunting for the Costs of Computer Software Developed or Obtained for Internal Use* (Mar. 4, 1998). Successful software projects normally wo at least an initial design phase, an application development phase, and a post-implementation/operational phase. Also, software eventually ld become obsolete or otherwise be replaced and therefore have a termination phase. Circular A-130 acknowledges that the "life cycle varies b ıature of the **information system**. Only two phases are common to all information systems--a beginning and an end. As a result, life cycle agement techniques that agencies can use may vary depending on the complexity and risk inherent in the project." (A-130, "Analysis of Key ions," p. 63).

General PP&E, as distinguished from **stewardship PP&E**, is defined in pars. 23-25, in SFFAS No. 6, *Accounting for Property, Plant, and ipment*.

For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal ernment* (June 1995), pars. 90-92. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

However, in instances where the useful life of the software is extended, the amortization period would be adjusted.

The Board has considered the cost associated with modifying internal use software for the year 2000 (Y2K) and has determined t cost should be charged to expenses as incurred, since it is a repair of a design flaw that allows existing software to continue being used. vever, an enhancement could presumably provide enhanced capabilities and at the same time, as an integral part of the new code and other ware enhancements, cure the Y2K problem. The total cost of such an enhancement should be capitalized rather than allocated between the Y2 and all other cost..

Presumably, NRV will be zero for software. However, in the rare case that it is not zero, NRV should be recognized.

For example, federal agencies use the following planning guidance: OMB Circulars A-11, *Budget Planning, Budgeting, and Acquisition of d Assets*; A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*; and A-109, *Acquisition of Major Systems*; OM *ital Programming Guide* (July 1997); GAO's *Assessing Risks and Returns: A Guide for Evaluating Federal Agencies' IT Investment Decision- ing* (Feb. 1997); and other federal guidance.

See SFFAS No. 6, par. 17.

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FASAB **Federal Accounting Standards Advisory Board**

Amendments to Accounting for Property, Plant, and Equipment

- Definitional Changes -

Amending SFFAS No. 6 and SFFAS No. 8
Accounting for Property, Plant, and Equipment
and
Supplementary Stewardship Reporting

Statement of Federal Financial Accounting Standards No. 11

October 1998

[Point of Contact: Rick Wascak, 202-512-7363, FAX 202-512-7366, email wascakr.fasab@gao.gov.]

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard is published by OMB and GAO and then becomes effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

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EXECUTIVE SUMMARY

a The purpose of this Statement is to amend certain standards in Statement of Federal Financial Accounting Standards No. 6, Accounting for Property, Plant, and Equipment, (SFFAS No. 6), which was issued in November 1995; and, Statement of Federal Financial Accounting Standards No. 8, Supplementary Stewardship Reporting, (SFFAS No. 8), which was issued in June 1996. The amendments specifically affect the definition in the standards for Federal mission property, plant, and equipment (PP&E) and the classification of space exploration equipment as general PP&E in these two Statements.

b Rather than specifying types of PP&E, the original standards defined Federal mission PP&E with a set of criteria. PP&E items that met those criteria would be reported as Federal mission PP&E. Those criteria, however, were subject to inconsistent interpretations and appeared to be resulting in a broader application of Federal mission PP&E than originally intended.

c To resolve this problem, the amendments eliminated the category of Federal mission PP&E and created a new category for national defense PP&E, which consists of: (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions, and (2) the vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. As a result space exploration equipment shall be treated as general PP&E.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION 1
Purpose 1
Background 1
Effective date 2

AMENDMENTS TO SFFAS No. 6 3
Introduction 3
National Defense
PP&E 3

AMENDMENTS TO SFFAS No. 8 8
Introduction 8
National Defense
PP&E 8

APPENDIX A: BASIS FOR CONCLUSIONS 9

APPENDIX B: CROSS REFERENCES 17

APPENDIX C: GLOSSARY 19

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INTRODUCTION

Purpose

1 The purpose of this Statement is to amend certain standards contained in Statement of Federal Financial Accounting Standards Number 6 (SFFAS No. 6), Accounting for Property, Plant, and Equipment, and Statement of Federal Financial Accounting Standards Number 8 (SFFAS No. 8), Supplementary Stewardship Reporting.

2 The amendments specifically affect the standards for:

- Federal mission property, plant, and equipment (PP&E) in SFFAS No. 6, paragraphs 21 and 46 through 52, and in SFFAS No. 8, paragraphs 52 through 59.

Background

3 In SFFAS No. 6, Federal mission PP&E are defined as PP&E having at least one characteristic from the group of characteristics related to "use" and one characteristic from the group of characteristics related to "useful life."

The "use" characteristics are:

- has no expected nongovernmental alternative uses; or
- is held for use in emergency, war, or natural disaster; or
- is specially designed for use in a program for which there is no other program or entity (Federal or non-federal, governmental or nongovernmental) using similar PP&E with which to compare costs.

The "useful life" characteristics are:

- has an indeterminate or unpredictable useful life due to the manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or premature obsolescence.

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The Board specifically identified two types of PP&E that met the Federal mission PP&E definition: (1) the PP&E components of national defense weapons systems, and (2) space exploration equipment.

4 Since SFFAS No. 6 was issued, however, many agencies have raised questions about the applicability of the Federal mission PP&E standard. Those questions indicate that the characteristics could be interpreted by agencies in various ways and the resultant applications could be either inconsistent or far broader than originally intended. Some agencies held the view that the characteristics are ineffectual as they would depend on subjective judgment by financial statement preparers and auditors. To prevent confusion, inconsistency, and unintended application, the amendments replace the definition of Federal mission PP&E with the definition of national defense PP&E and require that space exploration equipment be accounted for and reported as general PP&E.

Effective date

5 The amending accounting standards in this statement are effective for periods beginning after September 30, 1998, with earlier implementation encouraged.

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AMENDMENTS TO SFFAS No. 6

Introduction

6 Accounting standards for national defense PP&E are presented in paragraphs 8 through 14 that follow. The standards presented in these paragraphs supersede designated paragraphs in SFFAS No. 6 as they relate to Federal mission PP&E. Other paragraphs in SFFAS No. 6, which are not amended by this document, remain in effect.

7 Paragraphs 46 through 52 of SFFAS No. 6 are rescinded and replaced by paragraphs 8 through 13 below. In addition, paragraphs 21, 53 and 55 of SFFAS No. 6 are amended by replacing the category name "Federal mission property, plant, and equipment" with "national defense property, plant and equipment." Paragraph 14 provides implementation guidance.

National Defense PP&E

DEFINITION

8 National defense property, plant, and equipment (PP&E) are (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (2) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

a "Weapons systems" are a combination of one or more weapons[1] with all related property, plant, equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency.[2]

b "Military missions" are defined as the functions performed by the

[1] Weapons are instruments of combat used to destroy, injure, defeat or threaten an enemy. Adapted from *Dictionary of Weapons and Military Terms*.

[2] *Department of Defense Dictionary of Military and Associated Terms*, Joint Publication 1-02, March 23, 1994.

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Department of Defense or its component entities to prepare for the effective pursuit of war and military operations short of war; to conduct combat, peacekeeping, and humanitarian military operations; and to support civilian authorities during civil emergencies.

9 National defense PP&E components include: (a) Weapons Systems PP&E, (b) Weapons Systems Support Principal End Items, (c) Weapons Systems Support Real Property, and (d) Mission Support PP&E. These components are intended to provide guidance in identifying assets to be included in the overall national defense PP&E category. There is no requirement to report on the assets by component.

a Weapons Systems PP&E. Weapons systems PP&E is equipment that launches, releases, carries, or fires a particular piece of ordnance[3] and/or carries weapons systems-related property, equipment, materials, or personnel. Examples of weapons systems PP&E include aircraft, ships, tracked combat vehicles, and missiles.[4] Ammunition and other types of munitions (i.e., small and large caliber ammunition, rockets, grenades, mines, and other explosives) should be excluded from this category.

b Weapons Systems Support Principal End Items. These are end items[5] and replacement assemblies[6]. These items are acquired to support weapons systems and may ultimately be incorporated in weapons systems. Examples of these items include aircraft

[3] Ordnance is defined as explosives, chemicals, pyrotechnics, and similar stores, e.g., bombs, guns and ammunition, flares, smoke, napalm. *Department of Defense Dictionary of Military and Associated Terms,* Joint Publication 1-02, March 23, 1994.

[4] Missiles are unmanned, expendable, self-propelled flying vehicles with some form of guidance system that allows it to steer towards, rather than be aimed at, the target. Included are surface-to-air, air-to-air, air-to-surface, and surface to surface missiles.

[5] An end item is defined as a final combination of end products, component parts, and/or materials that is ready for its intended use, e.g., on a ship, tank, or aircraft. Adapted from *Department of Defense Dictionary of Military and Associated Terms,* Joint Publication 1-02, March 23, 1994.

[6] Replacement assembly is defined as an item forming a portion of an equipment, that can be provisioned and replaced as an entity and which normally incorporates replaceable parts or groups of parts. Adapted from *Department of Defense Dictionary of Military and Associated Terms,* Joint Publication 1-02, March 23, 1994.

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engines, tank engines, aircraft radars, ship sonar, uninstalled missile motors, missile control panels, gun mounts, gun turrets, and guidance systems.

c Weapons Systems Support Real Property. Weapons Systems Support Real Property is facilities and structures affixed to the land that are integral to a weapons system. Weapons Systems Support Real Property must be:

i. Of a permanent/fixed nature;

ii. Essential to the effective operation of a weapons system; and

iii. Currently utilized to support an active weapons system.

Examples include ammunition bunkers in active use and missile silos in active use.

The land associated with Weapons Systems Support Real Property shall not be included in this category. Land shall either be classified as general PP&E or Stewardship land and accounted for accordingly.

d Mission Support PP&E. Mission support PP&E is deployable[7] PP&E that:

i. Is essential to the effective operation of a weapons system or is used by the Department of Defense or its component entities to effectively perform their military missions;

ii. Has an indeterminate or unpredictable useful life[8] due to the manner in which it is used, improved, retired, modified, or maintained; and

[7] Possessing the characteristic of being positioned and ready for use in battle. Adapted from the *Dictionary of the Modern United States Military*.

[8] This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.

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iii. Is at a very high risk of being destroyed during use or of premature obsolescence.

Examples of mission support PP&E include: surveillance unmanned air vehicles (UAVs), non-tactical vehicles (e.g., fuel tanker, combat operations center, mess vehicles), field meteorological systems, crypto systems, and field security systems.

10 Government Property in the Possession of Contractors. Property and equipment in the possession of or acquired directly by the Government and delivered or otherwise made available to a contractor for use in accomplishing a contract is collectively referred to as "Government property." Government property should be accounted for based on the nature of the item regardless of possession. For example, operating materials and supplies remain operating materials and supplies subject to SFFAS No. 3 standards; and general PP&E remains general PP&E subject to SFFAS No. 6 standards.

11 National defense PP&E items may be delivered or otherwise made available to a contractor either for repair or for other uses, such as testing. These items are not to be excluded from national defense PP&E simply because they are in the hands of the contractors and are not being used directly by the Department of Defense or its component entities.

12 Property Excluded. There are types of Government property that generally do not meet the definition of national defense PP&E and, therefore, are excluded. Examples of these types include: **Government Material** - material which will become part of a deliverable end item; **Special Tooling** - equipment and manufacturing aids which are used in the development or production of particular supplies or parts, or in the performance of particular services; and **Specialized Test Equipment** - test equipment which is used to accomplish special testing in performing a contract.

13 Other Items Excluded. Other items that do not meet the PP&E definition (pars. 17 through 20, SFFAS No. 6) are also excluded

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from this category. For example, operating materials and supplies and stockpiled materials should be accounted for in accordance with SFFAS No. 3, Accounting for Inventory and Related Supplies.

IMPLEMENTATION GUIDANCE

14 For entities that implemented SFFAS No. 6 in prior years, any adjustments caused by these amendments should be reflected through a prior period adjustment.[9]

9SFFAS No.7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 76.

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AMENDMENTS TO SFFAS No. 8

Introduction

15 Accounting standards for national defense PP&E are presented in paragraphs 16 through 18 that follow. The proposed standards presented in these paragraphs supersede designated paragraphs in SFFAS No. 8 as they relate to Federal mission PP&E. Other paragraphs in SFFAS No. 8, which are not amended by this document, remain in effect.

National Defense PP&E

16 The category "Federal mission property, plant, and equipment" referred to in paragraph 17, SFFAS No. 8 is replaced with "national defense property, plant, and equipment."

17 The Standard inside the box on page 21 of SFFAS No. 8 is amended by replacing the category name "Federal mission property, plant, and equipment" with "national defense property, plant and equipment." Paragraphs 52 through 59 of SFFAS No. 8 are rescinded.

DEFINITION

18 Refer to paragraphs 8 through 13 of this document.

The provisions of this statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

19 This appendix summarizes the Board's considerations in recommending modifications to amend SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and SFFAS No. 8, *Supplementary Stewardship Reporting*, as they relate to Federal mission property, plant, and equipment (PP&E).

Background

20 The Board initially considered amendments to the definition of Federal mission PP&E due to numerous requests for interpretations to permit classifying certain property, plant, and equipment as Federal mission PP&E.

21 Based on review, presentations from affected entities, and multiple deliberations by the Board, it decided to redefine and rename Federal mission PP&E. This resulted in the elimination of the characteristics related to the "use" and the "useful life" of Federal mission PP&E and the classification of space exploration equipment as general PP&E. The decisions by the Board to redefine and rename Federal mission PP&E are discussed in the following paragraphs.

Definition

SFFAS Nos. 6 and 8 Standards

22 The Board developed the Federal mission PP&E category for "specific PP&E acquired to provide a unique good or service for which there is not necessarily a periodic output against which to match costs."[10] The Board specifically identified the PP&E components of weapons systems and space exploration equipment for this category. However, the Board believed it desirable to have "characteristics of Federal mission PP&E because it recognizes that there are other types of PP&E, or PP&E may be developed in the future that are similar to these two

[10] SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* paragraph 128.

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items."[11] The characteristics related to the "use" of the PP&E and to the "useful life" when used as intended.

23 Experience with the characteristics, however, revealed that they were creating confusion as to the appropriate use of the Federal mission PP&E category. Therefore, through this amendment, the Board strives to clarify which PP&E would be appropriate to include in this category. Recognizing the limitation of criteria, the Board sought more explicit means to limit the PP&E assignable to the category. Since the type of activity in which the PP&E was used would determine "whether there was a periodic output against which to match costs", the Board specifically identified the departments engaged in this type of activity. Thus, the new definition of Federal mission PP&E should limit the category to the PP&E components used in national defense.

Exposure Draft

24 In the development of a new definition for this classification of PP&E, the definition was crafted to include only the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities [12] for use in the performance of military missions. The DOD Board member and DOD staff assisted the Board in shaping the proposed definition by presenting DOD's definitions of specific types of assets that might be weapons systems components and/or support PP&E. The Board used the definitions provided by the DOD as the foundation for amending the definition of Federal mission PP&E. This was intended to assist in clarifying the definition and ease implementation of the standards by using existing DOD terminology where possible. Based on the new definition, the title "Federal mission PP&E" was changed to "national defense PP&E" to be more descriptive of what the standard was addressing.

[11] SFFAS No. 6., paragraph 129.

[12] The terminology "Department of Defense or its component entities" was deliberately chosen by the Board because many other departments and agencies provide some support to national defense. However, as explained in later paragraphs, the Board determined that predominant use should be considered and that cost accounting would support allocation of cost among multiple missions.

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25 In connection with the Board's deliberations, the Department of Transportation (DOT) request for interpretation was addressed. DOT had requested that the Maritime Administration's National Defense Reserve Fleet (NDRF) and certain US Coast Guard vessels and aircraft also be considered national defense PP&E. The NDRF consists of ships held in a preservation status. They are activated only during a military crisis or national emergency. Their predominant use is to provide supplemental shipping capacity that the United States can rely on during a military crisis or national emergency.

26 The Board deliberated this issue and agreed that because of the NDRF's preservation status and predominant use (i.e., to provide additional shipping capacity only during military missions such as a military crisis or national emergency), that depreciation of the cost of the ships was not meaningful. Therefore, the Board believes the NDRF ships should also be considered national defense PP&E.

27 The US Coast Guard presented very difficult issues for the Board and considerable time was devoted to discussion of appropriate treatment. The Coast Guard has an important role in National defense readiness. By law, the Coast Guard may be called on to participate in times of war or national emergency and is thus considered in military strategic planning. In fact,, one of Coast Guard's four missions is "military preparedness." However, the Coast Guard has substantial ongoing responsibilities for three non-defense missions: maritime law enforcement, maritime safety, and maritime environmental protection for which operating performance is the primary reporting objective.

28 The Board believed that, conceptually, an allocation of the acquisition cost of vessels (over 65 feet) and aircraft between national defense PP&E and general PP&E would be appropriate given their multiple uses. However, based on information provided by Coast Guard, the Board determined that it would not be cost-beneficial to allocate acquisition costs between the two categories of PP&E. Ultimately, the definition of national defense PP&E was written to exclude Coast Guard's vessels and aircraft.

29 The Board based this exclusion on the need to have cost

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information to support assessment of operating performance for the three non-defense missions. The exclusion provides consistency with the full cost standards provided in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and with the treatment of multi-use heritage assets discussed in later paragraphs. The Board indicated that meaningful information would result if the depreciation expense on these multi-use Coast Guard assets was allocated to each of the missions served by the PP&E. This approach would be consistent with requirements in SFFAS No. 4 and OMB's Form and Content for cost information by responsibility segments and programs.

30 Also, during the discussions on national defense PP&E, the Board agreed to a request made by National Aeronautics and Space Administration to remove space exploration equipment from this category for the following reasons: 1) NASA needs cost information in performing joint missions with other countries and in billing both government and non-government entities for reimbursable services performed by NASA, and 2) The function performed by NASA with its space exploration equipment is not a unique Government function similar to defense.

Board Decision on the Definition

31 Respondents to the ED were very supportive of the revised definition. Recommended changes were few.

- One respondent suggested that the Board add a category for National defense PP&E held for destruction, sale or abandonment. The Board did not adopt this recommendation because it believes DOD has the flexibility to identify this as a major class if separate reporting is desired.

- Responses to a question posed on the appropriateness of including ammunition and munitions in this PP&E category were mixed. The Board decided to exclude it from the definition. This decision is explained more fully in a later section of this appendix.
- The Board did not receive any responses from departments or agencies that believed the definition should be broadened

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to include additional PP&E.

The Board adopted the definition largely as it was presented in the ED.

AMMUNITION AND MUNITIONS

Background

32 In discussions relating to national defense PP&E, it was suggested that ammunition and munitions are not currently addressed in the Federal financial accounting standards. Therefore, questions were posed in the ED's **QUESTIONS FOR RESPONDENTS** asking how ammunition and munitions should be categorized for accounting and reporting purposes. Definitions for these items were presented in the ED and are presented below. No comments from respondents to the ED were received which disputed or challenged their accuracy.

33 **Ammunition.** "Ammunition" is defined as a "device charged with explosives, propellants, pyrotechnics, initiating composition, or nuclear, biological or chemical material for use in connection with defense or offense, including demolition." (from the *Encyclopedia of the U.S. Military*)

34 Ammunition is portrayed as having the following characteristics:

- It is not held for sale at ammunition depots (unlike DoD inventory, which is held for sale).
- It is held for use in a normal operating cycle or in reserve for future use.
- It is not long-lived, it can be used or consumed only once.

35 Projectiles fired from a gun are the principal form of modern ammunition. Projectiles are usually in the form of bullets or artillery. Items commonly designated as ammunition include small/medium caliber ammunition, mortar ammunition, tank

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ammunition, artillery ammunition, explosive mines, bombs, torpedoes, and missiles. It should be noted that, while missiles may be commonly designated as ammunition, they have been included in the Weapons System PP&E (e.g., aircraft, ships, tracked combat vehicles, and missiles. Paragraph 9 a) component of national defense PP&E.

36 **Munitions.** "Munition" (singular) is defined as "a complete device charged with explosives, propellants, pyrotechnics, initiating composition, or nuclear, biological, or chemical material for use in military operations, including demolitions." (from the *Department of Defense Dictionary of Military and Associated Terms*) This definition is almost exactly the same as the definition for ammunition. Also, ammunition is referred to as munition (singular.)

37 Whereas, "munitions" (the plural of munition), is used in a broad sense to refer to any and all supplies and equipment required to conduct offensive and defensive war, including guns, machines, ammunition, transport and fuel; but, excluding personnel and any supplies and equipment used for purposes other than direct military operations. In common usage, "munitions" (plural) can be military weapons, ammunition, and equipment. (from the *Dictionary of Military Terms, A Guide to the Language of Warfare and Military Institutions*)

38 Based on feedback in comment letters for the ED, four options for accounting and reporting ammunition and munitions were considered by the Board. They were:

- Categorize it as operating materials for accounting and reporting purposes.
- Categorize it so that it would be included in one of the components of national defense PP&E.
- Categorize it so that it would be a separate and unique component of national defense PP&E.
- Categorize it as a separate and unique asset recognized on the balance sheet for accounting and reporting purposes.

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39 During deliberations by the Board, it was noted that ammunition and munitions, although not specifically identified in the standard, were considered an item of operating materials and supplies in the development of SFFAS No. 3. SFFAS No. 3 was developed through full due process and considered some unique operating requirements of DOD. Included were provisions to categorize operating materials and supplies between those used in a normal operating cycle, those held in reserve for future use, and excess and obsolete items. Provisions to use the purchases method of accounting, instead of the consumption method of accounting, were also included in the standards. That is, if the items are not significant amounts, they are in the hands of the end user for use in normal operations, or it is not cost-beneficial to apply the consumption method.

40 Those respondents to the ED who addressed the issue were generally more in favor of categorizing ammunition and munitions as some component of national defense PP&E. Their argument was that ammunition and munitions are essential to the operations of or an integral part of weapons systems. Therefore, it seemed to these respondents that the information provided about national defense PP&E and ammunition and munitions should be the same.

41 The Board, however, did not agree with this argument and decided that ammunition and munitions should be categorized as operating materials and supplies. By categorizing ammunition and munitions as operating materials and supplies, the cost of these items would be recognized in the period they were consumed unless the conditions described in paragraph 40 of SFFAS No. 3 were met. The Board also noted that by following SFFAS No. 3 for ammunition and munitions, entities would provide similar treatment for the consumable items used each period such as training supplies and fuel.

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APPENDIX B: CROSS REFERENCES FROM PARAGRAPHS IN SFFAS NO. 6 AND NO. 8 TO PARAGRAPHS IN THESE AMENDMENTS

Table I: References Related to Standards in SFFAS No. 6

PAR. NUMBERS IN SFFAS NO 6	STATUS AND REFERENCE TO PARAGRAPHS IN THESE AMENDMENTS
PP&E categories, par. 21, 53 and 55	Par. 7
Federal mission PP&E, par. 46 through 52	Par. 8 through 13
All other paragraphs in SFFAS No. 6	Not changed

Table II: References Related to Standards in SFFAS No. 8

PAR. NUMBERS IN SFFAS NO 8	STATUS AND REFERENCE TO PARAGRAPHS IN THESE AMENDMENTS
The category name Federal mission property, plant, and equipment" in paragraph 17 is replaced with "national defense property, plant, and equipment."	Par. 16
The Standard inside the box on page 21 of SFFAS No. 8 is amended by replacing the category name "Federal mission property, plant, and equipment" with "national defense property, plant and equipment."	Par. 17
All other paragraphs in SFFAS No. 8	Not changed

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APPENDIX C: GLOSSARY

AMMUNITION - A generic term that includes a great variety of devices designed and constructed to inflict damage upon enemy personnel or material by action of an explosive, pyrotechnic, or chemical agent.

ASSETS - Tangible or intangible items owned by the federal government which would have probable economic benefits that can be obtained or controlled by a federal government entity. (Adapted from Financial Accounting Standards Board, Statement of Concepts No. 6, *Elements of Financial Statements*, and *Kohler's Dictionary for Accountants*.)

GENERAL PROPERTY, PLANT, AND EQUIPMENT (PP&E) - PP&E used to provide government services or goods. The cost of general PP&E is capitalized, i. e. recorded as assets on the balance sheet. For detailed characteristics of and accounting for general PP&E, see paragraphs 23 through 34, SFFAS No. 6.

MILITARY MISSIONS - Functions performed by the Department of Defense or its component entities to prepare for the effective pursuit of war and military operations short of war; to conduct combat, peacekeeping, and humanitarian military operations; and to support civilian authorities during civil emergencies.

NATIONAL DEFENSE PROPERTY, PLANT, AND EQUIPMENT (PP&E) - The PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions, and vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

PRINCIPAL END ITEMS - End Items and replacement assemblies acquired to support weapons delivery systems and may ultimately be incorporated as integral parts in a weapons delivery system. An end item is a final combination of end products, component parts, and/or materials that is ready for its intended use. Replacement assembly is an item forming a portion of an equipment that can be provisioned and replaced as an entity and which normally incorporates replaceable parts or groups of parts.

SPACE EXPLORATION EQUIPMENT - Items that are intended to operate above the atmosphere to explore space and any specially designed equipment to aid, service or operate other equipment engaged in exploring space.

STEWARDSHIP - The Federal Government's responsibility for the general welfare of the nation in perpetuity.

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USEFUL LIFE - The normal operating life in terms of utility to the owner.

WEAPONS - Instruments of combat used to destroy, injure, defeat or threaten an enemy. (adapted from *Dictionary of Weapons and Military Terms*)

WEAPONS SYSTEMS - A combination of one or more weapons with all related property, plant, equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency. (Joint Chiefs of Staff, *Department of Defense Dictionary of Military and Associated Terms*, Joint Publication 1-02, Mar. 23, 1994.)

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FASAB Board Members

David Mosso, Chairman

Dr. Linda J. Blessing

James L. Blum

Philip T. Calder

Donald H. Chapin

Norwood J. Jackson

Gerald Murphy, through September 3, 1998

Donald Hammond, from September 4, 1998

James E. Reid

Nelson E. Toye

Wendy M. Comes, Executive Director

Project Staff:
Rick Wascak
Richard Mayo
Andrea Palmer

Special Assistance Provided by Steve Tabone, Department of Defense

Federal Accounting Standards Advisory Board
441 G Street N.W.
Suite 3B18
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.financenet.gov/fasab.htm

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FASAB **Federal Accounting Standards Advisory Board**

RECOGNITION OF CONTINGENT LIABILITIES ARISING FROM LITIGATION: An Amendment of SFFAS No. 5, *Accounting for Liabilities of the Federal Government*

Statement of Federal Financial Accounting Standards
Number 12

December 1998

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB, or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the federal government.

The Board communicates its recommendations by publishing recommended accounting concepts and standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." After considering oral and written comments, the standards may be recommended by the Board. The Board's sponsors then decide whether to adopt the recommendations. If adopted, the standard is published by the OMB and the General Accounting Office and become effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

(1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

(2) the "Mission Statement of the Federal Accounting Standards Advisory Board"

Federal Accounting Standards Advisory Board
Accounting for Liabilities of the Federal Government
December 1998

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EXECUTIVE SUMMARY

This recommended accounting standard amends Statement of Federal Financial Accounting Standards Number 5, *Accounting for Liabilities of the Federal Government* (SFFAS No. 5). It provides an exception to the contingent liability standard for recognizing loss contingencies on matters of pending or threatened litigation and unasserted claims.

For loss contingencies covered by the exception, a contingent liability would be recognized[1] when a future outflow or other sacrifice of resources is "likely to occur," a past event or exchange transaction has occurred, and the future outflow or sacrifice of resources is measurable. Before the amendment, SFFAS No. 5 called for recognition when an outflow is "more likely than not." In addition to recognition, disclosure[2] would be required for loss contingencies on matters of pending or threatened litigation and unasserted claims if it is at least reasonably possible that a loss or an additional loss may have been incurred. The amendment does not affect recognition of other types of contingencies.

[1] The term "recognize" means the formal recording or incorporating of an item into the financial statements of an entity as an asset, liability, revenue, expense, etc. See FASAB Consolidated Glossary.

[2] The term "disclosure" means the reporting of information in notes or narrative regarded as an integral part of the basic financial statement. See FASAB Consolidated Glossary.

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TABLE OF CONTENTS

PURPOSE 1

SCOPE 1

BACKGROUND 1

MATERIALITY 2

EFFECTIVE DATE 2

ACCOUNTING STANDARD 3

APPENDIX A: BASIS FOR CONCLUSIONS 4

APPENDIX B: Selected Section from Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies.* 6

APPENDIX C: Selected Sections of Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government.* 7

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Introduction

PURPOSE

1. This Statement amends Statement of Federal Financial Accounting Standards Number 5 (SFFAS No. 5), A*ccounting for Liabilities of the Federal Government,* to provide an exception to the contingent liability standard for matters of pending or threatened litigation and unasserted claims. The proposed amendment would affect accounting for contingencies under SFFAS No. 5 by inserting an exception to the definition of "probable" and to the recognition criteria in SFFAS No. 5 (see current paragraphs 33, 36, and 38 of that standard in Appendix C).

SCOPE

2. This standard applies to evaluations and accounting recognition and disclosure of the future outcome of litigation.

BACKGROUND

3. The Federal Accounting Standards Advisory Board (FASAB) was asked to clarify the application of the standard for recognizing loss contingencies for pending or threatened litigation and unasserted claims. SFFAS No. 5 provides the definition for "liability" and establishes specific standards for five liability categories, including contingencies.

4. SFFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss.[3] SFFAS No. 5 requires a liability to be recognized for loss contingencies when a past event or exchange transaction makes a future outflow of resources probable and measurable.[4] It defines "probable" as that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.[5]

5. SFFAS No. 5 uses the same general framework for evaluating loss contingencies as Financial Accounting Standards Board (FASB) Statement of Financial

[3] SFFAS No. 5, par. 35, and also in Appendix C.

[4] SFFAS No.5, par. 36.

[5] SFFAS No. 5, par. 33 and also see SFFAS No. 5's Glossary.

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Accounting Standards No. 5, *Accounting for Contingencies* (SFAS No. 5). Contingencies can be "probable," "reasonably possible," or "remote;" and, based on that, are recognized on the balance sheet, disclosed in footnotes, or not mentioned in the financial statements, respectively. However, SFAS No. 5 defines "probable" as "likely to occur" instead of "more likely than not."[6]

6. Some auditors have expressed reservations about their ability under Statement of Auditing Standards 12 (SAS 12) to express an unqualified opinion on the entity's financial statements without a legal representation letter that refers to the SFFAS No. 5 standard. Lawyers have expressed serious objection to the definition of probable (“more likely than not”) contained in SFFAS No. 5. They state that a lawyer’s prediction of failure under the SFFAS No. 5 definition of “probable” (“more likely than not”), and the recording of a liability to reflect that judgment, could be used as an admission against interest, thereby jeopardizing the government’s ability to fairly defend the public interest. Similarly, they further state that a lawyer’s response to an auditor’s request for information on matters where an unfavorable outcome is more likely than not could result in the disclosure of information protected by the lawyer-client privilege, disadvantaging the government in any dispute, and violating the American Bar Association’s Code of Professional Responsibility.

7. The Board believes that this amendment clarifies the standard for contingencies involving pending or threatened litigation and unasserted claims and will facilitate communication among auditors, lawyers, those who prepare financial statements, and those who use the financial statements.

MATERIALITY

8. The provisions of this statement need not be applied to immaterial items.

EFFECTIVE DATE

9. This standard is effective for reports issued subsequent to the date of this statement for reporting periods beginning after September 30, 1997.

[6] SFAS No. 5, par. 3.

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Accounting Standard

10. Paragraph 33 of SFFAS No. 5 is amended by adding "with the exception of pending or threatened litigation and unasserted claims" at the end of the first sentence. Paragraph 33 is further amended by adding the following footnote to the first sentence:

    The concept of probability is imprecise and difficult to apply with respect to most legal matters. The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation. Accordingly, in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability, "probable" refers to that which is likely, not to that which is more likely than not. Note that the remaining two criteria for recognizing a liability--that is, a past event or exchange transaction has occurred and the future outflow or sacrifice of resources is measurable--also must be met before recognizing a contingent liability in matters involving litigation.

11. Other conforming changes to SFFAS No. 5 are:

    The first bullet of paragraph 36 is changed as follows: “Probable: The future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.”

    Paragraph 38 of SFFAS No. 5 is amended by replacing “more likely than not” in the second bullet with “likely.”

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Appendix A: Basis for Conclusions

12. In their capacity as legal counsel to federal agencies, lawyers should evaluate the outcome of matters of pending or threatened litigation and unasserted claims, and estimate any losses therefrom, in accordance with the American Bar Association's *Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information.* Attorneys note that neither the outcome of litigation nor any loss resulting therefrom can be assessed "in any way that is comparable to a statistically or empirically determined concept of probability" (see *Auditor's Letter Handbook,* American Bar Association, page 18). The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation.

13. Accordingly, in the context of such cases the standard refers simply to that which is "likely." In this context, therefore, "likely to occur" is used in federal accounting standards in the same way that it is used in Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies,* published by the Financial Accounting Standards Board in 1975.

14. The Board believes that this amendment will serve the objectives of financial reporting because it will facilitate communications among auditors, lawyers, those who prepare financial statements, and those who use the statements.

15. The Board published an exposure draft of this standard on October 30, 1998, and received thirty responses, six of which had no comment. Of the 24 who commented, 22 concurred with the proposed standard. (Two responses were positive but could not be characterized as concurrence.) No respondent objected to the amendment. Five respondents suggested broadening the scope of the amendment to apply "likely to occur" to all contingent liabilities.

16. Although some respondents suggested broadening the application, the Board concluded that the amendment should be limited to contingent liabilities resulting from litigation. Most respondents concurred with this approach. The Board plans additional research on this subject in 1999.

17. The Board has made minor changes to the proposal published as an exposure draft. Several respondents suggested minor changes in wording and/or notations in paragraphs 33 and 36 in addition to or instead of paragraph 38 to

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clarify the amendment. The Board has adopted most of these suggestions.

18. The Board makes this recommendation with a vote of nine members approving issuance and no members opposing issuance.

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Appendix B: Selected Section from Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies.*

1. For the purposes of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a "gain contingency") or loss (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

* * *

3. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms *probable, reasonably possible,* and *remote* to identify three areas within that range, as follows:

a. *Probable*. The future event or events are likely to occur.
b. *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
c. *Remote*. The chance of the future event or events occurring is slight.

* * *

8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if *both* of the following conditions are met:

a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statement. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.

b. The amount of the loss can be reasonably estimated.

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Appendix C: Selected Sections of Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government* (footnotes omitted).

* * *

33 "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.

* * *

CONTINGENCIES

35 A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).

36 This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incidence of a liability can range from probable to remote. The probability classifications are as follows:

- Probable: The future confirming event or events are more likely than not to occur.
- Reasonably possible: The chances of the future confirming event or events occurring is more than remote but less than probable.
- Remote: The chance of the future event or events occurring is slight.

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37 The following are some examples of loss contingencies:

- collectibility of receivables,
- pending or threatened litigation, and
- possible claims and assessments.

CRITERIA FOR RECOGNITION OF A CONTINGENT LIABILITY

38 A contingent liability should be recognized when all of these three conditions are met:

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).
- A future outflow or other sacrifice of resources is probable (e.g., the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is more likely than not to be settled in favor of the claimant).
- The future outflow of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount).

39 The estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed.

CRITERIA FOR DISCLOSURE OF A CONTINGENT LIABILITY

40 A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. "Disclosure" in this context refers to reporting information in notes regarded as an integral part of the basic financial information.

41 Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

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42 In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose federal financial reports. Specifically, contingencies classified as remote need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.

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FASAB Board Members

David Mosso, Chairman
Linda Blessing
James L. Blum
Philip T. Calder
Donald H. Chapin
Norwood Jackson
Donald Hammond
James E. Reid
Nelson Toye

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:

Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street, NW
Room 3B18
Washington, DC 20548

Telephone (202) 512-7350
Fax (202) 512-7366

Federal Accounting Standards Advisory Board
Accounting for Liabilities of the Federal Government
December 1998

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FASAB

Federal Accounting Standards Advisory Board

DEFERRAL OF PARAGRAPH 65.2 -- MATERIAL REVENUE-RELATED TRANSACTIONS DISCLOSURES

Amending SFFAS No. 7
Accounting for Revenue and Other Financing Sources

Statement of Federal Financial Accounting Standards Number 13

January 1999

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard is published by OMB and GAO and then becomes effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

- "Mission Statement: Federal Accounting Standards Advisory Board"

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Background

1. Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources* including paragraphs 65.2 became effective for fiscal year 1998. It included detailed provisions that apply to entities collecting taxes on behalf of the Federal Government.

2. Paragraph 65.2 of SFFAS No. 7 states:

> Entities that collect taxes and duties should disclose:
>
> 65.2 **Material revenue related transactions.** Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by the taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.

3. Because of difficulties in preparing the information and questions as to its usefulness, the Board agreed to consider deletion of paragraph 65.2. Ultimately, the Board agreed that more study of the issues was needed. Accordingly, it agreed that the requirement should be deferred.

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Statement of Standards

4. Paragraph 65.2 of SFFAS No. 7 is deferred three years; it will be effective for periods beginning after September 30, 2000.

Effective Date

5. This amendment is effective for fiscal periods beginning after September 30, 1998. Earlier implementation is encouraged.

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6. Experience gained by IRS and GAO while attempting to implement the provisions of SFFAS No. 7 provided greater insight into the difficulties of preparing, analyzing, and communicating the information described in paragraph 65.2 than was available when SFFAS No. 7 was approved. Based on that additional experience and insight, the Board proposed that subparagraph 65.2 should be rescinded. An exposure draft to accomplish this was published in November 1998. The exposure draft included the alternative view of one Board member. He believed that subparagraph 65.2 should be retained, albeit possibly with some modification.

7. The responses received by the Board which expressed an opinion on the proposal were approximately evenly divided. Respondents supporting the deletion indicated that the requirements were calling for more detailed analysis than generally found in accounting standards, were not cost beneficial, and were potentially misleading because assessments and associated abatements are often substantially overstated. Respondents opposing the deletion indicated that the requirements were essential for proper management and oversight, necessary to overcome the limitations of the modified cash basis of accounting for tax revenues, and helpful in ensuring that systems support evaluations of activity during the year.

8. After reviewing the comment letters and redeliberating, the Board agreed that the primary question was the degree to which the information would be relevant. Some members believe the information would be relevant to users and that it, or similar information, is needed to address the objectives of federal financial reporting. Other members believe that the information presented by IRS and the GAO staff responsible for auditing the financial statements of IRS calls into question the

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Board's prior conclusion that the information is relevant. Responses to the exposure draft that proposed deletion of subparagraph 65.2 did not resolve this issue. Therefore, the Board agreed that it should conduct further study regarding the relevance of the items of information discussed in subparagraph 65.2.

9. The Board concluded that the effective date for subparagraph 65.2 should be deferred three years; from fiscal year 1998 to fiscal year 2001. The Board expects to complete the study before the new effective date.

Board Approval

10. The Board approves this recommendation by a vote of eight members approving its issuance and one member opposing its issuance.

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Linda Blessing
James L. Blum
Philip T. Calder
Donald H. Chapin
Norwood Jackson
Donald Hammond
James E. Reid
Nelson Toye

- -

FASAB Staff

Wendy M. Comes, Executive Director

Project Director:
Robert Bramlett

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 3B18
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

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U.S. General Accounting Office
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Washington, DC 20548

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Federal Accounting Standards Advisory Board

AMENDMENTS TO DEFERRED MAINTENANCE REPORTING

Amending

SFFAS No. 6 *Accounting for Property, Plant and Equipment*

and SFFAS No. 8 *Supplementary Stewardship Reporting*

Statement of Federal Financial Accounting Standards No. 14

April 1999

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard becomes authoritative and is published by OMB and GAO.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"
- "Mission Statement: Federal Accounting Standards Advisory Board"

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TABLE OF CONTENTS

Executive Summary i

Introduction 1

Accounting Standards 2

Appendix A: Basis for Conclusions 3

Appendix B: Amended Standards 7

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_14.pdf.

I. Deferred maintenance reporting is a required disclosure per Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment* (SFFAS No. 6), and is referenced in SFFAS No. 8, *Supplementary Stewardship Reporting*. This amendment does not modify the information to be provided users of federal financial statements. It does, however, modify the status of that information and thus the level of its review by financial statement auditors.

II. When SFFAS No. 6 was issued, the Board indicated that deferred maintenance reporting would evolve as preparers gained experience. *The* Board provided maximum flexibility to preparers noting that management would determine "acceptable condition" against which deferred maintenance would be assessed. (see SFFAS No. 6, par. 78, footnote 58) In addition, the Board noted that acceptable condition might vary between entities **and** between sites within the same entity. To ensure that readers would understand the deferred maintenance disclosures, the Board required that management's method of measuring deferred maintenance and management's requirements for acceptable condition be disclosed with the estimated amounts.

III. After the statement became effective, questions arose about whether this flexibility was appropriate given the status of the information as basic information (i.e., an integral part of the financial statements). The Board agreed that a change in status was warranted.

IV. This statement amends SFFAS No. 6 and SFFAS No. 8 to define deferred *maintenance* information as required supplemental information (RSI) rather than within the financial statements and the notes thereto.

V. As required supplementary information, the deferred maintenance information will be subject to the audit procedures prescribed in AU Section 558.07, *Codification of* Statements *on Auditing Standards.* These procedures include inquiries to management and comparisons of the information for consistency. In addition, the auditor should consider whether the RSI should be covered in management's representation letter. The auditor may need to apply additional procedures required by other guidance, and to make additional inquiries if necessary based on the outcome of the required procedures. Readers should refer to the most current auditing standards for relevant guidance.

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Purpose

1. The purpose of this amendment is to change the status of deferred maintenance information required by Statement of Federal Financial Accounting Standard No. 6, *Accounting for Property, Plant, and Equipment*. Before amendment, this information would have been presented in association with the statement of net costs. As amended, the standards require that deferred maintenance information be included as required supplemental information (RSI). Thus, a line item for "deferred maintenance" would no longer be required on the statement of net costs with a reference to a note disclosure.

2. The Basis for Conclusions presents the reasons for these amendments.

Scope

3. The statement amends both SFFAS 6 and 8 with regard to information on deferred maintenance.

Effective Date

4. This amendment is effective for periods beginning after September 30, 1998 with earlier implementation encouraged.

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Amendments to SFFAS No. 6

5. Paragraph 79 and the heading "RECOGNITION" that precedes it are deleted.

6. The section heading "DISCLOSURE REQUIREMENTS" which appears before paragraph 80 is deleted. Paragraph 80 is amended by replacing "disclosed" with "reported."

7. The section heading "Disclosures" before paragraph 83 is replaced with "Required Supplementary Information."

8. Paragraph 83 is amended by adding the phrase "as required supplementary information" between the phrases "shall be presented" and "for all PP&E." The requirement to report a range estimate when using the condition assessment survey method is modified by inserting “or a point” after the words “and a range.”

9. The section heading "Optional Disclosures" before paragraph 84 is replaced with "Optional Information." In the second sentence, the word "disclose" is replaced with “report” and the word "disclosure" is replaced with "information."

Amendments to SFFAS No. 8

10. Bullet 4 of paragraphs 50, 68 and 81 are amended by replacing "a note to the financial statements in which case a reference to the note will suffice" with "with the deferred maintenance information included elsewhere in the report in which case a reference to the information will suffice."

11. Bullet 5 of paragraphs 50, 68 and 81 are amended by replacing "a note to the financial statements" with "the information.” Footnote 15 is amended by adding "as amended by SFFAS No. 14" to the end of the footnote.

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12. The Board believes that the experience gained in implementing SFFAS Nos. 6 and 8 provides greater insight into the required deferred maintenance disclosures. In recommending the deferred maintenance standards, the Board recognized that experimentation would be needed before high quality information on deferred maintenance was available throughout the federal government. However, the implementation experience brought to light concerns regarding the degree of flexibility afforded during the experimentation period and audit issues.

13. In December 1998, the Board issued an exposure draft proposing amendments intended to address the concerns being raised. The concerns included:

a) the ability of preparers to disclose an extremely large range estimate; and

b) users perceptions regarding the nature of the information[1] being presented.

14. The exposure draft proposed that deferred maintenance information be moved from being associated with the Statement of Net Cost to Required Supplementary Stewardship Information (RSSI). The Board believed that this was consistent with the importance of the information as well as the experimental nature of the information. The Board explained in the exposure draft that the information would be audited as if it were required supplemental information (RSI).

[1] While deferred maintenance information as required under the SFFAS 6 provisions is very relevant, implementation demonstrated that it may not be reliable or comparable. The Board is concerned that placement of this information in notes would be a disservice to users.

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15. There were 20 respondents to the exposure draft. The respondents were from the following groups:

	Federal	Nonfederal	Total
Users and others		2	2
Preparers	9		9
Auditors	9		9
Total	18	2	20

16. One respondent opposed the proposal and stated a preference for a delayed effective date. Seventeen respondents supported the proposal and two did not directly indicate support or opposition.

17. Respondents noted the need for more detailed guidance on preparing estimates as well as specific issues such as overseas facilities which have differing facilities standards. One respondent suggested that guidance be developed for small agencies for which deferred maintenance reporting may be unnecessarily burdensome. Many respondents acknowledged the importance of the disclosures and the need to address auditing standards for deferred maintenance as well as accounting standards.

18. A number of respondents suggested that moving deferred maintenance disclosures to stewardship reports would be appropriate because doing so would:

a) lower the profile of the information,

b) prevent distortion of *financial* data,

c) reduce the resources needed to prepare and audit the data, and

d) resolve audit concerns.

19. The Board is concerned that stewardship reports – required for the first time for fiscal year 1998 reports – may be considered of

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lesser significance than “financial statements” and the associated notes. In fact, stewardship reports were intended to facilitate presentation of highly important financial and non-financial information about complex aspects of federal government operations and responsibilities. Thus the Board plans a review of the results of the implementation of stewardship reporting requirements. That review is expected to take place during calendar year 1999.

20. The Board does not believe that adding deferred maintenance information to stewardship reports would be appropriate in light of the planned review. In addition, deferred maintenance information presents measurement issues not currently experienced in stewardship reports.

21. The Board believes that a period of experimentation is desirable for deferred maintenance information and that classifying it as RSI is appropriate during the experimentation period. The use of RSI for experimentation is consistent with the practices of other standard setting bodies. For example, the Financial Accounting Standards Board (FASB) conducted a five year experiment in reporting on changing prices through RSI. During the experimentation period, FASB permitted flexibility in measuring the effects of changing prices

22. The Board believes that experimenting with deferred maintenance reporting is vitally important to improving its usefulness. The current standards for estimating deferred maintenance are intentionally flexible in the following ways:

a) either life cycle costing or condition assessment may serve as the basis for the estimates;

b) management determines the “acceptable condition” of PP&E and may vary the acceptable condition by site and type of property; and

c) engineering and/or maintenance standards are not referenced.

23. The Board intends that the Accounting and Auditing Policy Committee (AAPC) work with government-wide groups such as the Chief Financial Officers Council and the Presidents Council on Integrity and Efficiency to review the first year reports and identify areas requiring further guidance. At a minimum, the Board expects to develop guidance on determining acceptable condition. The Board

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plans to revise the standards based on experience gained during the experimentation period.

Board Approval

24. This recommended statement was approved by the Board with a vote of seven members in favor of its issuance and one member opposing its issuance. (Only eight members voted on this recommendation due to a vacancy on the Board.)

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AMENDMENTS TO SFFAS 6

DEFINITION

77. "Deferred maintenance" is maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period.

78. For purposes of this standard, maintenance is described as the act of keeping fixed assets in acceptable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life.[58] Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.

~~**RECOGNITION**~~

~~79. A line item for "deferred maintenance amounts"[59] shall be presented on the statement of net cost with a note reference in lieu of a dollar amount.[60] No amounts shall be recognized for deferred maintenance.~~

~~**DISCLOSURE REQUIREMENTS**~~

Measurement

80. Amounts ~~disclosed~~ reported for deferred maintenance may be measured using:

- condition assessment surveys,
- or life-cycle cost forecasts.[61]

81. *Condition assessment surveys* are periodic inspections of PP&E to determine their current condition and estimated cost to correct any

---

[58] Acceptable services and condition may vary both between entities and among sites within the same entity. Management shall determine what level of service and condition is acceptable.

[59] ~~This requirement applies to all four categories of PP&E.~~

[60] ~~If management determines that there are no material amounts of deferred maintenance, this line item need not appear.~~

[61] Other methods may be used which are similar or identical to condition assessment survey or life-cycle costing. These methods would also be acceptable sources of information on deferred maintenance.

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deficiencies. It is desirable that condition assessment surveys be based on generally accepted methods and standards consistently applied.[62]

82. *Life-cycle costing* is an acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in a forecast of maintenance expense, these forecasts may serve as a basis against which to compare actual maintenance expense and estimate deferred maintenance.

~~Disclosures~~Required Supplementary Information

83. At a minimum, the following information shall be presented as required supplementary information for all PP&E (each of the four categories established in the PP&E standard should be included).

- Identification of each major class[63] of asset for which maintenance has been deferred.
- Method of measuring deferred maintenance for each major class of PP&E.
- If the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E:
  - description of requirements or standards for acceptable operating condition,
  - any changes in the condition requirements or standards, and
  - asset condition[64] and a range or a point estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition.

[62]Management shall determine what methods and standards to apply. Once determined, it is desirable but not required that methods and standards be applied consistently from period to period.

[63]"Major classes" of general PP&E shall be determined by the entity. Examples of major class include, among others, buildings and structures, furniture and fixtures, equipment, vehicles, and land.

[64]Examples of condition information include, among others, (1) averages of standardized condition rating codes, (2) percentage of assets above, at or below acceptable condition, or (3) narrative information.

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- If the total life-cycle cost method is used the following should be presented for each major class of PP&E:
  - the original date of the maintenance forecast and an explanation for any changes to the forecast,
  - prior year balance of the cumulative deferred maintenance amount,
  - the dollar amount of maintenance that was defined by the professionals who designed, built or manage the PP&E as required maintenance for the reporting period,
  - the dollar amount of maintenance actually performed during the period,
  - the difference between the forecast and actual maintenance,
  - any adjustments to the scheduled amounts deemed necessary by the managers of the PP&E,[65] and
  - the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance.

Optional Information ~~Disclosures~~

84. Stratification between critical and noncritical amounts of maintenance needed to return each major class of asset to its acceptable operating condition. If management elects to report ~~disclose~~ critical and noncritical amounts, the information ~~disclosure~~ shall include management's definition of these categories.

The provisions of this statement need not be applied to immaterial items.

[65] Adjustments may be necessary because the cost of maintenance foregone may not be cumulative. For example, if periodic painting is skipped twice it is not necessarily true that the cost would be double the scheduled amount.

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AMENDMENTS TO SFFAS 8

Paragraphs 50, 68 and 81 of SFFAS 8 as amended with respect to condition reporting are shown below:

Heritage Assets

50. (fourth bullet) Condition of the assets[14] unless it is already reported in ~~required supplementary information~~ deferred maintenance information included elsewhere in the report in which case a reference to the information will suffice. ~~a note to the financial statements in which case a reference to the note will suffice~~.

(fifth bullet) A reference to the information ~~a note to the financial statements~~ if deferred maintenance is reported for the assets.[15]

National Defense PP&E

68. (fourth bullet) Condition of the assets[21] unless it is already reported ~~required supplementary information~~ deferred maintenance information included elsewhere in the report in which case a reference to the information will suffice ~~a note to the financial statements in which case a reference to the note will suffice~~.

(fifth bullet) A reference to the information ~~the applicable note to the financial statements~~ if deferred maintenance is reported for the assets.

Stewardship Land

81. (fourth bullet) Condition[26] of the stewardship land, unless it is already reported in ~~required supplementary information~~ deferred

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[14] Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets at, or below acceptable condition; or (3) narrative information.

[15] For guidance relating to deferred maintenance reporting, see the Deferred Maintenance standard in *Accounting for Property, Plant, and Equipment,* SFFAS No. 6.

[21] Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets at, or below acceptable condition; or (3) narrative information.

[26] Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets at, or below acceptable condition; or (3) narrative information.

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maintenance information included elsewhere in the report in which case a reference to the information will suffice. ~~a note to the financial statements in which case a reference to the note will suffice~~.

(fifth bullet) A reference to the information ~~a note to the financial statements~~ if deferred maintenance is reported for the assets.[27]

[27]For guidance on deferred maintenance reporting, see the Deferred Maintenance standard Accounting for Property, Plant, and Equipment, SFFAS No. 6.

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Donald H. Chapin

Norwood Jackson

Donald Hammond

James Reid (through December 31, 1998)

Nelson Toye

Kenneth Winter (from February 25, 1999)

FASAB Staff

Wendy M. Comes, Executive Director

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 3B18
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

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Federal Accounting Standards Advisory Board

Statement of Recommended
Accounting Standards Number 15

MANAGEMENT'S DISCUSSION AND ANALYSIS

April 1999

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board")in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting concepts and standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The three officials who established the Board then decide whether to adopt the recommendations. If they do, the standard is published by the OMB and the GAO and becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board
Wendy M. Comes, Executive Director
441 G Street, NW -- Room 3B18
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366

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STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS
MANAGEMENT'S DISCUSSION AND ANALYSIS

EXECUTIVE SUMMARY..... i

STATEMENT OF STANDARDS..... 1

APPENDIX A: BASIS FOR CONCLUSIONS..... 4
- Background, Rationale, and Project History..... 4
- Concepts and Standards..... 5
- Responses to Second Exposure Draft..... 6
- Accountability Reports..... 8
- Forward-looking Information..... 8
- Incorporation by Reference..... 9

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EXECUTIVE SUMMARY

This document establishes standards for preparing Management's Discussion and Analysis (MD&A). MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the general purpose federal financial report (GPFFR),[1] and (3) providing understandable and accessible information about the entity and its operations, service levels, successes, challenges, and future. Some federal agencies also refer to MD&A as the "overview."

The basic concept that underlies the standards for MD&A is:

> Each general purpose federal financial report (GPFFR) should include a section devoted to management's discussion and analysis (MD&A). It should address the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.

A separate document titled *Concepts for Management's Discussion and Analysis* explains the conceptual basis for the role and importance of MD&A, the general content of the GPFFR, and the elements of MD&A. The concepts provide a foundation for the standards presented in this document. The concepts include suggestions about the contents of MD&A, but those suggestions are not accounting standards or principles for federal reporting entities. In particular, the concepts are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the *Codification of Statements on Auditing Standards* published by the American Institute of Certified Public Accountants (AICPA). The only standards and prescribed guidelines for MD&A are in paragraphs 1-8 of this document.

The standards require MD&A to be included in each GPFFR as required supplementary information (RSI). MD&A should address:

-- the entity's mission and organizational structure;

-- the entity's performance goals and results;

-- the entity's financial statements;

-- the entity's systems, controls, and legal compliance; and

-- the future effects on the entity of existing, currently-known demands, risks, uncertainties, events, conditions and trends.

The discussion and analysis of these subjects may be based on information in other discrete

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sections of the GPFFR or it may be based on reports separate from the GPFFR.

The standards are effective for reporting periods that begin after September 30, 1999.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

STATEMENT OF STANDARDS

1. A report that presents a Federal reporting entity's financial statements in conformance with Federal accounting principles should include management's discussion and analysis (MD&A) of the financial statements and related information. MD&A should provide a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should provide a balanced presentation that includes both positive and negative information about these topics. MD&A should be regarded as "required supplementary information" as that term is used in auditing standards.[2]

2. MD&A should contain sections that address the entity's:

- mission and organizational structure;
- performance goals, objectives, and results;
- financial statements; and
- systems, controls, and legal compliance.

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3. MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends.[1] Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

4. MD&A should discuss important problems that need to be addressed, and actions that have been taken or planned. Actions needed, taken, and planned may be discussed within the sections listed above or in a separate section of MD&A.

5. Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.

6. MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the GPFFR as a source of information. (The specific topics mentioned in *Concepts for Management's Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

o lead to significant actions or proposals by top management of the

[1]The word "anticipated" is used in a broad, generic sense in this document. In this context the term may encompass both "probable" losses arising from events that have occurred, which should be recognized on the face of the basic or "principal" financial statements, as well as "reasonably possible" losses arising from events that have occurred, which should be disclosed in notes to those statements. "Anticipated" may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label "projected" or "projection," and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity's financial statements; however, preparers and auditors may find useful background information in the AICPA's Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, "Financial Forecasts and Projections," of the AICPA's *Codification of Statements on Standards for Attestation Engagements.*

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reporting unit;

- be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or

- significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government.

7. Management of the reporting unit is responsible for the content MD&A.

8. The standards are effective for reporting periods that begin after September 30, 1999.

This Statement of Recommended Standards was adopted unanimously by the eight members of the Federal Accounting Standards Advisory Board serving on the Board in April 1999.

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4

APPENDIX A: BASIS FOR CONCLUSIONS

Background, Rationale, and Project History

9. The Board identified MD&A as a topic for its agenda shortly after the Board's inception. The Board deferred work on this topic, however, until it completed recommendations for an initial set of basic accounting standards.

10. FASAB published an initial exposure draft on MD&A in January, 1997. It was presented as a statement of recommended concepts rather than standards. The Board proposed that it would deal with MD&A conceptually, with the understanding that OMB would provide authoritative guidance on MD&A to implement the concepts. This approach would have been similar to the one used to deal with the topics of entity and display. The Board dealt with those topics conceptually in SFFAC 2. OMB then provided authoritative guidance in its Bulletin on Form and Content.

11. The Board received comment letters on the initial exposure draft from the following sources:

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	FEDERAL (internal)	NONFEDERAL (external)	TOTAL
CITIZENS, USERS, ACADEMICS AND OTHERS[3]		4	4
AUDITORS	7	3	10
PREPARERS AND FINANCIAL MANAGERS	16		16
TOTALS	23	7	30

Concepts and Standards

12. The first exposure draft asked respondents whether all or part of the exposure draft's provisions should be issued as recommended standards rather than recommended concepts. Responses were mixed; most of those who commented on this question favored concepts, but a significant number expressed the view that standards would be appropriate. The Board concluded that, given the importance of MD&A as an integral part of the GPFFR, it would be appropriate for federal accounting principles to include standards for MD&A.

13. At the same time, the Board concluded that MD&A should be treated as required supplementary information. The Board agreed that it would recommend no detailed requirements or guidelines for MD&A at this time, beyond those in paragraphs 1-8. In other words, a discussion and analysis by management that addresses the listed topics should be required, because it is an essential part of a complete GPFFR. At the same time, management should have great discretion regarding what to say about those topics, subject only to the criteria in paragraphs 1-8 and the pervasive requirement that MD&A not be misleading. The standard itself, therefore, is not extremely prescriptive.

14. Because of this change from what was originally exposed for comment, the Board decided to expose separately the proposed standards and concepts for further comment. The exposure drafts were issued in October, 1998; responses were requested by January 1999.

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The proposed standard, like the final recommended standard, would require the auditor to note the omission of MD&A or the failure to address the specified topics. At the same time, RSI status for MD&A--coupled with the lack of specific, detailed, prescriptive standards for the content of MD&A--would minimize the requirement for the auditor to scrutinize MD&A. This, the Board believed, would provide the flexibility appropriate for dealing with topics such as performance measurement at this point in the evolution of federal financial reporting.

Responses to Second Exposure Draft

15. The Board received comment letters on the second exposure draft from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)	TOTAL
CITIZENS, USERS, ACADEMICS AND OTHERS		3	3
AUDITORS[4]	3	3	6
PREPARERS AND FINANCIAL MANAGERS	11		11
TOTALS	14	6	20

16. Most comments were generally favorable, but comments were mixed regarding some points. A few auditors and preparers expressed some concern about requiring forward-looking information as RSI. Others expressed support for doing so. After considering these responses, the Board agreed to defer the recommended implementation date of the standard by one year and to make minor editorial changes to the standards and concepts that were exposed for comment.

17. Although the resulting standard differs from private sector standards, the Board expects that, in practice, the effect on auditors will not be greatly different.[2] In the private sector, corporations frequently include with their annual financial report the MD&A that they are required to file with the SEC. Because it is required by the SEC rather than by accounting standards, the auditor engaged to audit the corporation's financial statements normally treats MD&A as "accompanying information" that is not audited in the context of the audit of the financial statements. The auditor also may review the submission to the SEC and may have certain responsibilities in that regard, but the auditor's usual role regarding MD&A is, nevertheless, fairly limited.

[2]The standard itself differs from the SEC's guidance for MD&A in ways that reflect the unique federal reporting environment. This will affect what financial statement preparers must do to comply with the standard. For example,

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18. Because this standard defines MD&A for federal reporting entities as RSI, auditors will have certain responsibilities regarding it; however, both the accounting standards specified here and the auditing standards specified by the AICPA (and incorporated in Government Audit Standards) for RSI are rather general. Therefore, the Board does not expect that this standard will cause the auditor to be deeply involved in reviewing the contents of MD&A.

19. More specific requirements regarding the content of MD&A may be added later by OMB acting on its own authority or pursuant to future FASAB recommendations. For example, OMB might at some time in the future require preparers to address certain of the suggested items in *Concepts for Management's Discussion and Analysis*. OMB also may provide more specific guidance regarding the auditor's responsibility for MD&A. That guidance may call for more extensive review of all or parts of MD&A than the minimum contemplated by this accounting standard in the context of current auditing standards. For example, OMB might at some time in the future decide that the minimum scope of engagements to audit federal financial statements should be expanded to include a review or examination of all or parts of MD&A, consistent with attestation guidelines published by the AICPA.[3]

Accountability Reports

20. The Board notes that the concept and practice of the "Accountability Report" continue to evolve through the pilot project voluntarily undertaken by several agencies.[5] The Board supports this evolution and encourages agencies to participate in the pilot project. The concepts and standards FASAB recommends are intended to be applicable to the GPFFR of Federal entities, whether those reports are prepared pursuant to the Chief Financial Officers Act, the Government Management Reform Act, or some future law that might establish a statutory basis for Accountability Reports. In the event of such future legislation, OMB will need to resolve any questions about how to apply existing Federal accounting standards in the context of new legislative requirements.

Forward-looking Information

reporting on performance of governmental programs requires measures in addition to net income or net cost.

[3]See Statement on Standards for Attestation Engagements No. 8, *Management's Discussion and Analysis,* issued by the Auditing Standards Board of the AICPA, March 1998.

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21. MD&A should include forward-looking information regarding the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends. This kind of forward-looking information is required when management believes it would be important to people who read the financial report. Though not required, MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends. FASAB encourages management to include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends to the extent management believes such information would be useful and relevant. This information can be highly useful, but management should avoid turning this part of MD&A into mere "lobbying" for more budgetary authority.

Incorporation by Reference

22. Some respondents expressed concern that, if MD&A is to be regarded as RSI, audit problems might arise from "incorporation by reference" in MD&A of information drawn from other sources that might not have been subject to audit or review as basic or required supplementary information, and for which authoritative guidance had not been provided by a standard setter. The Board noted that most of those who commented, including most auditors, did not appear to be greatly concerned about this potential problem. The Board concluded, therefore, that any such problems were not likely to be insurmountable. The Board did, however, agree to defer by one year the implementation date of the standard to allow OMB and GAO time to resolve any audit issues that may arise.

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Wendy M. Comes, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 3B18
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

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[1] The term "general purpose federal financial report," abbreviated GPFFR, is used as a generic term to refer to the report that contains the entity's financial statements that are prepared and audited pursuant to the CFO Act of 1990, as amended. Entities may refer to these reports using different terms, such as "Annual Report," "Accountability Report," "Financial Management Report," etc. Paragraphs 54-112 and Appendix 1 of Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, describe and illustrate the contents of the GPFFR.

[2] See section 558, "Required Supplementary Information," in *Codification of Statements on Auditing Standards*, American Institute of Certified Public Accountants (AICPA).

[3] This category includes representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other GPFFR users.

[4] Includes the AICPA's Federal Accounting and Auditing Subcommittee and the Comptroller General's Advisory Council on Government Audit Standards.

[5] Accountability reports are broader in scope than traditional general purpose financial reports. As explained by OMB: "Six pilot agencies volunteered to produce an 'Accountability Report' for FY 1995 to provide more useful

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information to decision makers by linking together information required by several management statutes....Accountability Reports integrate the following information: the FMFIA report, the CFOs Act Annual Report (including audited financial statements); management's Report on Final Action as required by the IG Act; Civil Monetary Penalty and Prompt Payment Act reports; and available information on agency performance compared with its stated goals and objectives, in preparation for implementation of GPRA." *Federal Financial Management Status Report and Five Year Plan*, June 1996, pp. 33-34. Twelve agencies produced accountability reports for FY 1997; eighteen plan to do so for FY 1998; the number will increase to 23 for FY 2000. (The requirement to include Civil Monetary Penalty and Prompt Payment Act reports has been deleted.)

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FASAB **Federal Accounting Standards Advisory Board**

Amendments to Accounting for Property, Plant, and Equipment

Measurement and Reporting
for
Multi-Use Heritage Assets

Amending SFFAS No. 6 and SFFAS No. 8
Accounting for Property, Plant, and Equipment
and
Supplementary Stewardship Reporting

Statement of Federal Financial Accounting Standards

July 1999

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of Federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comments as "exposure drafts." The Board's sponsors then decide whether to adopt the recommendations. If they do, the standard is published by OMB and GAO and then becomes effective.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

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EXECUTIVE SUMMARY

a The purpose of this Statement is to amend certain standards for heritage assets in Statement of Federal Financial Accounting Standards No. 6, Accounting for Property, Plant, and Equipment, (SFFAS No. 6), which was issued in November 1995; and, Statement of Federal Financial Accounting Standards No. 8, Supplementary Stewardship Reporting, (SFFAS No. 8), which was issued in June 1996. Specifically, the amendments affect accounting and reporting standards for heritage assets that serve a dual purpose; that is, heritage assets that 1) have a heritage characteristic, and 2) are used in general government operations.

b In SFFAS No. 6 and SFFAS No. 8, these heritage assets were referred to as "multi-use heritage assets." To clarify the meaning of the term "multi-use heritage assets," the amendments define "multi-use heritage assets" as being heritage assets whose predominant use is general government operations. Heritage assets having incidental use in general government operations are not referred to as "multi-use heritage assets.' Rather, they are simply "heritage assets."

c In addition, the original standards required the cost of multi-use heritage assets that did not directly relate to operations be accounted for as an expense, while costs that directly support operations be accounted for as general property, plant, and equipment (PP&E). This treatment would have resulted in inconsistent cost measures between agencies using heritage office buildings and those using non-heritage office buildings.

d To alleviate this inconsistency, the Board decided that ~~the~~ all acquisition, reconstruction, and betterment costs of multi-use heritage assets (i.e., heritage assets whose predominant use is general government operations) be capitalized as general PP&E and depreciated over their service life. This amendment should result in consistent accounting for the cost of PP&E predominantly used in general government operations.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION 1
Purpose 1
Scope 1
Effective Date 1

AMENDMENTS TO SFFAS No. 6 3
Introduction 3
Heritage Assets 3

AMENDMENTS TO SFFAS No. 8 7
Introduction 7
Heritage Assets 7

APPENDIX A: BASIS FOR CONCLUSIONS 9

APPENDIX B: CROSS REFERENCES 13

APPENDIX C: GLOSSARY 15

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_16.pdf.

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INTRODUCTION

Purpose

1 The purpose of this Statement is to amend certain standards contained in Statement of Federal Financial Accounting Standards Number 6 (SFFAS No. 6), Accounting for Property, Plant, and Equipment, and Statement of Federal Financial Accounting Standards Number 8 (SFFAS No. 8), Supplementary Stewardship Reporting.

Scope

2 This Statement specifically affects the accounting standards for heritage assets in SFFAS No. 6, paragraphs 59 and 60 through 63, and SFFAS No. 8, paragraphs 48 through 50.

Effective date

3 The amending accounting standards in this statement are effective for periods beginning after September 30, 1999, with earlier implementation encouraged.

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AMENDMENTS TO SFFAS No. 6

Introduction

4 Accounting standards for multi-use heritage assets are presented in paragraphs 5 through 15 that follow. The standards presented in these paragraphs supersede designated paragraphs in SFFAS No. 6 as they relate to multi-use heritage assets. Other paragraphs in SFFAS No. 6, which are not amended by this document or by Statement 11, remain in effect.

Heritage Assets

5 Heritage assets are defined in paragraphs 57 and 58 in SFFAS No. 6. Those paragraphs are not changed. However, accounting for "multi-use heritage assets" is changed. The new provision is provided in paragraph 6 below, which replaces paragraph 59 of SFFAS No. 6.

6 Heritage assets may in some cases be used to serve two purposes--a heritage function and general government operations. In cases where a heritage asset serves two purposes, the heritage asset shall be considered a multi-use heritage asset if the predominant use of the asset is in general government operations (e.g., the main Treasury building which is a heritage asset used as an office building). The cost of acquisition, betterment, or reconstruction of all multi-use heritage assets shall be capitalized as general PP&E and depreciated.

RECOGNITION AND MEASUREMENT

7 Paragraphs 8 through 12 below replace paragraphs 60 through 62 of SFFAS No. 6.

8 The cost of acquiring, improving, reconstructing, or renovating heritage assets, other than multi-use heritage assets, shall be recognized on the statement of net cost for the period in which the cost is

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incurred. The cost[1] shall include all costs incurred during the period to bring the item to its current condition at its initial location (See paragraph 26 of SFFAS No. 6 for examples of the costs to be considered).

9 The cost of acquisition, betterment, or reconstruction of multi-use heritage assets shall be capitalized as general PP&E and depreciated, with an appropriate footnote disclosure explaining that "physical quantity" information for the multi-use heritage assets is included in supplemental stewardship reporting for heritage assets. The multi-use heritage assets shall be depreciated over their useful life.

10 With the exception of multi-use heritage assets, as stated in paragraph 11 below, no amounts for heritage assets acquired through donation or devise[2] shall be recognized in the cost of heritage assets. The assets' fair value, if known and material, shall be disclosed in notes to the financial statements in the year received. If fair value is not known or reasonably estimable, information related to the type and quantity of heritage assets received shall be disclosed.

11 Multi-use heritage assets acquired through donation or devise shall be recognized as general PP&E at the assets' fair value, and the amount shall also be recognized as "nonexchange revenues" as defined in SFFAS No. 7, Accounting for Revenue and Other Financing Sources.

[1] For a full discussion of cost, including full cost, direct cost and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995). Also, see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

[2] A will or clause of a will disposing of property.

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12 Additional reporting requirements are provided in SFFAS No. 8, *Supplementary Stewardship Reporting*.

IMPLEMENTATION GUIDANCE

13 Paragraph 14 below replaces paragraph 63 of SFFAS No. 6. Paragraph 15 provides additional guidance on multi-use heritage assets. (Paragraphs 64 and 65 of SFFAS No. 6 remain in effect.)

14 Heritage assets (excluding multi-use heritage assets) previously recognized as assets for balance sheet reporting and their related contra amounts (e.g. accumulated depreciation) shall be removed from the balance sheet and charged to the net position of the entity. The amount of the adjustment shall be reported as a "prior period adjustment" in the statement of changes in net position.

15 Implementation guidance for general PP&E, in paragraph 40 through 44, SFFAS No. 6, is applicable to multi-use heritage assets. Entities that implemented the multi-use heritage asset standard in SFFAS No. 8 in prior years for stewardship assets, will need to capitalize those amounts upon implementation of this amendment. That amount shall be added to the balance sheet and reported as a "prior period adjustment" in the statement of changes in net position.[3]

[3] SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, paragraph 76.

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AMENDMENTS TO SFFAS No. 8

Introduction

16 Accounting standards for multi-use heritage assets are presented in paragraphs 17 and 18 that follow. The standards presented in these paragraphs supersede designated paragraphs in SFFAS No. 8 as they relate to multi-use heritage assets. Other paragraphs in SFFAS No. 8, which are not amended by this document, remain in effect.

Heritage Assets

17 Paragraphs 48 and 49 in SFFAS No. 8 are rescinded. The reader should refer to paragraphs 6 through 15 in this document for guidance on multi-use heritage assets. Paragraph 18, which is presented below, is added as a reporting requirement in paragraph 50 of the Heritage Assets **Minimum Reporting** requirements in SFFAS No. 8. Other paragraphs on heritage assets in SFFAS No. 8 remain in effect.

18 A footnote shall explain that financial information for multi-use heritage assets is presented in the principal statements.

The provisions of this statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

19 This appendix summarizes the Board's considerations in recommending modifications to amend SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and SFFAS No. 8, *Supplementary Stewardship Reporting*, as they relate to heritage assets.

MULTI-USE HERITAGE ASSETS

Background

20 In the original PP&E Exposure Draft (February 1995), renovation, improvements, restoration or reconstruction costs for that portion of the heritage asset used in general government operations were to be capitalized and depreciated. Meanwhile, the costs that primarily related to the preservation of the asset for a heritage purpose (e.g., excess cost of maintaining original design and construction materials) rather than general government operations were to be excluded from general PP&E (i.e., expensed in the period incurred). The response to this proposal contained in the ED was that costs could not be divided between heritage and general PP&E in this manner.

21 In the existing standards (SFFAS No. 6 and No. 8), costs of renovation, improvement, restoration, or reconstruction that can be directly related to government operations (e.g., modification or improvement of office space, upgrading of electrical or communication equipment/wiring) are to be capitalized and depreciated. Meanwhile, the costs to renovate, restore, or reconstruct the heritage asset itself (the shell) were to be excluded from general PP&E (i.e., expensed in the period incurred). Again, comments the Board received pertaining to implementing this requirement were that the distinction for the costs cannot be made and that it produces inconsistent results.

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Exposure Draft

22 In February 1998, the Board issued an exposure draft (ED), *Amendments to Accounting for Property, Plant, and Equipment*, proposing amendments to SFFAS No. 6 and No. 8. In the proposed amendments, the costs of acquisition, betterment, or reconstruction of multi-use heritage assets (i.e., heritage assets used in general government operations) were to be treated as general PP&E and depreciated. The Board believes that this treatment would be consistent with the full cost standards, eliminate the need to adjust cost amounts presented in the government-wide consolidated financial statements, and be consistent with the predominant use notion.

23 The proposed modification for multi-use heritage assets is based on various entities' accounting for and reporting on multi-use heritage assets. The current accounting standards created inconsistent treatment of assets that were ultimately used in the same ways. For example, because the general PP&E category includes all PP&E used in a business-type activity, the General Services Administration (GSA) will capitalize the full cost of its buildings because they are used in business. Meanwhile, entities performing non-business-type entities (i.e., providing a service without receiving value in return) will not show the full costs of their building because of its multi-use heritage asset status. This is inconsistent accounting that is not justified by the uses of the assets.

24 The Board found that consolidation of entities accounting for similar assets differently also could add unnecessary complexity to the consolidation process. Since a monumental office building accounted for by GSA as general PP&E and entirely capitalized by GSA becomes a multi-use heritage asset at the government-wide level the asset, cost of heritage assets, and depreciation expense amounts would have to be adjusted on consolidation (subject to materiality limitations). The Board believes that this change to the accounting for multi-use heritage assets will also correct this unnecessary complexity.

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Responses to ED

25 Thirty written responses were received in regard to the ED. Of the thirty responses received, fifteen respondents commented on the proposed amendments for multi-use heritage assets. Thirteen of the respondents who commented on the proposed amendments for multi-use heritage assets agreed with the proposed amendments, while the other 2 respondents who commented on them disagreed.

Board Decisions

26 To allow for full costing on assets used in general government operations, the Board believes that the costs of acquisition, betterment, or reconstruction of multi-use heritage assets should be capitalized and depreciated to allow for full costing in accordance with SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.* Thus, the Board decided to capitalize and depreciate multi-use heritage assets and allocate the depreciation based on function.

27 Some respondents to the ED asked if multi-use heritage assets reported as general PP&E on the balance sheet should also be reported in supplemental stewardship reporting, in order to recognize them as heritage assets. It was observed by the Board that it would be desirable to report all material heritage assets in stewardship reporting, including those multi-use heritage assets reported on the balance sheet, to show a complete picture for stewardship purposes of all material assets classified as heritage assets. This is consistent with the Board's decision in SFFAS No. 8 to specifically note that some land might be included in heritage assets and in stewardship land. Different information is captured under the reporting for each category.

28 This dual reporting of multi-use heritage assets is highlighted through note disclosures directing readers from the balance sheet to the stewardship reports and vice versa. The amended standards require balance sheets to have a note disclosure which

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explains that "physical quantity" information for the multi-use heritage assets is included in supplemental stewardship reporting for heritage assets. In addition, for multi-use heritage assets reported in stewardship reporting, an appropriate note disclosure is required to explain that financial information for multi-use heritage assets is presented in the principal statements.

29 The ED also added the predominant use notion for multi-use heritage assets because the Board agreed that incidental office use should not determine the accounting treatment; that the predominant use should prevail. An example of incidental office use would be administrative offices or shop space in the Jefferson Memorial. In this case both uses are incidental and the Jefferson Memorial should be treated as a heritage asset and not be capitalized and depreciated.

30 One respondent to the ED suggested that "predominant use" be defined in the standard. During its deliberations, however, the Board noted that the terminology "predominant use" is already used in SFFAS No. 8 without any questions or problems being raised about its definition. Therefore, the Board believed that if it did define the term, that action may create a problem where no problem exists.

Board Approval

31 The Board approved this recommendation by a vote of 8 members approving its issuance and 0 member(s) opposing its issuance. Although the Board is comprised of 9 members, only 8 members cast a vote on SRAS 16. This is because the term of one Board member had expired and the appointment of a successor had not been finalized.

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APPENDIX B: CROSS REFERENCES FROM PARAGRAPHS IN SFFAS NO. 6 AND NO. 8 TO PARAGRAPHS IN THESE AMENDMENTS

Table I: References Related to Standards in SFFAS No. 6

PAR. NUMBERS IN SFFAS NO 6	STATUS AND REFERENCE TO PARAGRAPHS IN THESE AMENDMENTS
Multi-use heritage assets, par. 59	Par. 6
Heritage assets measurement and recognition, par. 60 through 62	Par. 8 through par. 12
Heritage assets implementation, par. 63	Par. 14

Table II: References Related to Standards in SFFAS No. 8

PAR. NUMBERS IN SFFAS NO 8	STATUS AND REFERENCE TO PARAGRAPHS IN THESE AMENDMENTS
Multi-use heritage assets par. 48 and 49	Par. 6 through 15
Heritage Assets Minimum Reporting Requirements, par. 50	Add par. 18

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APPENDIX C: GLOSSARY

BETTERMENT - An expenditure having the effect of extending the useful life of an existing asset, increasing its normal rate of output, lowering its operating cost, increasing rather than merely maintaining its efficiency or otherwise adding to the worth of benefits it can yield. A betterment is distinguished from repair or maintenance in that the latter have the effect of merely keeping the asset in its customary state of operating efficiency without the expectation of added future benefits. (*Kohler's Dictionary for Accountants*.)

CAPITALIZE - To record and carry forward into one or more future periods any expenditure the benefits or process from which will then be realized. (*Kohler's Dictionary for Accountants*)

CONDITION - The physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a momentous tragic event ranging from extreme misfortune to utter ruin), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence.

COST - Defined in SFFAC No. 1, *Objectives of Federal Financial Reporting* as the monetary value of resources used (para. 195). Defined more specifically in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, as the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service (page 105). Depending on the nature of the transaction, cost may be charged to operations immediately, i.e., recognized as an expense of the period, or to an asset account for recognition as an expense of subsequent periods. In most contexts within *Accounting for Revenue and Other Financing Sources*, "cost" is used synonymously with expense. See also "Full Cost."

DIRECT COST - The cost of resources directly consumed by an activity, and is specifically identified with a cost object. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities.

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EXPENDITURE - With respect to provisions of the Antideficiency Act (31 U.S.C. 1513-1514) and the Congressional Budget and Impoundment Control Act of 1974 (2 U.S.C.622(i)), a term that has the same definition as outlay. (GAO *Budget Glossary*)

FAIR VALUE (Or fair market value) - Value determined by bona fide bargain between well-informed buyers and sellers, usually over a period of time; the price for which an PP&E item can be bought or sold in an arm's length transaction between unrelated parties; value in a sale between a willing buyer and a willing seller, other than in a forced or liquidation sale; an estimate of such value in the absence of sales or quotations. (*Kohler's Dictionary for Accountants*)

FULL COST - The total amount of resources used to produce the output. More specifically, the full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities. (SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, para. 89) All direct and indirect costs to any part of the Federal Government of providing goods, resources, or services. (OMB *Circular A-25*).

GENERAL PROPERTY, PLANT, AND EQUIPMENT (PP&E) - PP&E used to provide government services or goods. The cost of general PP&E is capitalized, i. e. recorded as an asset on the balance sheet. For detailed characteristics of and accounting for general PP&E, see paragraphs 23 through 34, SFFAS No. 6.

HERITAGE ASSETS - Property, plant, and equipment that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic (e.g., aesthetic) importance; or, significant architectural characteristics.

INDIRECT COST - A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.

MULTI-USE HERITAGE ASSETS - Heritage assets whose predominant use is general government operations.

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RECOGNITION (OR RECOGNIZE) - The term recognition, as used in this Statement, bears the same meaning as used by the Financial Accounting Standards Board in its conceptual statements. Recognition is the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item. (Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 5, *A Replacement of FASB Concepts Statement No. 3,* para. 6.)

STEWARDSHIP - The Federal Government's responsibility for the general welfare of the nation in perpetuity.

USEFUL LIFE - The normal operating life in terms of utility to the owner.

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Nelson E. Toye

Wendy M. Comes, Executive Director

Project Staff:
Rick Wascak
Richard Mayo
Andrea Palmer

Federal Accounting Standards Advisory Board
441 G Street N.W.
Suite 3B18
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366

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FASAB **Federal Accounting Standards Advisory Board**

Accounting for Social Insurance

Statement of Recommended Accounting Standards
Number 17

August 1999

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established in October 1990 by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General. The nine-member Board was created to consider and recommend accounting principles for the Federal Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." After considering oral and written comments, the standards may be recommended by the Board. The Board's sponsors then decide whether to adopt the recommendations. If adopted, the standards are published by OMB and the General Accounting Office (GAO), and become authoritative.

The following documents related to the establishment and mission of the Board are available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, partment of the Treasury, and the Office of Management and Budget, on Federal ıment Accounting Standards and a Federal Accounting Standards Advisory Board"*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

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EXECUTIVE SUMMARY

I. This statement presents accounting standards for federal social insurance programs. The standards cover the following programs: Social Security (Old-Age, Survivors, and Disability Insurance), Medicare (Hospital Insurance [Part A] and Supplementary Medical Insurance [Part B]), Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. The standards do not cover any other programs at this time.

II. Social insurance programs have complex characteristics and thus require specialized accounting standards. These programs blend elements of exchange and nonexchange transactions and therefore do not completely fit traditional accounting notions of either annual governmental assistance programs (nonexchange transactions) or long-term pension programs (exchange transactions).

III. Because taxpayers rely on social insurance programs in their long-term planning, fundamental questions about social insurance programs include (1) whether they are sustainable as currently constructed and (2) what their effect on the government's financial condition will be. The requirements of this standard reflect the complexity of these programs. In its entirety, the information required will help users assess the government's financial condition and the sufficiency of future budgetary resources for these programs. No single element of the information required is sufficient to meet all the users' needs.

IV. The standards require that a liability be recognized when payments are due and payable to beneficiaries or service providers. Supplementary stewardship information is to be reported to facilitate assessing the program's long-term sustainability and the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.

V. The supplementary stewardship information is required in the financial reports of both the individual agency and the governmentwide entity. The information is tailored for specific programs but generally includes narrative and/or graphic presentation of the following:

(1) long-range cashflow projections in nominal dollars and as a percentage of (a) the payroll that is subject to the tax earmarked for the program and (b) the Gross Domestic Product;

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(2) long-range projection of the ratio of contributors to beneficiaries (commonly called the "dependency ratio"); and

(3) a statement presenting the actuarial present values of (i) future benefits and (ii) contributions and tax income for social insurance programs.

VI. Although some RSSI is required for all programs, the differences in financing and benefits among programs require some tailoring of the RSSI. The standards also address the governmentwide entity where the RSSI necessarily must be presented at a more summarized level than at the agency level.

VII. The Board is issuing this statement after years of debate. Taken as a whole, the package of disclosures is a major step forward in meeting the objectives of federal financial reporting. Nonetheless, federal financial reporting is in a period of great change and the Board expects that further research regarding presentation of a federal balance sheet is needed. In Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, the Board acknowledged that an evolutionary approach would be taken:

> The FASAB recognizes that developing and implementing standards that will contribute to achieving certain objectives may take considerable time. Time will be needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches. [par. 35]
>
> The FASAB expects that some of these objectives may best be accomplished through means of reporting outside general purpose financial reports. Indeed, the FASAB recognizes that information sources other than financial reporting, sources over which the FASAB may have little of no influence, also are important to achieving the goals implied by these objectives. [par. 36]

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Table of Contents

PURPOSE 1

SCOPE 1

MATERIALITY 4

EFFECTIVE DATE 5

ACCOUNTING STANDARDS FOR SOCIAL INSURANCE 6
COMPONENT ENTITY ACCOUNTING & REPORTING STANDARD 9
Expense & Liability Recognition 9
Required Supplementary Stewardship Information 9
CONSOLIDATED GOVERNMENTWIDE ENTITY ACCOUNTING & REPORTING STANDARD 15
Expense & Liability Recognition 15
Required Supplementary Stewardship Information 15

APPENDICES 18
APPENDIX A -- BASIS FOR CONCLUSIONS 18
SECTION 1 -- RESPONSE TO COMMENTS RECEIVED 18
SECTION 2 -- BASIS FOR CONCLUSIONS FROM THE EXPOSURE DRAFT 23
APPENDIX B - SAMPLE REPORTING FOR ILLUSTRATION ONLY 43
Social Security 44
Unemployment Insurance Programs 60
Governmentwide Entity Perspective 76
APPENDIX C - HISTORICAL BACKGROUND 88
APPENDIX D - GLOSSARY 92

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_17.pdf.

Abbreviations

ANPV	actuarial net present value
APB	Accounting Principles Board
CFS	consolidated financial statements
COLA	cost of living adjustment
CPI	Consumer Price Index
DI	Disability Insurance
DOL	U.S. Department of Labor
ED	exposure draft
ESAA	Employment Security Administration Account
EUCA Account	Extended Unemployment Compensation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FECA	Federal Employees Compensation Account
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act
GAO	General Accounting Office
GDP	Gross Domestic Product
HI	Hospital Insurance (Medicare)
IBNR	incurred but not reported
OASDI	Old-Age, Survivors, and Disability Insurance
OASI	Old-Age and Survivors Insurance
OMB	Office of Management and Budget
RSSI	required supplementary stewardship information
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SMI	Supplementary Medical Insurance (Medicare)
SSA	Social Security Administration
UI	Unemployment Insurance
UTF	Unemployment Trust Fund

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Introduction
1

PURPOSE 1. The purpose of this statement is to establish standards for reporting information on social insurance programs that will assist users in evaluating operations and aid in assessing the government's financial condition and the sufficiency of future budgetary resources to sustain program services and meet program obligations as they come due. Social insurance programs were studied and analyzed during the Board's work on Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, and No. 8, *Supplementary Stewardship Reporting*. However, the Board decided to address the subject in a separate project.

SCOPE 2. This statement establishes accounting standards to be used by component entities and by the governmentwide entity for the following federal programs: Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security"), **Medicare** [1] Hospital Insurance (HI), Medicare Supplementary Medical Insurance (SMI), **Railroad Retirement** benefits, **Black Lung** benefits, and **Unemployment Insurance** (UI) for the general public. Accounting standards for UI for federal employees are provided in Statement of Federal Financial Accounting Standards No. 5 and are not within the scope of this statement. This statement should be applied only to programs listed in paragraph 14.

BACKGROUND

3. As noted in FASAB's Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting* (*Objectives*), the Federal Government is unique when compared with any other entity in the country. It is the vehicle that citizens of the United States use to exercise their sovereign power. It has continuing responsibility for the general welfare. It also has unique access to financial resources in that it has the power to tax, to borrow, and to create money.

4. As a result of these responsibilities, the Federal Government engages in many activities that have no counterpart or that are a relatively small part of the activities in the private sector. The government is concerned, for example, with macroeconomic policies to maintain incomes during recessions and therefore provides unemployment compensation and other benefits. It is concerned with the distribution of income and therefore (1) provides a wide variety of welfare payments in cash and in kind to low-income households and (2) makes taxes and many kinds of benefits "progressive." It

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is concerned about conditions and services in certain regions and communities, urban and rural, and therefore provides grants to state and local governments for various purposes. The fiscal year 2000 Budget of the United States reports that Social Security, Medicare, and other health and income security payments for individuals constituted more than 50 percent of the federal budget; grants to state and local governments comprised 15 percent.

5. In *Objectives*, the Board established four major reporting objectives around which accounting standards should be organized. Taken together, they provide a framework for assessing the existing accountability and financial reporting systems of the Federal Government and for considering how new accounting standards might enhance those systems.[1] The four objectives are

    1. Budgetary Integrity,
    2. Operating Performance,
    3. Stewardship, and
    4. Systems and Controls.

6. Although all the objectives are important, Nos. 2 and 3 directly impact the social insurance standards. Objective No. 2 provides,

> Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.[2]

As noted in *Objectives,* because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure "net income." Moreover, directly measuring the value added to society's welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relation to a variety of measures of the achievement of results. Information about social insurance that is relevant to this objective includes the cost of the program as well as long-range estimates (and ranges of estimates) of future costs

[1] SFFAC No. 1, par. 109.
[2] SFFAC No. 1, par. 122.

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and other obligations. Estimates of future costs highlight the cost impact of changes in benefit levels as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

7. Meeting Objective No. 3 is the other focus for this statement. It says,

> Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.[3]

This objective is based on the government's responsibility for the general welfare of he nation in perpetuity. It focuses not on the provision of specific services but on the requirement that the government report the broad outcomes of its actions. Thus, federal financial reporting should provide information that helps the reader to determine

- whether the government's financial position improved or deteriorated over the period,
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- whether government operations have contributed to the nation's current and future well-being.

8. In light of Objective Nos. 2 and 3, fundamental questions about social insurance programs that can be addressed by accounting standards include whether the programs are sustainable as currently constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information required by this standard, taken as a whole, will help users make this assessment while acknowledging the complexity of the programs and the uncertainty of long-term projections.

[3] SFFAC No. 1, par. 134.

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9. To meet the objectives of federal financial reporting, the standards require that:

   (1) a liability be **recognized**[4] when payments are due and payable to beneficiaries or service providers and

   (2) supplementary stewardship information be reported to facilitate the assessment of:

      (i) the long-term sustainability of the program from both an entity and a governmentwide perspective and

      (ii) the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.

10. The RSSI includes:

   - long-range cashflow projections,
   - long-range projections of the ratio between the number of those paying taxes earmarked for the program and the number of program beneficiaries, and
   - actuarial present values of (i) future benefits for and (ii) contributions and tax income from or on behalf of current and future program participants.

11. The specification of RSSI by the Board should not be construed as precluding management from voluntarily providing any additional information pertaining to the financial condition of its program that it believes useful and appropriate.

MATERIALITY

[4] The terms "recognition," "disclosure," and "required supplementary stewardship information" (RSSI) have specific, technical application in accounting. As explained further in the glossary to this statement, "recognition" (or "recognize") means formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, etc. "Disclosure" (or "disclose") means reporting information in notes or narrative regarded as an integral part of the basic financial statements. RSSI is information reported outside the principal financial statements that the Board considers essential to an entity's financial reporting and therefore recommends authoritative guidelines for its measurement and presentation.

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12. The provisions of the accounting standards in this statement need not be applied to mmaterial items.

EFFECTIVE DATE

13. The provisions of this statement would be effective for reporting periods that begin after September 30, 1999.

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ACCOUNTING STANDARDS FOR SOCIAL INSURANCE

14. The following programs are designated as social insurance and subject to these standards:

- Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security");
- Hospital Insurance (HI) and Supplementary Medical Insurance (SMI), known collectively as "Medicare";
- Railroad Retirement benefits;
- Black Lung benefits; and
- Unemployment Insurance (UI).

No other programs are subject to these standards, and the characteristics presented below should not be used to include other programs.

Characteristics of Social Insurance Programs

15. These programs were developed to carry out the responsibilities of the government and generally have characteristics that make them unique. Although they generally share certain characteristics, "social insurance" programs are too diverse to allow definitive criteria to be applied to include some and exclude others from the category. This statement identifies the following five characteristics common among social insurance programs:

(1) Financing from participants or their employers,

(2) Eligibility from taxes/fees paid and time worked in **covered employment**,

(3) Benefits not directly related to taxes/fees paid,

(4) Benefits prescribed in law, and

(5) Programs intended for the general public.

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These characteristics are briefly described below.

Financing From Participants

16. Some of the resources needed to run these programs are raised through explicit taxes and fees collected from the program participant or from the participant's employer. Taxes paid are usually a fixed percentage of the participant's wage income.

17. Federal social insurance programs utilize "trust funds" to account for dedicated collections held for later use to accomplish the program's purpose. Federal **trust funds** are accounts designated by law as such for receipts earmarked for specific purposes and the associated expenditure of those receipts. Trust funds serve useful purposes in allocating federal spending authority and accounting for earmarked taxes.

Eligibility from Taxes/Fees Paid and Time Worked in Covered Employment

18. Eligibility for benefits under social insurance programs usually rests, in part, on current or previous taxes and/or fees paid by the individual, the individual's employer, or both, and the time worked in covered employment. Frequently an individual's taxes and/or fees paid and time worked in covered employment also make family members eligible.

Benefits Not Directly Related to Taxes/Fees Paid

19. Social insurance programs sometimes intentionally redistribute toward lower-wage workers. Lower-wage workers tend to receive proportionately more in benefits relative to taxes paid than the higher-wage workers, sometimes much more. Many social insurance plans also subsidize benefits for nonworking members of workers' families and others.

Benefits Prescribed in Law

20. Social insurance programs normally have uniform sets of entitling events; and

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schedules of benefits are developed, announced, and applied to all participants. Administrators of such programs have little discretion in determining who should get benefits or how much they should get.

Intended for the General Public

21. These programs are intended for the general public and not solely for present or former federal employees.

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COMPONENT ENTITY ACCOUNTING & REPORTING STANDARD

Expense & Liability Recognition

22. The expense recognized for the reporting period should be the benefits paid during the reporting period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (IBNR).

23. For Unemployment Insurance (UI), the liability to be recognized includes (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which they have not withdrawn funds from the federal unemployment trust fund (UTF) as of fiscal year end, and (2) estimated amounts to be withdrawn from UTF and benefits paid by states and territories after fiscal year end for compensable days occurring prior to fiscal year end.

Required Supplementary Stewardship Information

24. The entity responsible for the social insurance program should include in its financial report, as **required supplementary stewardship information** (RSSI), a clear and concise description of the program, how it is financed, how benefits are calculated, and its financial and actuarial status. The description should include a discussion of the long-term sustainability and financial condition of the program. A display should illustrate and the discussion should explain the trends revealed in the data. The entity should consider both narrative and graphic presentations. Statutory or other material changes affecting the program after the current fiscal year, including those enacted between the fiscal year end and the date of the report, should be described, along with the implications thereof.

25. The projections and estimates used should be based on the entity's best estimates of demographic and economic **assumptions**, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.

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26. All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

27. The information on financial and actuarial status should include the following measures and data:

(1) *Cashflow Projections* - Projections of cashflow for those persons who are participating or eventually will participate in the program as contributors or beneficiaries during a projection period sufficient to illustrate long-term sustainability (e.g., traditionally the "Social Security," or OASDI, program has used a projection period of 10 years for relatively short-term and 75 years for long-term projections, and the UI program has used a projection period of 10 years for its projections). The projection should include current workers, retirees, survivors, disabled persons, and new participants entering the workforce or becoming beneficiaries, including those who will be born or immigrate to the United States during the projection period. The information should include the following:

(a) Actuarial projections of the annual cashflow, in nominal dollars, with amounts reported for at least every fifth year in the projection period. The cashflow information should show

(i) total cash inflow from:

1) all sources and
2) excluding net interest on intragovernmental borrowing/lending,[2] and

(ii) total cash outflow.

The narrative accompanying the cashflow data should include identification of any year or years during the projection period when cash outflow exceeds inflow, both in total and excluding interest on intragovernmental

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borrowing/lending (the "cross-over points"), and an explanation of the significance of the "cross-over points.

(b) The actuarial estimate provided in 27(1)(a)(i)2) and 27(1)(a)(ii) immediately above as a percentage of

(i) **taxable payroll**[5] and
(ii) **Gross Domestic Product** (GDP).[6]

(2) *Ratio of Contributors to Beneficiaries* - With respect to the OASDI and HI programs, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio") during the same projection period as for cashflow projections (e.g., 75 years), using the program managers' best estimate.[7] At a minimum, the ratio should be reported for the beginning and end of the projection period.

(3) *Actuarial Present Values* - For all programs except UI, a statement presenting the actuarial present value of each of the following:

All future expenditures during the projection period related to benefit payments:

(a) to or on behalf of current participants who have not yet attained retirement age (e.g., the Social Security Administration has assumed an age of 15 years for new participants and an age of 62 years for retirement),

(b) to or on behalf of current participants who have attained retirement age,

[5] Certain social insurance programs (i. e., SMI , Black Lung benefits, and UI) are either not financed by earmarked payroll taxes or are financed by state-determined payroll taxes on employers that can vary by state and by employer; therefore these programs are not required to provide this estimate.

[6] This requirement does not apply to the RRB, Black Lung, and UI programs.

[7] SMI, Black Lung benefits, and UI programs are financed by, respectively, premiums paid by covered participants and general fund contributions (SMI); direct payments from employers, excise taxes per ton of coal, and general fund contributions (Black Lung); and state/employer-specific payroll taxes (UI). Therefore, these programs are not required to provide the ratio of contributors to beneficiaries. The OASDI trustees refer to the ratio of beneficiaries to contributors as the "dependency ratio."

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(c) to or on behalf of those who are expected to become plan participants (i.e., new entrants) during a projection period encompassing substantially all the present value attributed to (a) and (b) immediately above;[8]

All future contributions and tax income (from taxation of benefits) during the projection period:

(d) from or on behalf of current participants who have not yet attained retirement age (same group as in (a) above),

(e) from or on behalf of current participants who have attained retirement age (same group as in (b) above),

(f) from or on behalf of those who are expected to become plan participants (same group as in (c) above) during a projection period encompassing substantially all the present value attributed to (d) and (e) immediately above.

Net present value of cashflow during the projection period:

(g) the actuarial present value of future contributions and tax income during the projection period [(d)+(e)+(f)] should be subtracted from the actuarial present value of future expenditures for the projection period related to benefit payments [(a)+(b)+(c)] to derive a total excess of future benefit payments over future contributions and tax income (or contributions and tax income over benefits).

Notes to the statement should present:

[8] A projection period for ***future*** participants would cover their working and retirement years. The entity would make an assumption about the length of this period. For example, the OASDI program uses a projection period of 75 years. A projection period for ***current*** participants (that is, for the people actually participating in the program) would theoretically cover all of their working and retirement years, a projection period that could be greater than 75 years a in few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years usually would not be material, and a 75 year projection period would include virtually all the future contributions, tax income, and benefit payments for current as well as future participants.

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(h) the accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date, and

(i) a statement that the actuarial net present value of the excess of future expenditures related to benefit payments to or on behalf of current participants, that is, of the "closed group" of participants (see (a) and (b) above), over future contributions and tax income from them or paid on their behalf (see (d) and (e) above) is calculated by subtracting the actuarial present value of future contributions and tax income paid by and for current participants [(d)+(e)] from the actuarial present value of the future benefit payments to them or on their behalf [(a)+(b)].

(j) information required in subparagraphs 27(3)(a)-(h) for the current year and separate estimates for each of the four preceding years.

(4) *Sensitivity Analysis* -

(a) For all programs except UI illustrate the sensitivity of the projections and present values required by paragraphs 27 (1) and 27(3) to changes in the most significant individual assumptions. For example, using the entity's "best estimate" cost assumptions as a baseline, show the effect of varying several significant assumptions one at a time to show the effect on the projection. At a minimum the OASDI and Medicare programs should analyze assumptions regarding the birth and death rates, net immigration, the real wage differential, and the real interest rate. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI. The Medicare program should also analyze the health care cost factors and their trend.

(b) For UI illustrate the sensitivity of the projections required by paragraph 27(1) to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by

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approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).

(5) *State-by-State Analysis* - For the UI program provide a state-by-state analysis illustrating the relative solvency of individual state programs. The analysis should provide the ratio of each state's current accumulated fund balance to a year's projected benefit payments based on the highest level of annual benefit payments experienced by that state over the last 20 years.

Transition

28. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

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CONSOLIDATED GOVERNMENTWIDE ENTITY ACCOUNTING & REPORTING STANDARD

29. The standard for consolidated governmentwide accounting and reporting for social insurance programs is the same as that for component entities except as provided below. Thus, except for the specific modifications listed below, the governmentwide entity should refer to the relevant paragraphs of the standard for component entities in the preceding section for a description of the information to be provided.

Expense & Liability Recognition

30. Expense and liability recognition for the consolidated governmentwide entity are the same as for the component entities (see pars. 22-23).

Required Supplementary Stewardship Information

31. The consolidated governmentwide financial report should include, as required supplementary stewardship information (RSSI), a summary of the entities' descriptions of their social insurance programs (see paragraph 24). The description should include a discussion of the long-term sustainability and financial conditions of the programs, illustrate and explain the trends revealed in the data, and explain the relationship of the social insurance program(s) to governmentwide financing, especially regarding the intra-governmental nature of trust fund assets and government debt.

32. The information on financial and actuarial status should include the following measures and data:

(1) *Cashflow Projections* -

(a) Cashflow projections should be made for all social insurance programs as described under the component entity standard (see par. 27), except that only cash inflow from the public (that is, excluding interest on intragovernmental borrowing/lending) and total cash outflow are required. At a minimum the OASDI, HI, and SMI programs should be separately

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identified. The projection period of the display should be based on those used by the component entities, which may require summarization or presentation techniques such as using more than one graph (e.g., a 10-year graph and a 30-year graph). The presentation should include an explanation of material crossover points, if any, where cash outflow exceeds cash inflow and the possible reasons therefore.

(b) For the programs indicated immediately below, estimated future cash inflow (excluding net interest on intergovernmental borrowing/lending) and outflow for the projection period described in paragraph 27 as a percent of

(i) taxable payroll for OASDI and HI, presenting each program separately, and

(ii) GDP for OASDI, HI, and SMI, presenting each program separately.

(2) *Ratio of Contributors to Beneficiaries* - For OASDI and HI, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio") during the projection period as described under the standard for component entities (see par. 27(2)).

(3) *Actuarial Present Values* - For all programs except UI provide a statement combining the entity statements required in paragraph 27(3)(a)-(i). The presentation should include data for the current year and separate estimates for each of the four preceding years. At a minimum OASDI, HI, and SMI should be separately identified.

(4) *Sensitivity Analysis* - For all social insurance programs provide a summary of the sensitivity analyses required under the standard for component entities (see par. 27(4)). At a minimum the summary should present the OASDI, HI, SMI, and UI separately.

(5) *State-by-State Analysis* - Provide a summary of the state-by-state analysis

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required for the UI program (see par. 27(5)).

Transition

33. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

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APPENDICES

APPENDIX A -- BASIS FOR CONCLUSIONS

SECTION 1 -- RESPONSE TO COMMENTS RECEIVED

34. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important matters that the FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

35. FASAB published the exposure draft *Accounting for Social Insurance* in February 1998. The exposure draft included five questions and invited comments on the usefulness of the proposal for accounting and reporting for social insurance. Twenty-nine letters were received from the following sources:

	Federal (internal)	Nonfederal (external)	Total
General Public	2 [retired employees]	8	10
Auditors	3	4	7
Preparers and Financial Managers	12	0	12
Total	17	12	29

36. FASAB also held a public hearing on the exposure draft on October 5-6, 1998. Testimony was received from representatives of accounting, auditing, and actuarial organizations; from a public service organization; and from the Social Security and Medicare programs. Appendix C, Historical Background, provides a history of past

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accounting for these programs.

37. Section 1 of this basis for conclusions addresses certain responses to the exposure draft and the comments received at the public hearing.

38. The responses to the exposure draft illustrate what was described in the basis for conclusions for the exposure draft as two polarized views regarding recognizing or even disclosing a liability measure beyond the due and payable amount called for in this standard. Some respondents restated their views on the propriety of the accounting proposed in the ED, and/or they said they favored one or the other of the two opposing views described in the basis for conclusions. Some respondents argued once again that social insurance programs are pay-as-you-go, income transfer programs for which an estimate of accrued and future benefits and contributions and tax income is inappropriate. Other respondents reiterated the contrary argument. They said that such programs are commitments for which a long-range accrual is not only appropriate but also essential for the balance sheet, if the information presented therein is not to be misleading.

39. The Board continues to believe that the original basis for conclusions in the exposure draft describes and explains the Board's conclusions adequately. Therefore, except for those issues specifically discussed immediately below, the Board is presenting the original basis for conclusions from the exposure draft in Section 2. Changes were made where necessary to reflect the requirement for a statement of social insurance in the final standard.

Expanded Presentation and Visibility of Actuarial Present Values

40. In response to comments received on the exposure draft and subsequent public hearing, the Board is adding a requirement for a statement presenting the actuarial present values (APV) of future benefits for and future contributions and tax income from or on behalf of all current and future participants during the projection period normally used by the programs. For example, the OASDI program uses a 75-year projection period. The net total of the statement will present the total excess of benefits over contributions and tax income.

41. The Board believes that this information will be useful in analyzing the sustainability and financial position of SI programs. The added detail on individual

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components of the actuarial net present value will provide analysts interested in different facts with useful detail. In addition, the statement presentation will increase the prominence of important data otherwise obscured in a long narrative.

42. The Board has considered whether the changes made regarding the presentation of actuarial present values requires re-exposure. The original exposure draft focused on one net actuarial present value, for the "closed group," while the final standard presents the components of that value as well as data on future participants. Also, the exposure draft proposed subtracting the fund balance at the valuation date from the actuarial present value of the net cash outflow over the projection period, while the standard now calls for fund balance information to be presented in a note to the statement.

43. The Board decided that the new presentation and data did not require re-exposure. The information added to the standard results from adding more detail and modifying the display to increase visibility. These modifications are responsive to the views expressed by many during the comment period. The Board believes that the difference in the presentation does not warrant delaying the issuance of the standard.

Specific Identification of Social Insurance Programs

44. A few of the respondents disagreed with the approach in the exposure draft whereby programs are specifically identified. One respondent reasoned that an accounting standard would be more useful if it established definitive criteria for current and future programs to meet rather than designating only specific programs. Conversely, another respondent said the standard should be even more specific and deal with the individual programs separately because some have characteristics of defined benefit plans while others are similar to welfare programs.

45. After weighing these arguments carefully, the Board continues to believe that definitive criteria would be unworkable. Although these programs do generally share certain characteristics, they are complex. Each program has unique benefits, different eligibility requirements, and different financing arrangements. Because definitive criteria would be subject to interpretation, questions would arise about individuals programs that would require a response from the Board. The Board has decided to identify social insurance programs that now exist and consider the classification of other programs as they may arise in the future.

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Consistency of Assumptions

46. Several respondents to the exposure draft expressed concern that projections of cashflow and GDP would not be consistent between entities and within an entity due to the use of different assumptions by separate programs. One respondent believed that cashflow estimates as a percentage of GDP would not be meaningful without a tremendous amount of effort and cost expended in coordinating assumptions and methodologies to achieve consistency.

47. The Board considered these arguments and decided not to require uniform assumptions. The assumptions used by Social Security and Medicare, the two predominant programs, will be consistent. These programs use the same principal assumptions and have the same **trustees**. On the other hand, the Board concluded that the GDP projection should not be required of smaller programs and therefore explicitly exempts them from that requirement.

Sensitivity Analysis

48. Some respondents disagreed with the approach in the exposure draft regarding sensitivity analysis, which calls for showing the effect of changing one major assumption at a time. One respondent favored a general requirement that entities provide sensitivity analysis rather than telling them how to do it. This respondent favored the high-, low-, and intermediate sets of cost assumptions that are featured in the trustees' annual reports for Social Security and Medicare. Another respondent suggested that the standard not require sensitivity analysis because most users would not understand it and the potential for misuse would be great. Another respondent said that the requirement in the standard was useful because it gives an idea about the uncertainty associated with the estimate. However, this respondent said sensitivity analysis was inadequate without a further discussion of the nature of uncertainty itself and recommended mandating such a discussion.

49. The Board continues to believe that the analysis required by the standard is a clear, easily understood illustration of the sensitivity of projections to changes in assumptions. The Board recognizes the difficulty in illustrating the uncertainty inherent in all projections, especially very long-range projections. However, the

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requirement in the standard would not preclude the entity from presenting additional discussions of uncertainty and the Board expects that agencies would do so voluntarily.

State and Local Government Pension Accounting

50. Some respondents urged the Board to consider whether the approach used by state and local governments to account for employee pensions would be suitable, at least for some social insurance programs that are most analogous to pensions, such as the retirement benefit portion of Social Security. Those respondents focus on similarities, such as defined benefit formulas tied to earnings.

51. The Board concluded that there are important differences in the programs and environments involved. For example, state and local pension plans typically do not have extensive income transfer features. They are much like federal employee pension programs, which are not considered to be social insurance. On balance the Board concluded that such an approach would be inappropriate.

Vote of Approval

52. This recommended statement was approved by the Board with a vote of 6 members in favor of its issuance and 3 member(s) opposing its issuance. Two members submitted written dissents, which are available for public inspection at the FASAB's offices.

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SECTION 2 -- BASIS FOR CONCLUSIONS FROM THE EXPOSURE DRAFT

[Note: The Board's recommendation differs from the proposal made in the exposure draft. Certain sections from the basis for conclusion in the exposure draft were deleted since they are no longer relevant to the final recommendation. Paragraphs 40-51 explain the differences and reasons therefore.]

53. The following paragraphs address the basis for the Board's proposals on

- defining social insurance,
- recognition of liabilities and expense for social insurance, and
- required supplementary stewardship information (RSSI).

Characteristics of Social Insurance Programs

54. As stated in the introductory sections, the Board has analyzed certain programs that are generally considered social insurance. These programs have certain characteristics that set them apart from general assistance programs on the one hand and insurance programs on the other hand. Accounting standards for liabilities associated with general assistance and insurance programs are provided in SFFAS No. 5, *Accounting for Liabilities of the Federal Government.*

55. After analyzing specific programs, the Board determined that, although these programs generally shared certain characteristics, their operational features were too diverse for establishing definitive criteria that would include all the subject programs and exclude all other federal programs for which accounting standards have already been provided. Thus, the Board has outlined the general characteristics that social insurance programs usually -- but not always -- possess and has listed the specific programs to which the standards apply. This does not preclude the Board from considering an additional program(s) in the future and, given the individual circumstances pertaining to that program, including it within this statement. However, no entity on its own volition should apply this statement to any program not listed in this statement.

56. Accounting for UI for federal employees is provided in SFFAS No. 5 and is not within the scope of this standard. SFFAS No. 5 provides that the unemployment program for federal employees should be accounted for like other postemployment benefits

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(e.g., severance benefits and workers' compensation) because the nature of the liability is similar. Federal employer entities must reimburse the Labor Department for the full cost of unemployment benefits received by former federal employees rather than paying a payroll tax each period.

Nature of Social Insurance

57. In determining how social insurance program transactions should be recognized in the financial statements and the supplementary information that should be provided about them, the Board considered the nature of the Federal Government, the nature of those programs, and the needs of users of federal financial reports. Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting*, notes the Federal Government's unique responsibilities for the common defense and general welfare and its unique access to financial resources and financing, including the power to tax and create money. The government undertakes many programs despite potentially unfavorable effects on its financial condition, and transactions between citizens and the government generally are not individual exchanges between willing buyers and sellers.[3]

58. Consideration of guidance for the recognition, measurement, and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The programs are complex, reach a unique order of magnitude, and involve projections that are extremely sensitive to assumptions whose range of possibilities is large.

Expense & Liability Recognition

59. The Board believes that the annual expenses of such programs should be the benefits paid during the accounting period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period, including claims incurred but not reported. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, and supplementary stewardship information should be provided as described in the standards.

Exchange and Nonexchange Transactions

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60. During its consideration of social insurance and, before that, of liability accounting, the Board considered whether social insurance programs result in **exchange** or **non-exchange transactions** or whether they contained features of both. As described in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, nonexchange transactions give rise to a different kind of obligation than exchange transactions under federal accounting principles.

61. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. However, for a nonexchange transaction, a liability is recognized for any unpaid amounts due and payable as of the reporting date, including estimates of claims incurred but not yet reported.

62. As defined in SFFAS No. 5, obligations become liabilities against the Federal Government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing the liability recognition point among various federal programs is whether a nonexchange transaction is involved. Although a high probability may exist that a grant, a subsidy, or an income transfer will be made or will continue to be made in future years, the recipients do not have as high an equitable claim to receive grants, subsidies, or transfers in the future as do those who exchange service for promises of future payments. The latter have a greater probability of being paid than the former. At the same time, many people feel that some social insurance benefits, Social Security in particular, also have similar "exchange" or "equitable" claims. They also believe that social insurance benefits have as great a probability of being paid as any other payments.

63. Whether on the balance sheet or elsewhere in the financial report, estimates of the future amounts required to continue present policies regarding such programs are relevant to certain decisions and should be disclosed or otherwise reported. In the context of the Board's definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute

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a liability.[9]

Polarization

64. With regard to social insurance, the Board notes the strength of feelings on this issue. The Board has been faced with two polarized views. On the one hand there are those who believe a liability should be recognized for the net benefits expected to be paid in future periods to current participants. On the other hand, there are those who believe that the long-term obligation (i.e., beyond amounts due and payable at the end of an accounting period) associated with these programs is not a liability and should not be recognized as such. Some people also believe such amounts should not be reported as RSSI.

Arguments against Recognition, Disclosure, or Supplementary Reporting

65. The latter group would argue that social insurance programs do not result in exchange transactions, that social insurance programs are income transfers financed primarily by compulsory earmarked taxes and also, in certain cases, general revenues of the government. For them, the political nature of the commitment is critical, for its terms can be and are changed by the Congress to maintain **actuarial balance**. In this regard, they point to *Flemming, Secretary of HEW v. Nestor, Part I* (363 U.S. 608-611) wherein Mr. Justice Harlan, delivering the opinion of the Court, said,

> [T]he entire [Social Security System] rests on the legislative judgment that those who in their productive years were functioning members of the economy may justly call upon that economy, in their later years, for protection from the 'rigors of the poor house'...

He continued,

> It is apparent that the noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity, whose right to benefits are bottomed on his contractual premium payments.... *To engraft upon the Social Security System a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands.* (Emphasis added.)

[9] SFFAS No. 5, pars. 129-131.

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66. Those who believe that only the due and payable amount should be recognized as the liability would argue that, under social insurance, the government uses its sovereign power to require payment of taxes that it dedicates to finance benefits. The individual beneficiaries of these programs are receiving payments that may be indirect and disproportionate to the taxes paid by them or on their behalf. In the case of Social Security, the oldest social insurance program, those who retired in the first years after enactment in 1935 received benefits that were many times their taxes. This was possible because the system transfers resources across generations. The system transfers resources within a generation as well, from those working and paying taxes to the disabled, the surviving spouse, and dependent children.

67. They would argue that benefits have also been very different by family type, wage level, and sex. One-earner couples receive benefits that are far larger than taxes paid, followed by two-earner couples. Single females have still lower benefit/tax ratios, followed by single males. Low-wage earners have a higher benefit ratio than those with average or high wages. For each type of recipient, benefit/tax ratios have been trending down. High- and average-earning single males retiring now cannot expect to get their money back, with interest; and this will soon also be true for high-earning single females.[10]

Uncertainty

68. Some of those who do not believe that social insurance obligations constitute a liability argue that the level of future benefit payments is too uncertain for accrual as a liability. They point out that not only did Congress expressly include (and retain) the right to alter, amend, or repeal any provision in the **Social Security Act** itself, it has made such changes frequently. In the early years, the changes generally expanded benefits -- for example, to dependents, the disabled, and early retirees; to a broader coverage of workers; to protect retirees against inflation -- and increased tax rates. But as the system has matured, the changes have increased the tax rate further, taxed an increasing proportion of benefits, reduced cost of living adjustments and various benefit provisions, and prospectively raised the retirement age.

69. They argue further that the benefit payments that might be made in the

[10] See Steuele, C. Eugene, and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, (The Urban Institute Press, Washington, DC).

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future are ependent on economic and demographic variables including the growth of real wages, interest rates, births, immigration, and labor force participation. The aggregate benefits under the **high cost Social Security assumptions** in 2070 are estimated by the Social Security Trustees to be 2.5 times those under the **low cost assumptions**. And the estimates change over time. The legislative changes in 1983 were expected to maintain a positive fund balance until 2063; however, by current **intermediate cost assumptions** the fund will run out three decades sooner.

Period Costs

70. Some argue that the critical issue is the period to which a particular cost or expense relates. They emphasize that a significant determination in accounting is to decide in which period a transaction should be recognized as an expense. They believe that social insurance benefits, like other non-exchange transactions, should be recognized as expenses in the time period when they are paid or are due and payable and not earlier when a participant has covered wages. Future social insurance benefits constitute program costs of future periods, notwithstanding that they may be for the purpose of carrying out responsibilities that the government has already assumed.

71. They would argue further that, given the nature of the Federal Government and of social insurance, liability-type measures of the social insurance obligation (e.g., the closed group measure ...) are meaningless or even potentially misleading. In particular, they argue that this information would not be useful to assess sustainability. It ignores the pay-as-you-go financing, excludes future earmarked taxes from future participants, and results in such an enormous **actuarial present value** that it may needlessly scare those unfamiliar with the debate. Such measures do not reflect the way the program is financed under current law and could, if taken out of context, imply that the current participants have a right to benefits superior to future participants.

72. They argue that other supplementary information would provide useful sustainability information. For example, the Social Security Trustees' annual report provides "open group" projections of cashflow -- in dollars, as a percentage of the tax base earmarked for the program, of the GDP, etc. -- and the "dependency ratio." The open group measure reflects the way the program is financed; and the dependency ratio -- the ratio of contributors to beneficiaries -- indicates whether the program

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could potentially encounter stress in the future. Both of these were proposed in the exposure draft on social insurance as part of the supplementary information. They argue that these and other measures provide meaningful sustainability information.

Arguments for Recognition, Disclosure, or Supplementary Reporting

73. Those who hold a contrary view believe either that the distinction between exchange and non-exchange transactions is not relevant to the liability recognition or supplementary reporting issue or that the programs possess characteristics that make the transactions predominantly exchanges. They argue that social insurance programs possess certain characteristics that, taken together, cause the criteria for recognizing a liability to be met long before payments are due and payable. Those characteristics are

    1. the contributory nature of the program (i.e., benefits are predicated to some extent on prior payments),
    2. time in covered employment,
    3. government sponsorship,
    4. benefits prescribed in law, and
    5. specific accounting entity (e.g., the trust fund) and long-range financing.

74. These characteristics, in conjunction with the historical experience and political climate affecting the programs, create obligations and societal expectations that make the outflow of resources highly probable -- far more than 50 percent. Therefore, an accounting liability should be recognized at an earlier point than when payments are due and payable; and the liability should be based on long-term or actuarial estimates of future payments.

75. Supporters of this view note that social insurance programs, as distinguished from general assistance programs, require the payment of taxes in order to establish an "insured status" before an individual is eligible for benefits. This is often referred to as an "earned right to benefits." In addition, most such programs have an element of individual equity in their benefit formulas whereby greater levels of taxes result in greater levels of benefits -- although Medicare HI is a notable exception. Moreover, both the participant and the employer sacrifice value in anticipation of future benefit. Not only do the participants anticipate retirement benefits as a result of these sacrifices, many employers, including the Federal Government, build in the value of

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Social Security benefits when designing retirement plans. Those holding this view would argue that these factors make social insurance programs predominantly exchanges.

76. Some of those arguing for recognition or **disclosure** believe that social insurance programs are constructive liabilities and that users of financial statements are accustomed to seeing commitments as firm as these quantified in financial statements or in notes to the statements. Some say that there is little conceptual difference between the liability that is recognized for federal pensions and the closed group obligation for social insurance. They would say that the failure at least to disclose a liability-type measure of the obligation therefore would potentially be misleading to those who relied on the financial statements and would raise questions about the credibility of the statements.

77. In addition, they believe that the closed group number is a measure of the intergenerational transfer implicit in the program under its current terms and that this number should be reported. They would argue that the failure to disclose this number makes these programs look healthier than they are and thus may lead to poor decisions about consumption and saving by Congress and by citizens. Those who hold this view would argue that a closed group measure that treats social insurance benefits as earned annually would help users to understand the extent to which social insurance programs have committed future-year taxpayers to finance amounts earned by participants as of a given point in time.

78. Some of those who argue that a liability should be recognized on the balance sheet maintain that most of the financial reporting community in the United States have adopted a different standard than exchange or nonexchange. The Financial Accounting Standards Board (FASB) concept statements adopt an "asset/liability" perspective in which what matters is whether a promise has been made, not whether something has been received for it or how it will be funded -- in other words, what matters is whether a future sacrifice of resources is probable, regardless of whether it arises from an exchange of consideration. From this perspective, the only reason for not recognizing a liability for the amount promised by the social insurance program would be the assumption that it may not be paid.

79. Because most users are familiar with FASB's definition, or at least are accustomed to seeing financial reports based on it, those who favor recognition or disclosure of a

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liability-type measure argue it is inherently misleading to fail to quantify the size of the promise that is continually being made and on which people are told they can rely. While many who support liability-type disclosure agree the open group data are desirable to aid in assessing the sustainability of social insurance programs, they also believe that an assessment of the financial condition of the program -- and more importantly, of the Federal Government -- is not possible absent liability or closed group data. If a reader seeks to answer the question -- Have we burdened future generations of citizens with the cost of the current and past years? and, if so, to what extent? -- the very large obligations for social insurance must be considered.

The Board's Conclusion Regarding Recognition, Disclosure, or Supplementary Reporting

80. The Board acknowledges that it is faced with two polarized views without much hope of one side convincing the other side of the correctness of its position. On the one side are those who believe that social insurance programs -- especially Social Security and Medicare -- constitute a liability of the Federal Government that should be recognized on the consolidated balance sheet and that the closed group is the best measure of it. They agree that other measures such as a long-range projection of a program's cash inflow from all sources and outflow for all purposes are also useful, and note that all measures of sustainability and financial condition must be taken in context to be meaningful. At the opposite pole are those who firmly believe that the closed group measure is meaningless or even potentially misleading and should not be disclosed at all in the financial report.

81. The Board recognizes that both approaches have limitations and that the data are best understood when used together. An "earned right" measure, for example, produces a relatively large dollar amount that could confuse the reader who is unaware of the way in which the program was intended to be funded. Although both sides make strong arguments, no empirical evidence has been offered that would prove one side right and the other wrong. The Board believes the best approach to resolve this issue is for the closed group data to be reported off the balance sheet as part of a balanced RSSI package of disclosures about the Social Security and other social insurance programs. *[The Board subsequently affirmed that the data necessary to calculate the closed group measure should be reported. See paragraphs 40-43 for a discussion of the Board's final recommendation.]*

82. The Board believes such disclosure will provide useful information and also serve the

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interests of users who are concerned primarily with federal accounting in its entirety. The Board has heard much from the two opposing sides, within the Federal Government, with the keenest interest in this issue. It does not forget, however, a larger third group of constituents, both within and outside the Federal Government, who are concerned with federal accounting in its entirety.

83. The Board believes that these users would consider social insurance accounting in general and Social Security accounting in particular to be important but only as one element of the complex of problems in federal accounting that led to the establishment of the FASAB. A closed group measure of some type undoubtedly will be provided to this group of users from some source if it is not provided based on government standards. These users will be better served if the Federal Government defines a credible measure, calculating it by using assumptions consistent with other Social Security and other social insurance program estimates, and disclosing it with explanatory materials and in a governmentwide and national context.

Measurement of Social Insurance Obligations

84. Considering the polarity of these positions, the Board is persuaded that the requirements incorporated in this statement best serve the users of federal financial information. The Board continues to believe that, given the strength of these differing views concerning the nature of social insurance transactions, an overriding concern exists that no single measurement on the balance sheet or elsewhere could adequately convey the financial sustainability of social insurance programs or the impact on the financial condition of the administrative entities or the government as a whole. Using Social Security as an example, one could approach measurement from the perspective of an obligation to participants based on earned rights to future benefits; or one could approach measurement from a pay-as-you-go funding perspective, giving consideration to both future inflows and outflows. Projections based on a pay-as-you-go approach would acknowledge the way in which Social Security is funded and provide data on long-range sustainability based on the current benefit structure. An "earned rights" approach would acknowledge that, at any given point in time, Social Security has $X of accumulated obligation to current participants that would need to be provided by future generations under current law.

85. The Board believes that a more complete picture of the financial condition of the government can be provided by a forward-looking assessment of whether it can

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"sustain public services and meet obligations as they come due." The users of federal financial information need to know a great deal about the future of social insurance programs, a large and growing proportion of federal spending with financing that is under demographic and other strains. Understanding the financial condition of these programs is important to understanding the condition of the Federal Government as a whole. In addition, many citizens depend on these programs for their own financial security. The Board therefore believes that useful information about the future prospects of these programs should be fully and impartially presented in the financial reports of entities operating these programs and in the consolidated financial report of the United States government. The social insurance standards set forth the minimum information that the Board believes necessary for that purpose.

Required Supplementary Stewardship Information

86. The Board believes that the required information is relevant for assessing the sustainability of social insurance programs and also bears on the government's financial condition. The following paragraphs discuss each of the RSSI elements.

Cashflow

87. An estimate based on the amount and timing of future cash inflows and outflows will help users understand the long-range sustainability of the social insurance programs based on current revenue and benefit structure. The Board believes that the yearly inflows and outflows under the open group method should be disclosed over a sufficient number of years (e.g., 10 years, 75 years) to display "crossover" points where outflows begin exceeding inflows. Crossover points provide an early warning as to the need to adjust either the revenue stream or the expenditure stream to ensure that the program is sustainable under current law.

88. The Board considered specifying the length of the projection (e.g., 10-20 years). However, it decided that allowing the entity to use its traditional timeframe was preferable, if the period presented is long enough to reveal anticipated critical points as mentioned in the preceding paragraph.

Percentage of Taxable Payroll & GDP

89. Cashflow should also be put in relation to the taxable payroll or other tax base

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earmarked for the program, the GDP, or other benchmark that would be meaningful to users. The sustainability of a social insurance program cannot be determined solely on the basis of the financial position of the Federal Government. Rather, the size of the total fiscal burden shifted by government to future taxpayers -- in relation to their ability to bear it -- is critical to that determination. Thus, sustainability from the governmentwide perspective is better measured in terms of a healthy relationship between social insurance programs -- and, indeed, the entire budget -- and the national economy, as measured by the GDP or taxable wages.

Dependency Ratio

90. The ratio of contributors to beneficiaries, also commonly called the "dependency ratio" shows the estimated number of contributors (e.g., **covered workers**) per program beneficiary. The Board believes that a projection of the trend in the relationship between contributors and beneficiaries should be displayed. This ratio helps readers assess whether the program is under potential stress and whether it is sustainable as currently constructed. A deteriorating dependency ratio would illustrate the effect of demographic trends on relationships between contributors and beneficiaries that may affect the sustainability of the program as currently constructed.

The "Closed Group" Measure

[The social insurance exposure draft proposed that the net APV for the closed group of participants be reported as RSSI. As explained in paragraphs 40-43, the final standard requires information about the closed group APV, within the structure of the new statement of actuarial values, and an explanation of how to calculate it. See note No. 3 of the illustrated statement of social insurance, page 46. The closed group measure proposed in the exposure draft represented the actuarial net present value of (a) the future benefit payments to currrent participants, (b) future contributions to be made be them and their employers, and (c) the accumulated excess of cash receipts over cash disbursements within the social insurance program represented by fund balance at the valuation date. The Board continues to believe that the closed group measure is useful, and that the following paragraphs from the exposure draft retain their cogency.]

91. The closed group measure is sometimes referred to as an actuarial liability[11] for

[11] [A variety of actuarial methods exist which can be used to calculate an actuarial liability. The "closed group" measure is not identical

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certain social insurance programs relating to the closed group of current participants. Some believe it is analogous to the liability that would be recognized on the face of the balance sheet if social insurance programs were accounted for like federal pension and retiree health care benefits. Others dispute this, pointing to different financing arrangements, legal status, and the nature of social insurance and pensions.

92. Until 1985, the "prototype" *Consolidated Financial Statements of the United States* recognized a liability for Social Security, using a calculation similar to that called for by Opinion No. 8 of the Accounting Principles Board, *Accounting for the Cost of Pension Plans*, (APB 8). This liability was calculated by amortizing the "closed group" obligation and recognizing as a liability the unfunded portion that was amortized each year. APB 8 defined a variety of acceptable methods for measuring pension expense and required that any unfunded pension expense be recognized as a liability. APB 8 was superseded by Statement 87 of the Financial Accounting Standards Board (FASB), published in December 1985. FASB published Statement 87 to make accounting for pensions more independent of the financing arrangements, to provide more standardization in measurement of the pension expense and liability, and to require that at least a "minimum liability" be recognized in employers' Statements of Financial Position (balance sheets). From 1985 through 1994, the closed group amount was disclosed in a footnote in the *CFS*.

93. Some people believe that the closed group measure is analogous to the measure of "risk assumed" that would be reported as supplementary stewardship information if social insurance programs were accounted for like other federal insurance programs. SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, defines "risk assumed" as the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force (i.e., the expected loss on the "current book of business"). In the context of social insurance, one would use the term "closed group" instead of "current book of business."

94. SFFAS No. 5 requires insurance programs, other than social insurance programs, to report the risk assumed amount if it differs from the amount recognized as a liability. (SFFAS No. 5 exempts federal life insurance and loan guarantee programs from this disclosure requirement because the relevant accounting standards already incorporate a similar concept in determining the amount to be recognized in the financial

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to the methods that would be used in pension accounting. See paragraph 97]

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statements.) Some people believe that it is useful to report this information, for the same reason that it is useful to report it for other kinds of government programs. This reason was summarized in a report on budgeting for federal insurance programs other than social insurance. Although FASAB is concerned with financial reporting, not budgeting, the underlying rationale is similar:

> As a general principle, decision-making is best informed if the government recognizes the costs of its commitments at the time it makes them. For most programs, cash-based budgeting accomplishes this. However, for insurance programs, accrual-based budgeting, which would recognize the expected long-term cost of the insurance commitment at the time the insurance is extended, offers the potential to overcome a number of the deficiencies of cash-based budgeting by improving cost recognition. In concept, recognition in the budget of the risk assumed by the government would permit policymakers to consider these costs in relation to other funding demands and would improve the measurement of a program's impact on private economic behavior. In most cases, the risk-assumed approach to accrual would be analogous to a premium rate-setting process in that it looks at the long-term expected cost of an insurance commitment at the time the insurance commitment is extended. The risk assumed by the government is essentially that portion of a full risk-based premium not charged to the insured.[12]

95. Other people believe that, because there has been no intent for individuals or cohorts of individuals (generations) to make contributions commensurate with the benefits they receive (as would be the case in other kinds of insurance programs), it would be misleading to report the amount of this intergenerational transfer implicit in social insurance.

96. The Board believes that ... the closed group measure represents a reasonably good estimate of the net responsibility of future participants, under current laws, to pay benefits to current participants. Although this amount is subject to change due to changing long-range demographics, it is not as volatile as the computation under the "open group" method that includes all current and future participants over the next 75 years since it relates only to individuals who already are participating in the program.

Transition Costs

97. Some people note that the closed group measure, in addition to being an important

[12] ~~Budget issues: Budgeting for Federal Insurance Programs~~, General Accounting Office, GAO/AIMD-97-16, Sept. 30, 1997, p. 5.

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factor in assessing the financial position and condition of the program and of the government, also represents a rough estimate of the maximum "transition cost" of the program if it were to move from the present pay-as-you-go system to one that, like most pension plans, sets aside resources during workers' careers to finance the benefits they will receive after they retire.[13] The primary reason for reporting the size of this implicit liability in general purpose federal financial reports is to ensure that the financial report fairly presents the financial position, condition, and results of operations of the reporting entities involved. It is also true, however, that this number is one way of quantifying the financing challenges relating to changing social insurance programs and is relevant to the concerns of users who are assessing options for dealing with those challenges. The number not only draws attention to the challenge but also quantifies it in a way that can support further analysis and decision-making. Federal accounting and financial reporting attempt to address the needs of users and to inform them for their decisions, including decisions on these highly important and topical issues.

98. For example, the 1994-96 Advisory Council on Social Security expressed interest in three different approaches to restoring financial solvency and improving the rate of return on individual's contributions to the Social Security System. The three plans were entitled "Maintenance of Benefits," "Individual Accounts," and "Personal Security Accounts (PSA)." The PSA plan involved transition costs that the plan's advocates explained as follows:

> Transition costs arise because, under the present system, there are large unfunded accrued obligations -- that is, benefits scheduled to be paid to current retirees and to workers who have already paid taxes in excess of assets on hand. Under the plan, these obligations would be met as they mature. At the same time, the new fully-funded component of the system would be implemented. During the phase-in of the new system, the cost of meeting obligations under the existing system is sometimes referred to as the "transition cost."

[13] Several ways exist for measuring transition costs depending on, among other things, whether one assumes the current program will continue for current participants alongside a new program for new participants (similar to federal employees continuing with the Civil Service Retirement System after the creation of the Federal Employee Retirement System in 1983). In such a transition, the older program would be closed to new entrants. Another type of transition would be where the current participants will move on to the new system, with the transition cost being the amount owed them under the former program. The discussion of different methodologies for calculating transition cost is beyond the scope of this accounting standard; but see the Stephen Goss, "Measuring Solvency in the Social Security System," *Prospects for Social Security Reform*, ed. Olivia S. Mitchell, Robert J. Myers, and Howard Young (Philadelphia: University of Pennsylvania Press, 1999), 16-36.

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> Transition costs would be met with a combination of added taxes and added Federal borrowing. The SSA [Social Security Administration] actuaries project that a 1.52 percent supplement to the payroll tax would cover average long-range transition costs over the next 72 years.[14] However, because the unfunded accrued obligations under the existing system are highest in the next couple of decades and taper off in later decades, there is a shortfall of revenues between about 2000 and 2034 and an excess of revenues thereafter. It is assumed that the shortfall would be met by issuing bonds to the public for the next 40 years (totaling an estimated $1.9 trillion in 2034, in 1995 dollars), and that these bonds would be fully repaid by the excess of tax revenues in the later period. [vol. 1, p. 32]

99. Similarly, Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, has discussed the challenge confronting the Social Security system and the relevance of the transition amount:

> ... It has become conventional wisdom that the social security system, as currently constructed, will not be fully viable after the baby boom generation starts to retire.... This imbalance in social security stems primarily from the fact that, until very recently, payments into the social security trust accounts by the average employee, plus employer contributions and interest earned, were inadequate to fund the total of retirement benefits. This has started to change. Under the most recent revisions to the law and presumably conservative economic and demographic assumptions, today's younger workers will pay social security taxes over their working years that appear sufficient, on average, to fund their benefits during retirement. However, the huge liability for current retirees, as well as for much of the work force closer to retirement, leaves the system as a whole badly underfunded.[15]

100. In the course of discussing a variety of economic issues and policy options (including "privatization") that transcend accounting, Mr. Greenspan continues:

> Any move toward privatization will confront the problem of how to finance previously promised benefits. That would presumably involve making the implicit accrued unfunded liability of the current social security system to beneficiaries explicit.... If markets perceive that this liability has the same status as explicit federal debt, then one must presume that interest rates have already fully adjusted to the

[14] Note that this rate differs from the 2.17 percent increase in the payroll tax that has been estimated to be necessary to maintain benefits under current law; see p. 25 of the 1994-96 Advisory Council report, vol. 1.

[15] Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Task Force on Social Security, Committee on the Budget, United States Senate, Nov. 20, 1997, p. 1.

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> implicit contingent liability. However, if markets have not fully accounted for this implicit liability, then making it explicit could lead to higher interest rates for U.S. government debt.... There is reason to suspect, however, that if such a liability is made explicit in a manner similar to the transition procedure in Chile, each dollar of new liability will weigh far less on financial markets than a dollar of current public debt.[16]

101. Mr. Greenspan mentioned some reasons why the capital market's reaction -- though possibly substantial -- might be muted if the government made this implicit liability more explicit. The Federal Reserve has estimated that, using a 2 percent real rate of discount and other assumptions, the value of all currently accrued legislated future Social Security retirement benefits would be roughly $9.5 trillion.

102. The assumptions, benefits, population, and actuarial approach covered by this estimate differ somewhat from those used by the Social Security Trustees in the past to produce the closed group estimate comparable to the one called for by this statement. The calculation used for Mr. Greenspan's testimony is an estimate of the actuarial present value of future benefits arising from individuals' covered employment to the date of calculation, without considering their expected future employment until they retire. The estimate for the closed group in this standard considers both benefits to be earned and contributions to be made for current participants, in addition to benefits already earned or credited. Also, Mr. Greenspan's estimate is for Old-Age and Survivors Insurance only while this standard proposes that the closed group estimate for Social Security also include Disability Insurance. However, the numbers are roughly comparable.

103. The Chairman concluded by saying

> We owe it to those who will retire after the turn of the century to be given sufficient advance notice to make what alterations in retirement planning may be required. If we procrastinate too long, the adjustments could be truly wrenching. Our senior citizens, both current and future, deserve better.[17]

. . .

[16] Greenspan, p. 4-5.
[17] Greenspan, p. 9.

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Money's Worth

104. The Board considered requiring a "money's worth" measure. Such a measure would show all contributions paid and benefits received by different age groups (e.g., those born in 1920 compared with 1940). The 1994-96 Advisory Council on Social Security recommended that Social Security meet a test of providing a reasonable money's worth return on the contributions of younger workers and future generations, while taking into account the redistributive nature of the system. The Council said that, although money's worth return was only one measure among many, it was important to the long-range sustainability of the program for younger generations to believe that they were getting a reasonable return on their taxes. The Council said,

> **Social Security should provide benefits to each generation of workers that bear a reasonable relationship to total taxes paid, plus interest.**
>
> Many important values served by a Social Security system are not fully captured by looking solely at money's worth or rates of return. Nevertheless, the Council believes that it is important that young workers perceive that the system is fair. This perception suggests that the younger generation should be well treated in terms of the issue of money's worth, taking into account the fact that within each generation there will be a redistribution toward the lower paid. [vol. 1, p. 17]

105. Some argue that the money's worth measure may be viewed as a good measure of potential future stress caused by the disparity between taxes and anticipated benefits. However, others argue that this measure is of questionable relevance given the basic design and breadth of the benefits available under some social insurance programs. For example, the Social Security benefit formula is designed to provide relatively higher benefits for workers with lower earnings. This feature of the program is inconsistent with a pure focus on money's worth. Finally, as commonly reported, this measure does not reflect some social insurance programs and program features such as benefits to the disabled or dependents in the event of the participant's death.

106. The Board considered the money's worth measure and believes that it presents a useful perspective. However, the Board decided not to require it because it fails to capture the complexity of social insurance programs and could be calculated from too many perspectives. The Board recognizes the usefulness of the measure for policy analysis (and management may wish to report it voluntarily) but it goes beyond what the Board regards as essential to present fairly the financial position, condition, and

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results of operations of the reporting entities involved (including the governmentwide entity). Accordingly, the Board decided not to require RSSI about money's worth.

Trust Fund Ratio

107. The Board also considered the "trust fund ratio" which is defined as the fund balance at the beginning of the year expressed as a percentage of the outgo during the year; or, in other words, the proportion of a year's outgo that could be paid with the funds available at the beginning of the year.[18] The trust fund ratio is one of several measures the Social Security trustees use to evaluate the short-term financial status of the trust funds. Also, the 1994-96 Social Security Advisory Council advocated using the trust fund ratio as a gauge of long-term sustainability. The Council recommended that, in addition to the actuarial balance over 75 years, the program should have a stable trust fund ratio over the final years of the 75-year forecast horizon.[19] The Council believed that the trend of trust fund ratio would indicate whether there would be cause for concern about the years beyond the 75-year horizon. The Council was concerned that all factors known at the time of the 75-year projection be considered and reported, including whether there were problems beyond the 75-year projection period. For example, even as the trustees are reporting that the system is in actuarial balance over 75 years, demographic trends could make the next 10 years beyond the 75-year horizon more expensive.

108. The Board decided not to recommend the trust fund ratio as RSSI for a number of reasons. In particular, to be useful, the ratio would have to be used in conjunction with a projection that was in actuarial balance or nearly so. Under the current "best estimate" projection, where fund balance is expected to be exhausted well before 75 years, the trust fund ratio would not be useable. Although the Board acknowledges that the ratio may be useful as an indicator of short-term financial condition, it believes the projections and estimates in this standard will be more informative for accounting purposes.

. . .

[18] *The 1997 Annual Report of The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, p. 221.
[19] See *Findings and Recommendations*, vol. 1, p. 17 (Jan. 1997).

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Component & Governmentwide Perspectives

109. In developing these standards, the Board attempted to address the component entity as well as governmentwide reporting. From the perspective of the component federal entity, the accounting and reporting includes assets in the form of Treasury securities as well as interest thereon. These are not claims on third parties. The assets of the funds are offset by an identical liability of the U.S. Treasury. Like other intragovernmental assets and liabilities, they do not represent assets (or liabilities) of the Federal Government as a whole and are eliminated for governmentwide reporting. The nonmarketable Treasury debt securities are evidence of the accumulation of excess cash receipts over cash disbursements within the social insurance program.

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APPENDIX B - SAMPLE REPORTING FOR ILLUSTRATION ONLY

NOTE

The sample report sections in Appendix B provide nonauthoritative illustrations of possible RSSI that would comply with this standard. The narrative, charts, tables, and other information shown there are intended to be one approach among others to provide a full description of the programs and to supply the required information. The standard does not require any particular format or graph. Most, but not all, of the data presented in Appendix B would be required by pars. 27 and 32 of the standard (e.g., the year the fund balance is exhausted [see par. 117] and the open group actuarial deficit as a percentage of taxable payroll [see par. 120] would not be required). This is done to illustrate that management may provide more supplementary information than is required by the standard.

Most data are taken from various reports for FY 1996 and are "actual data." Certain data are hypothetical. Although the data are realistic, readers should not rely on the validity of the data in the sample reports.

OMB provides specific form and content guidance on financial reports.

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Social Security - Required Supplementary Stewardship Information

Statement of Social Insurance
Old-Age, Survivors and Disability Insurance
75-Year Projection[1] as of September 30, 1996
(trillions of dollars)
[HYPOTHETICAL DATA]

		Prior Years			
	1996	1995	1994	1993	1992
Actuarial present value of future benefit payments[2] during the 75-year period to or on behalf of:					
Current participants not yet having attained retirement age[3]	$ X	$ X	$ X	$ X	$ X
Current participants who have attained retirement age[3]	X	X	X	X	X
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
Subtotal - benefit payments for the 75-year period	19	X	X	X	X
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:					
Current participants not yet having attained retirement age[3]	Y	Y	Y	Y	Y
Current participants who have attained retirement age[3]	Y	Y	Y	Y	Y
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y
Subtotal - contributions and tax income for the 75-year period	16	Y	Y	Y	Y
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period[4]	$ 3	$ X	$ X	$ X	$ Y

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Notes to the Statement:

[1] The projection period for new entrants covers the next 75 years. The projection period for current participants (or "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years a in few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

[2] "Benefit payments" include administrative expenses.

[3] To calculate the actuarial net present value of the excess of future benefit payments to current participants (that is, to the "closed group" of participants) over future contributions and tax income from them or on their behalf, subtract the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

[4] The calculation of the "close actuarial balance" used for analysis by the Social Security trustees differs from the calculation of the amount presented on this line. The trustees' close actuarial balance calculation includes the fund balance at the beginning of the period as an item of cash inflow and the cost of about one year's expenditure, as a target fund balance at the end of the period, as a cash outflow. The fund balance--which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over cash outflow within the social insurance program--for 1996 for the OASDI program is $ .6 trillion (OASI, $ .5 trillion, and DI $ .1 trillion). The fund balances for 1995-2, in trillions, were $.6, .5, .5, .4, respectively. The fund balance consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

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Program Description

110. The Old-Age, Survivors, and Disability Insurance (OASDI) program, collectively referred to as "Social Security" or OASDI, provides cash benefits for eligible U.S. citizens and residents. During calendar year 1996, OASDI provided benefits to approximately 44 million beneficiaries. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law provides that the amount of the monthly benefit payments for individuals, or dependent spouses and children, is based on the individuals' taxable earnings up to the date when payments commence.

111. The amount of the effective monthly OASDI benefits may be altered by changes in laws governing the program. In 1983 for example, up to one-half of OASDI benefits became taxable; cost-of-living-adjustments (COLAs) were permanently delayed six months; and the age for full retirement benefits was gradually increased from 65 to 67 over a 24-year period.

112. OASDI has been described as an income transfer program -- that is, a program designed to reduce economic disparity by redistributing income between households. OASDI transfers income in at least two ways. First, its benefit structure is progressive in the sense that benefits during retirement for lower-income workers replace a larger proportion of income earned during their working years than is the case for higher-income workers. This results in an income transfer among workers of the same age group but in different income groups. Second, OASDI is financed largely on a pay-as-you-go basis. The payroll taxes paid to OASDI each year by current workers are primarily used to pay the benefits provided during that year to current beneficiaries. This results in income transfers between current workers and current beneficiaries and therefore between younger workers and older retirees, the disabled, and surviving family members.

Program Finances and Sustainability

113. As discussed in Note X to the consolidated financial statements, a liability of $34 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of OASDI benefits due to recipients for periods ended on or before September 30, 1996 ($33 billion in FY 1995). Virtually all of this amount was paid in October 1996. Also, an asset is recognized for the "investments in Treasury securities" as of September 30, 1996, of $550 billion ($483 billion in FY 1995). This investment represents trust fund assets accumulated from the excess of payroll taxes over benefits in prior periods. This fund balance is available for OASDI's use in future periods when a deficit occurs in the program. These investments are referred to as "trust fund assets" throughout the remainder of this disclosure.

114. No liability has been recognized on the balance sheet for future payments to be made to present and

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future program participants, beyond the unpaid amounts as of September 30, 1996. This is because the OASDI is accounted for as a social insurance program rather than a pension program. Accounting for a social insurance program recognizes the expense of benefits when they are actually paid or are due to be paid because benefit payments are primarily nonexchange transactions and are not considered deferred compensation as would employer-sponsored, employee's pension benefits. Accrual accounting for a pension program, by contrast, would recognize the retirement benefit expenses as they are earned during a worker's career so that the full actuarial present value of the expected retirement benefits has been recognized by the time the worker retires.

115. ***Supplementary Stewardship Information*** - While no liability has been recognized on the balance sheet for future payments beyond those due at period end, actuarial estimates of future program activities are made annually to assess the financial condition and prospects for OASDI and are presented here as supplementary stewardship information. The statement presented above and the displays below represent the best estimate of future cash inflow and outflow based on the assumptions shown at the end of this section and considering future changes previously mandated by law. However, estimates extending so far into the future are inherently uncertain, and the uncertainty is greater for the later years in the period. This stewardship information includes:

(1) actuarial present values of future benefits for and contributions and tax income from or on behalf of current and future program participants;

(2) cashflow in **nominal dollars** and as percentages of taxable payroll and the GDP;

(3) the ratio of contributors to beneficiaries or "dependency ratio" showing the long-range relationship between the program's beneficiaries and contributors; and

(4) an analysis of the sensitivity of the projections to changes in assumptions.

116. *Cashflow Projections* - Chart 1 below shows the actuarial estimate of OASDI cash inflow and outflow for each of the next 35 years, in nominal dollars, using data from the OASDI Trustees' annual report. The estimate is based on what the Trustees refer to as the **open group population** (i.e., all persons who will participate in the program as contributors or beneficiaries or both over the next 35 years). Thus, it includes payments from, and on behalf of, employees who will enter the workforce during the next 35 years as well as those now in the workforce.

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117. As chart 1 shows, present estimates indicate that, in nominal dollars, cash outflow would start to exceed total inflow (including interest on intragovernmental borrowing/lending) in about 2019. This deficiency would continue at an increasing rate thereafter, require the redemption of investments in Treasury securities held as assets by the trust fund, and result in the exhaustion of accumulated asset balances in 2029.[4] Even before 2019, outflow would exceed cash inflow from the public (i.e., excluding interest paid by Treasury). Estimates indicate this will happen in about 2012, as shown in chart 1. From about 2012 forward, OASDI would pay more to the public than it would receive in taxes. This would increase the government's financing needs. Compared to a situation in which OASDI taxes equaled outgo, the government would have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.

Terms Used In Chart 1

The following terms are used in chart 1:

- **total inflow** includes payroll taxes, income tax on certain OASDI benefits, interest income, and miscellaneous reimbursement from the general fund;
- **cash inflow excluding interest** is income exclusive of interest on trust fund assets;
- **total outflow** includes benefit payments, administrative expenses, net transfers to the Railroad Retirement program, and vocational rehabilitation expenses for disabled beneficiaries.

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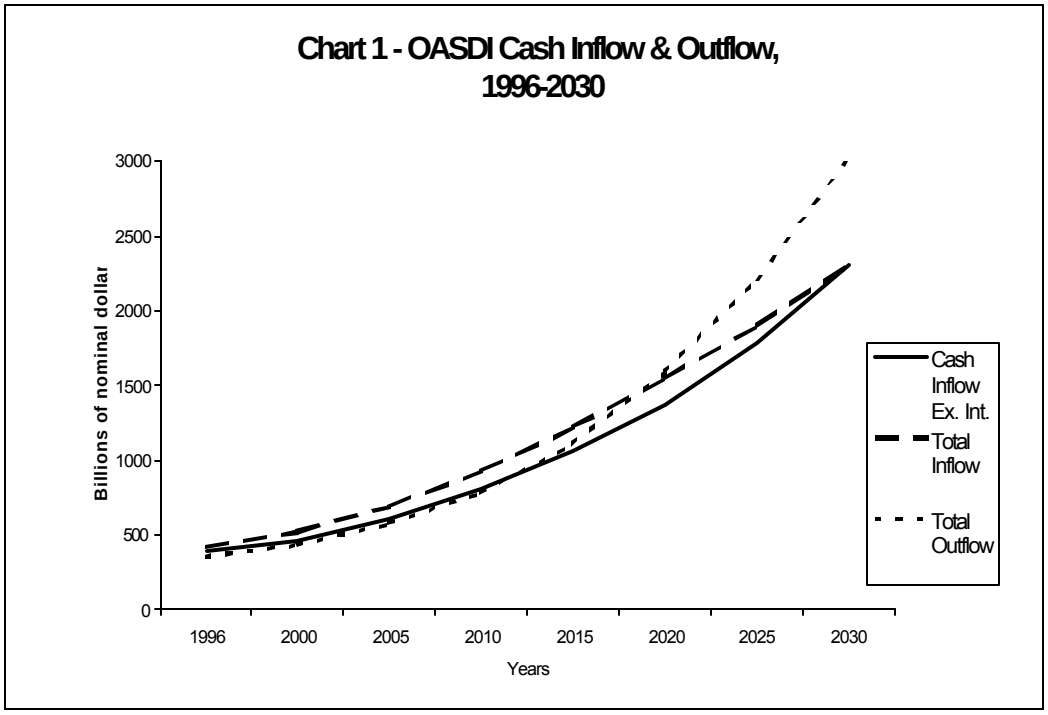

Data from Tables III B1, B3, & C1, 1996 OASDI Trustees' Report

118. *Percentage of Taxable Payroll* - The excess of cash outflow over inflow is due to a variety of factors including the retirement of the "baby boom" generation and the relatively small number of people born during the subsequent period of low birth rate. As presently constructed, the program receives most of its cash inflow from the 6.2 percent payroll tax that employees and employers each pay, for a total of 12.4 percent of taxable payroll. Chart 2 below illustrates the rising annual cost of the program relative to its annual income as a percentage of taxable payroll.

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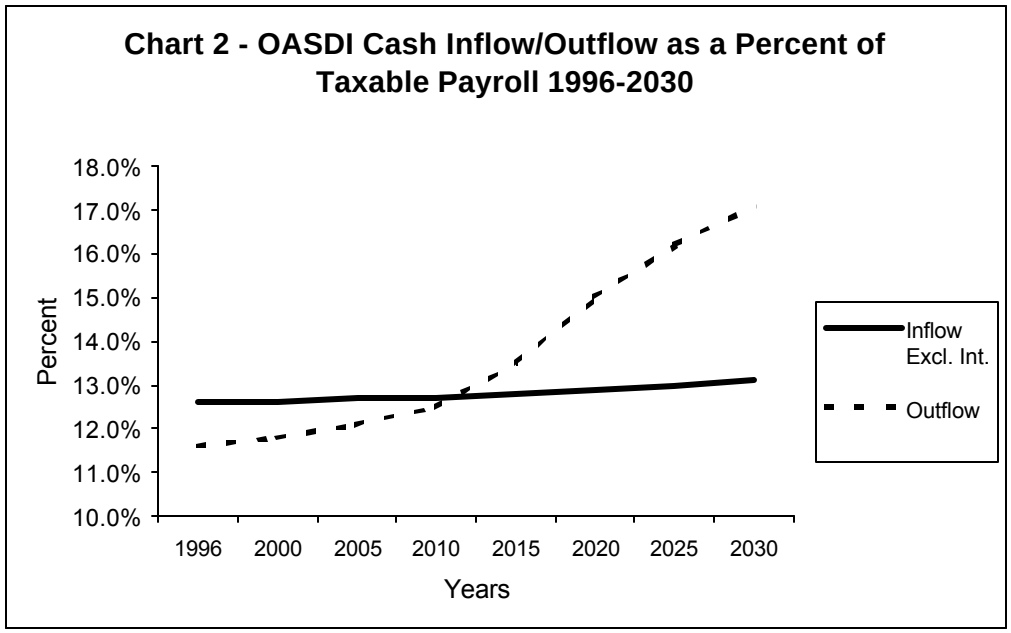

Data from Tables III A2, 1996 OASDI Trustees' Report

119. The total excess of cash outflow over inflow for OASDI over the next 75 years is estimated to be 2.17 percent of taxable payroll; in other words, a tax increase today of about 1.09 percent of taxable payroll each on employees and employers, over the 6.2 percent they each now pay, would produce enough inflow over 75 years to pay all benefits due under current law.[20] There would be trust fund surpluses in the early years of the projection from which the Trustees would acquire Treasury securities to be used to pay benefits later.

120. Stated in terms of actuarial present value, the 2.17 percent deficit equates to an excess of expenditures over contributions of about $3 trillion over the next 75 years from September 30, 1996. The accumulation and subsequent redemption of substantial trust fund assets have economic and public policy implications that go beyond the operation of the OASDI program itself. Discussion of these broader issues is not within the scope of this report.

121. *Percentage of GDP* - In addition to analyzing OASDI operations as a percentage of taxable payroll, viewing them as a percentage of the Gross Domestic Product (GDP) provides an additional

[20] [Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 2.]

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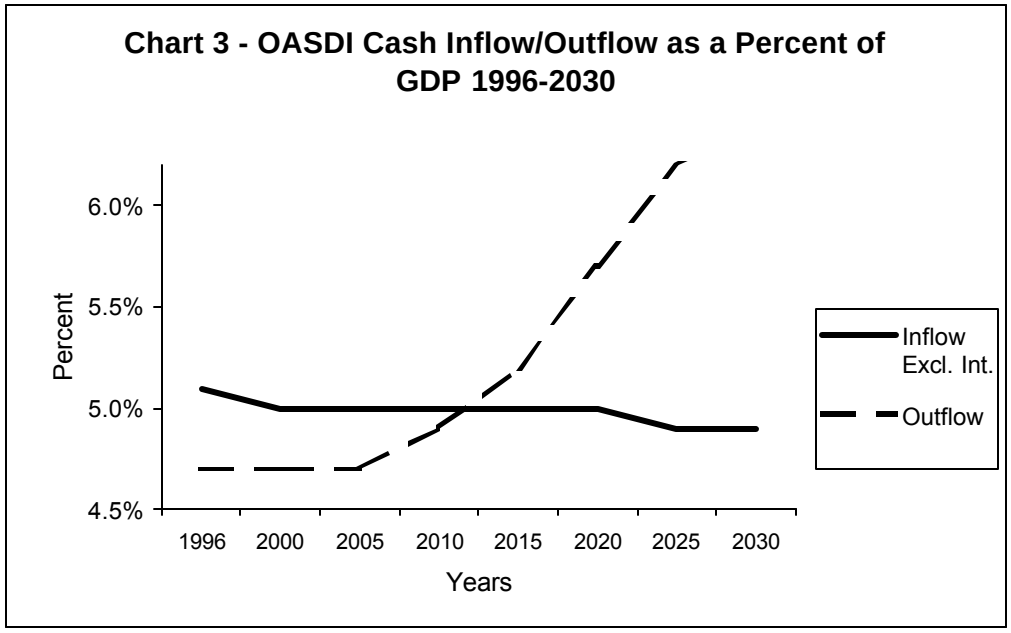
perspective on these funds in relation to the capacity of the national economy to sustain them. The GDP represents the total value of goods and services produced in the United States. Chart 3 below shows OASDI's cost as a percentage of GDP.



Data from Table III C1, 1996 OASDI Trustees' Report

122. In 1996, federal spending for OASDI exceeded $350 billion, which was about 4.7 percent of GDP. By 2030, when most baby boomers will have retired, the program (based on current law) will consume nearly 50 percent more of GDP than it does today -- 6.4 percent. Nearly all of the increase between now and 2030 will occur between 2010 and 2030, as retired baby boomers become eligible for those programs.

123. ***Sensitivity Analysis*** - As indicated by the assumptions shown at the end of this section, the future cashflow of the OASDI program depends on many economic and demographic assumptions, including GDP, labor factors, unemployment, average wages and self-employment earnings, interest rates on Treasury securities, productivity, inflation, fertility, mortality, net immigration, marriage, divorce, retirement patterns, and disability incidence and termination. The cash inflow will depend on how these factors affect the size and composition of the working population and the level and distribution of wages and earnings. Similarly, the outgo will depend on how these factors affect the size and

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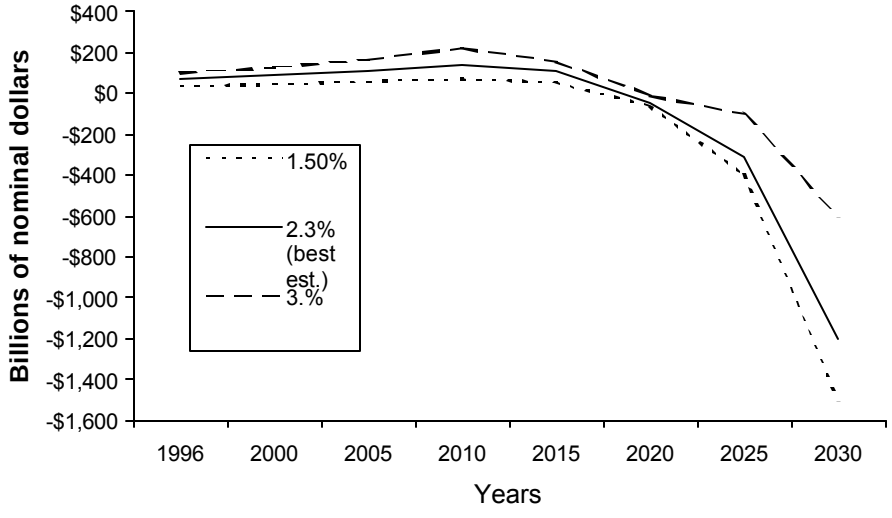
composition of the beneficiary population and the general level of benefits. Precise long-range projections of these factors is impossible.

124. This section illustrates the sensitivity of the long-range projections to changes in assumptions by analyzing five key individual assumptions: the real interest rate, the death and birth rates, net immigration, and the real wage differential. For this analysis the "best estimate" cost assumptions are used as the reference point, and each assumption is varied within it individually.

125. *Real Interest Rate* - The "best estimate" long-range cashflow projections presented in Chart 1 above assume a 4 percent increase in Consumer Price Index (CPI) per year after the year 2000 as the inflation rate and a 2.3 percent real interest rate. The "real interest rate" is the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the CPI. Chart 4 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 2.3 percent real interest rate, with the net cashflow that would result from decreasing the real interest rate to 1.5 percent and increasing it to 3 percent.

Chart 4 - OASDI Net Cashflow with Alternative Assumptions about the Real Interest Rate 1996-2030



Data regarding “best estimate” is from Tables III B1, B3, C1, 1996 OASDI Trustees’ Report

As stated above, the estimated total excess of OASDI cash outflow over cash inflow over the next 75

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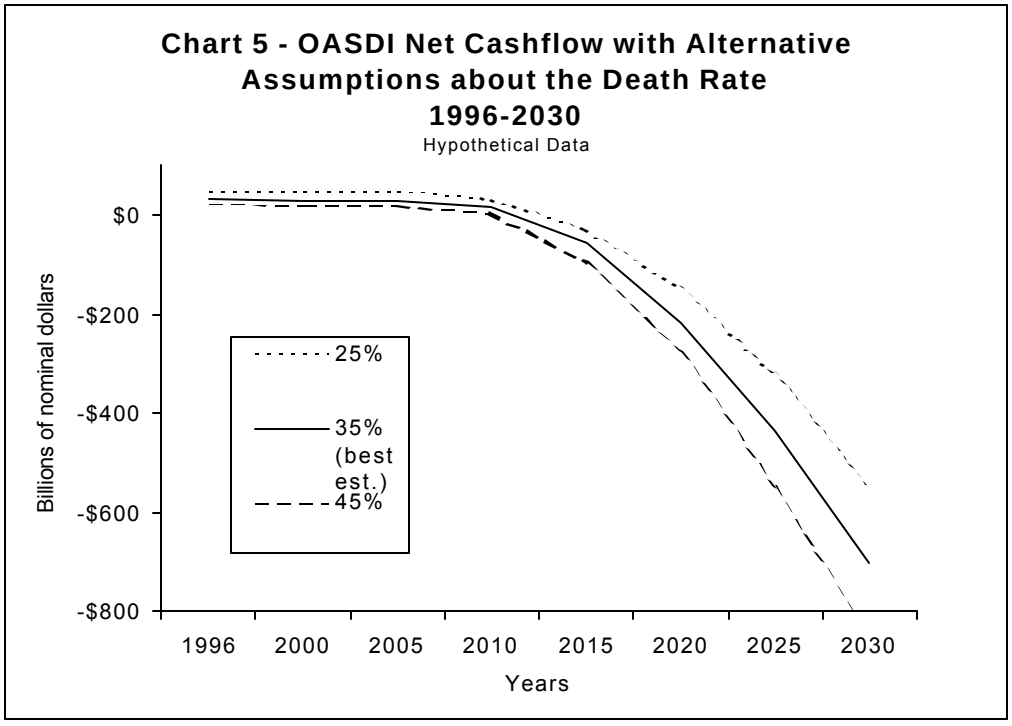
years is $3 trillion. If the annual real interest rate--that is, the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the Consumer Price Index (CPI)--is changed from the 2.3 percent used for the best estimate projection to 1.5 percent, the total excess of cash outflow would increase to $3.8 trillion; if the rate were changed to 3 percent, the total excess would decrease to $2.5 trillion.

126. *Death Rate* - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during 1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.



Data regarding "best estimate" is from Tables III B1, B3, C1, 1996 OASDI Trustees' Report

Regarding actuarial present values for a 75-year projection period, if the decrease in the death rate is changed from the 35 percent used for the best estimate projection to 15 percent, meaning that more people are dying, the total excess of cash outflow for the period would decrease to $2.1 trillion, from $3.0 trillion; if the rate were changed to 55 percent, the total excess cash outflow would increase to

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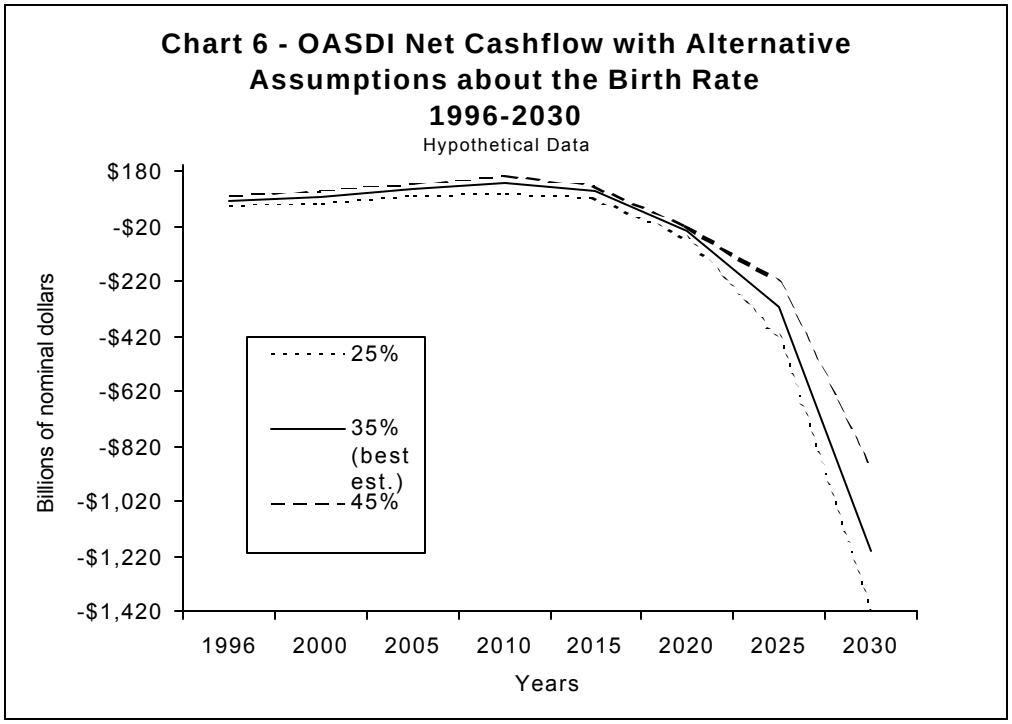
$4.2 trillion.

127. *Birth Rate* - Table 1 below shows the estimated total excess OASDI cash outflow over inflow over a 75 year projection period using a birth rate above and below the rate used for the best estimate projection. This analysis was developed by varying the percentage increase in the birth rate assumed to occur during 1996-2070. The rate used for the best estimate projection assumes a ultimate birth rate in 2070 of 1.9 children per woman. Chart 6 below shows the estimated OASDI cash inflow and outflow using a birth rate above and below the rate used for the projection in Chart 1 above. Chart 6 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1.9 birth rate, with the net cash outflow that would result from decreasing the rate to 1.6 percent and increasing it to 2.2 percent.



Data regarding "best estimate" is from Tables III B1, B3, C1, 1996 OASDI Trustees' Report.

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Table 1 presents the affect of using rates of 1.6 and 2.2 on the excess of cash outflow over inflow during the projection period. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions Valuation Period: 1996-2070

Valuation Period: 1996-2070	Ultimate Birth Rate Per Woman (trillions of dollars)		
	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	$3.7	$3.0	$2.5

128. *Net Immigration* -- Chart 7 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 900,000 per year net immigration rate, with the net 1cashflow that would result from decreasing the rate to 750,000 and increasing it to 1,150,000.

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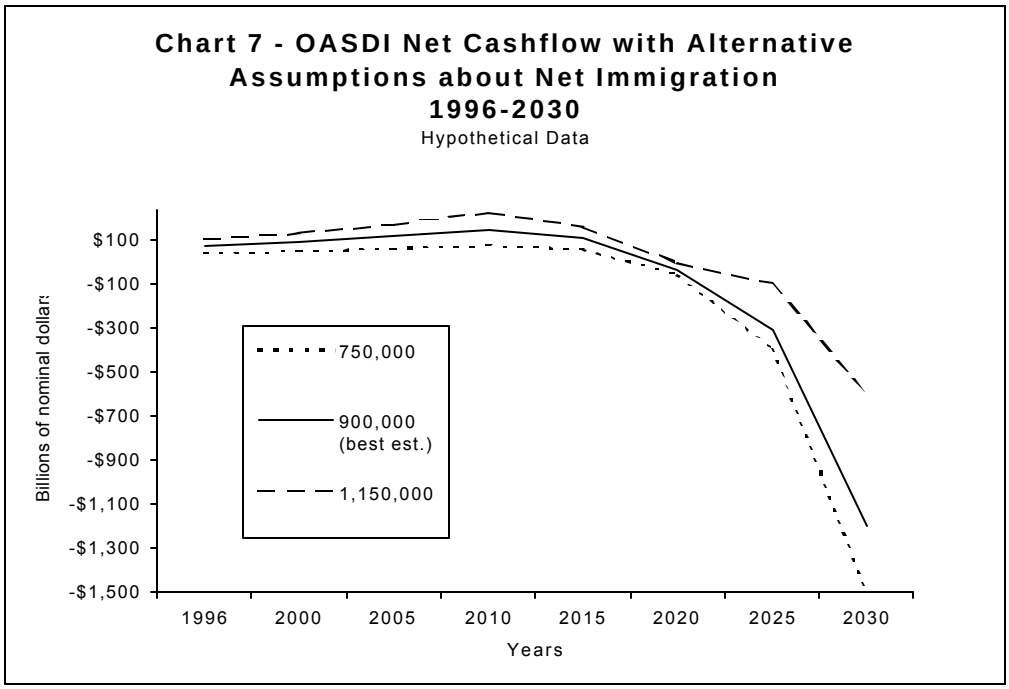

Data regarding "best estimate" is from Tables III B1, B3, C1, 1996 OASDI Trustees' Report

Regarding actuarial present values over 75 years, table 2 below shows the estimated total excess of OASDI cash outflow over inflow with assumptions that differ from those used for the "best estimate" projection.

Table 2 - Estimated Total Excess OASDI Cash Outflow over Inflow with Various Net Immigration Assumptions Valuation Period: 1996-2070

Valuation Period: 1996-2070	Net immigration per year (trillions of dollars)		
	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over cash inflow	$3.2	$3.0	$2.9

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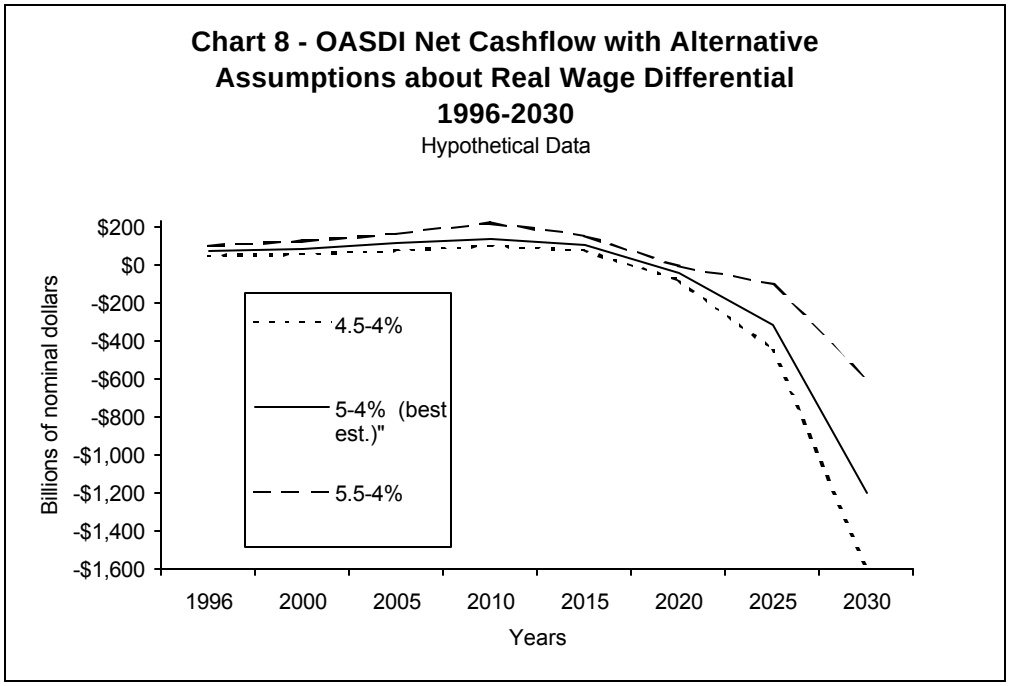
129. *Real-Wage Differential* - Chart 8 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1 percent real wage differential, with the net cashflow that would result from decreasing the rate to .5 percent and increasing it to 1.5 percent. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI.



Data regarding "best estimate" is from Tables B1, B3, C1, 1996 OASDI Trustees' Report.

Regarding actuarial present values over 75 years, table 3 below shows the estimated total excess of OASDI cash outflow over inflow with various assumptions about the real-wage differential.

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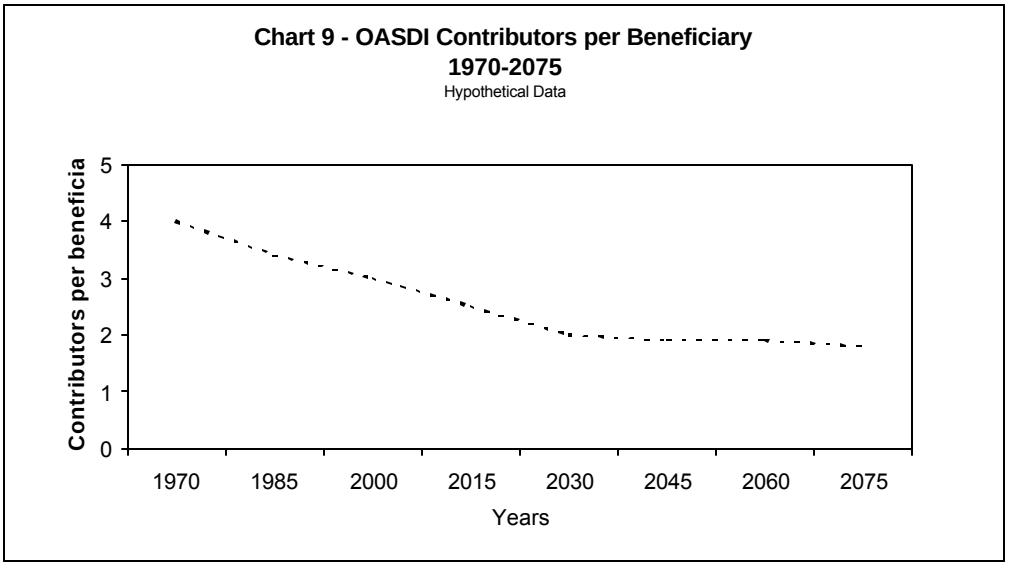
Table 3- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Real-Wage AssumptionsValuation Period: 1996-2070

	Ultimate percentage in wages-CPI (trillions of dollars) *[The first value in each of the pairs below is the assumed ultimate annual percentage increase in average wages in covered employment. The second value is the assumed ultimate annual percentage increase in the CPI. the difference between the two values is the real-wage differential.]*		
Wages-CPI	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Excess cash outflow over inflow	$3.9	$3.0	$2.3

130. ***Dependency Ratio*** - Chart 9 below shows the estimated number of covered workers per OASDI beneficiary using the Trustees' best estimate. As defined by the Trustees, covered workers are persons having earnings creditable for OASDI purposes on the basis of services for wages in covered employment and/or on the basis of receipts from covered self-employment. As Chart 6 shows, the number of workers to beneficiaries will decline from 3.3 per beneficiary in 1995 to 2 per beneficiary in 2030 and 1.8 in 2075.



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Social Security Assumptions -

Assumptions Used

The estimates used in this presentation are based on the assumption that the programs will continue as presently constructed. They give effect to certain additional economic and demographic assumptions, including those in the following table:

	Average Annual Percent Change			Average Annual Interest Rate on Treasury Securities (%)	Average Annual Unempl.. Rate	Average no. of children per woman	Death rate per 100,000	Life expectancy	
	GDP	Wages	CPI					Men	Women
1996	2.0	4.0	2.0	6.0	5.0	2.0	757	72	79
2000	2.0	4.3	3.5	6.5	6.0	2.0	731	73	79
2005	2.0	5.1	4.0	6.4	6.0	2.0	700	73	80
2010	1.8	5.0	4.0	6.3	6.0	2.0	677	74	80
2020	1.3	5.1	4.0	6.3	6.0	1.9	638	75	81
2030	1.4	5.0	4.0	6.3	6.0	1.9	603	76	81

These assumptions and the other values on which these displays are based represent the latest and most likely -- or "best" -- estimates of these values by the Trustees. Estimates made in certain prior years have changed substantially because of revisions to the assumptions due to changed conditions or experience, and to changes in actuarial methodology. It is reasonable to expect more changes for similar reasons in the future.

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Unemployment Insurance Programs

131. The U. S. Department of Labor operates two programs classified under federal accounting standards as social insurance, the Unemployment Insurance Program and the Black Lung Disability Benefits Program. Presented below is the required supplementary stewardship information for the Unemployment Insurance Program.

Program Description

132. The Unemployment Insurance (UI) program was created in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. The program protects workers during temporary periods of unemployment, through the provision of unemployment compensation benefits. These benefits replace part of the unemployed worker's lost wages and, in so doing, stabilize the economy during recessionary periods by increasing the unemployed worker's lost wages and purchasing power. The UI program operates counter cyclically, paying benefits during recessionary periods and collecting UI tax revenue during periods of recovery.

133. ***Program Administration and Funding*** - The UI program is administered through a unique system of federal-state partnerships, established in federal law but executed through conforming state laws by state officials. The Federal Government provides broad policy guidance and program direction through the oversight of the U.S. Department of Labor, while program details are established through individual state UI statutes, administered through state UI agencies.

134. ***Federal and State Unemployment Taxes*** - The UI program is financed through the collection of federal and state unemployment taxes levied on subject employers and deposited in the unemployment trust fund (UTF). Federal unemployment taxes are used to pay for the administrative costs of the UI program, including grants to each state to cover the costs of state UI operations, as well as the federal share of extended UI benefits. Federal unemployment taxes are also used to maintain a loan account within the UTF, from which insolvent state accounts may borrow funds to pay UI benefits. State UI taxes are used exclusively for the payment of regular UI benefits, and the state's share of extended benefits. These taxes and the UTF established to account for their receipt, investment, and disbursement are discussed below.

135. *Federal Unemployment Taxes* - Under the provisions of the Federal Unemployment Tax Act (FUTA), a federal tax is levied on covered employers, at a current rate of 6.2 percent of the first $7,000 in annual wages paid to each employee. This federal tax is reduced by a credit of up to 5.4 percent granted to employers paying state UI taxes under conforming state UI statutes. Accordingly, in conforming states, employers pay an effective federal tax of .8 percent. Federal unemployment taxes are collected by the Internal Revenue Service.

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136. *State Unemployment Taxes* - In addition to the federal tax, individual states finance their UI programs through state tax contributions from subject employers on the wages of covered employees. (Three states also collect contributions from employees.) Within Federal confines, state tax rates are assigned in accordance with an employer's experience with unemployment. Actual tax rates vary greatly among the states and among individual employers within the state. At a minimum, these rates must be applied to the federal tax base of $7,000; however, states may adopt a higher wage base than the minimum established by FUTA. State UI agencies are responsible for the collection of state unemployment taxes.

137. ***Unemployment Trust Fund*** - Federal and state UI taxes are deposited into designated accounts within the UTF. The UTF was established under the authority of Title IX, section 904 of the Social Security Act of 1935, as amended, to receive, hold, invest, loan, and disburse federal and state UI taxes. The U.S. Department of the Treasury invests amounts in excess of disbursing requirements in Treasury securities. The UTF is comprised of the following accounts:

138. *Federal Accounts* - The Employment Security Administration Account (ESAA) was established pursuant to section 901 of the Social Security Act. All tax receipts collected under the FUTA are appropriated to the ESAA and used to pay the costs of federal and state administration of the UI program and veterans employment services, as well as 97 percent of the costs of the state employment services. Excess balances in ESAA, as defined under the act, are transferred to other federal accounts within the fund, as described below.

139. The Federal Unemployment Account (FUA) was established pursuant to section 904 of the Social Security Act. FUA is funded by any excesses from the ESAA as determined in accordance with section 902 of the act. Title XII, section 1201 of the act authorizes the FUA to loan federal monies to state accounts that are unable to make benefit payments because the state UI account balance has been exhausted. Title XII loans must be paid with interest. The FUA may borrow from the ESAA or the Extended Unemployment Compensation Account (EUCA), without interest, or may also receive repayable advances, with interest, from the general fund of the U.S. Treasury when the FUA has a balance insufficient to make advances to the states.

140. The Extended Unemployment Compensation Account (EUCA) was established pursuant to section 905 of the Social Security Act. EUCA provides for the payment of extended unemployment benefits authorized under the federal/state Extended Unemployment Compensation Act of 1970, as amended. Under the extended benefits program, extended unemployment benefits are paid to individuals who have exhausted their regular unemployment benefits. These extended benefits are financed one-half by state unemployment taxes and one-half by FUTA taxes obtained from the EUCA. The EUCA is funded by a percentage of the FUTA tax transferred from the ESAA in accordance with section 905(b)(1) and (2) of the Social Security Act. The

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EUCA may borrow from the ESAA or the FUA, without interest, or may also receive repayable advances from the general fund of the Treasury when the EUCA has a balance insufficient to pay the federal share of extended benefits. During periods of sustained high unemployment, the EUCA may also receive payments and non repayable advances from the general fund of the Treasury to finance emergency unemployment compensation benefits. Emergency unemployment benefits require congressional authorization.

141. The Federal Employees Compensation Account (FECA) was established pursuant to section 909 of the Social Security Act. FECA provides funds to states for unemployment compensation benefits paid to eligible former federal civilian personnel and ex-service members. Generally, benefits paid are reimbursed to the FECA by the various federal agencies. Any additional resources necessary to ensure that the account can make the required payments to states, due to the timing of the benefit payments and subsequent reimbursements, will be provided by non repayable advances from the general fund of the Treasury.

142. *State Accounts* - Separate state accounts were established for each state and territory depositing monies into the UTF, in accordance with section 904 of the Social Security Act. State unemployment taxes are deposited into these individual accounts and may be used only to pay state unemployment benefits. States may receive repayable advances from the FUA when their balances in the UTF are insufficient to pay benefits.

143. *Railroad Retirement Accounts* - The Railroad UI Account and Railroad UI Administrative Account were established under section 904 of the Social Security Act to provide for a separate unemployment insurance program for railroad employees. This separate unemployment insurance program is administered by the Railroad Retirement Board, an agency independent of the Department of Labor (DOL). DOL is not responsible for the administrative oversight or solvency of the railroad unemployment insurance system. Receipts from taxes on railroad payrolls are deposited in the Railroad UI Account and the Railroad UI Administrative Account to meet benefit payment and related administrative expenses.

144. ***UI Program Benefits*** - The UI program provides regular and extended benefit payments to eligible unemployed workers. Regular UI program benefits are established under state law, payable for a period not to exceed a maximum duration. In 1970, federal law began to require states to extend this maximum period of benefit duration by 50 percent, during periods of high unemployment. These extended benefit payments are paid equally from federal and state accounts.

145. *Regular UI Benefits* - There are no federal standards regarding eligibility, amount, or duration of regular UI benefits. Eligibility requirements, benefit amounts, and benefit duration are determined under state law. Under state laws, worker eligibility for benefits depends on experience in covered employment during a past base period, which attempts to measure the workers' recent attachment to the labor force. Three factors are common to state eligibility requirements: (1) a minimum duration of recent employment and earnings during a

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base period to unemployment, (2) unemployment not the fault of the unemployed, and (3) availability of the unemployed for work.

146. Benefit payment amounts under all state laws vary with the worker's base period wage history. Generally, states compute the amount of weekly UI benefits as a percent of an individual's average weekly base period earnings, within certain minimum and maximum limits. Most states set the duration of UI benefits by the amount of earnings an individual has received during the base period. Currently, all but two states have established the maximum duration for regular UI benefits at 26 weeks (Massachusetts and Washington state provide 30 weeks). Regular UI benefits are paid by the state UI agencies from monies drawn down from the state's account within the UTF.

147. *Extended UI Benefits* - The Federal/State Extended Unemployment Compensation Act of 1970 provides for the extension of the duration of UI benefits during periods of high unemployment. When the insured unemployment level within a state, or in some cases total unemployment, reaches certain specified levels, the state must extend benefit duration by 50 percent, up to a combined maximum of 39 weeks. Fifty percent of the cost of extended unemployment benefits is paid from the EUCA within the UTF, and 50 percent by the state, from the State's UTF account.

148. *Emergency UI Benefits* - During prolonged periods of high unemployment, Congress may authorize the payment of emergency unemployment benefits to supplement extended UI benefit payments. Emergency benefits were last authorized in 1991 under the EUCA. Emergency benefit payments in excess of $28 billion were paid over the three year period ending in 1994. Emergency benefits were paid from the surplus of federal unemployment taxes in EUCA and, once EUCA balances were exhausted, from general revenues of the U.S. Treasury.

149. *Federal UI Benefits* - Unemployment benefits to unemployed federal workers are paid from the FECA within UTF and then reimbursed by the responsible federal agency. They are not considered to be social insurance benefits. Federal unemployment compensation benefits are not included in this discussion of social insurance programs.

Program Finances and Sustainability

150. At September 30, 1996, total assets within the UTF exceeded liabilities by $54.0 billion.[5] This fund balance approximates the accumulated surplus of tax revenues and earnings on these revenues over benefit payment expenses and is available to finance benefit payments in future periods when tax revenues may be insufficient. Treasury invests this accumulated surplus in federal securities. The net value of these securities at September 30, 1996, was $53.9 billion. These investments accrue interest, which is distributed to eligible state

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and federal accounts within the UTF. Interest income from these investments during FY 1996 was $3.4 billion. As discussed in Note 1.B.3 to the consolidated financial statements, DOL recognized a liability for regular and extended unemployment benefits to the extent of unpaid benefits applicable to the current period. Accrued unemployment benefits payable at September 30, 1996, were $506.4 million.

151. ***Effect of Projected Cash Inflows and Outflows on the Accumulated Net Assets of the UTF*** - The ability of the UI programs to meet a participant's future benefit payment needs depends on the availability of accumulated taxes and earnings within the UTF. The DOL measures the effect of projected benefit payments on the accumulated net assets of the UTF, under an open group scenario, which includes current and future participants in the UI program. Future estimated cash inflows and outflows of the UTF are tracked by DOL for budgetary purposes. These projections allow the DOL to monitor the sensitivity of the UI program to differing economic conditions, and to predict the program's sustainability under varying economic assumptions. Charts I through IV graphically depict the effect of varying economic conditions on the UTF over the next 10 years.

152. *Projected Cash Inflows and Outflows Under Expected Economic Conditions* - Chart I depicts projected cash inflow and outflow of the UTF over the next 10 years, under expected economic conditions. Total cash inflow as well as cash inflow excluding interest earnings is displayed. DOL's current estimates were based on an expected unemployment rate of 5.1 percent during FY 1997, increasing to 5.5 percent in FY 2001 and thereafter. These projections indicate net cash inflow through FY 2004, with a crossover to net outflow in FY 2005. Cash inflows combined with interest earnings exceed cash outflows for each of the 10 years presented, although this net excess decreases from $8.7 billion at the end of FY 1997 to $3.9 billion at the end of FY 2006.

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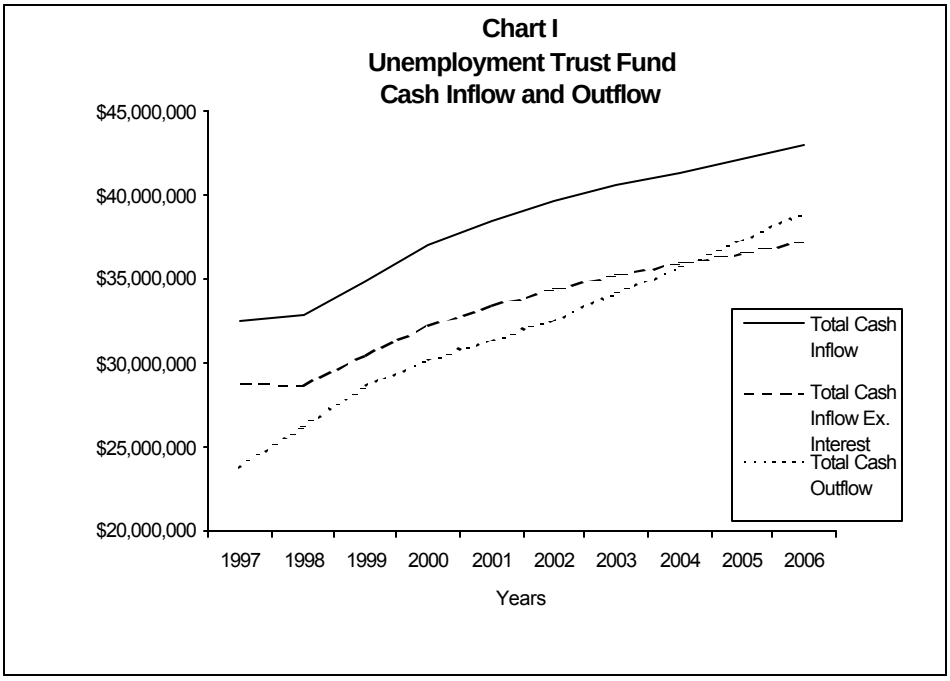

153. *Effect of Expected Cashflows on UTF Assets* - Chart II demonstrates the effect of the expected cash inflow and outflow on the net assets of the UTF over the 10-year period ending September 30, 2006. Yearly projected total cash inflows, including interest earnings, and cash outflows are depicted, as well as the net effect of this cashflow on UTF assets.

Under this scenario, total cash inflow exceeds cash outflow in each of the 10 years projected, although the margin of excess decreases by 55 percent from FY 1997 to FY 2006. Net UTF assets increase by 87 percent over the 10-year period, from $62.5 billion in FY 1997 to $117.0 billion in FY 2006.

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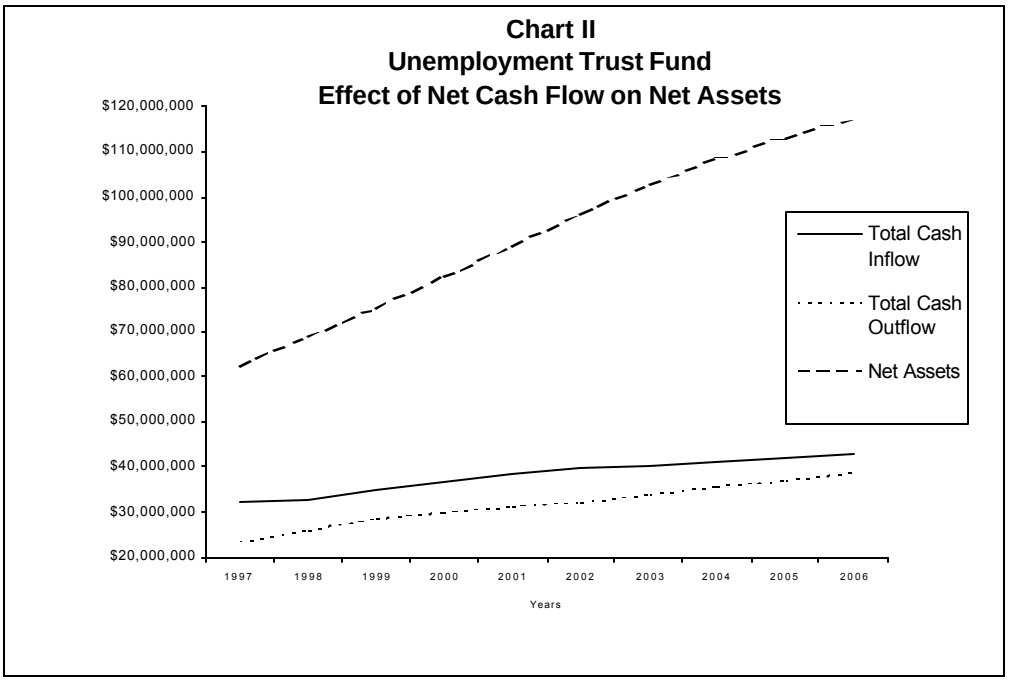

154. ***Recession Scenarios*** -- Charts III and IV demonstrate the effect on accumulated UTF assets of projected total cash inflow and cash outflow of the UTF over the 10-year period ending September 30, 2006, under moderate and severe recession scenarios. Each scenario uses an open group, which includes current and future participants in the UI program. Charts III and IV assume increased rates of unemployment during mild and deep periods of recession.

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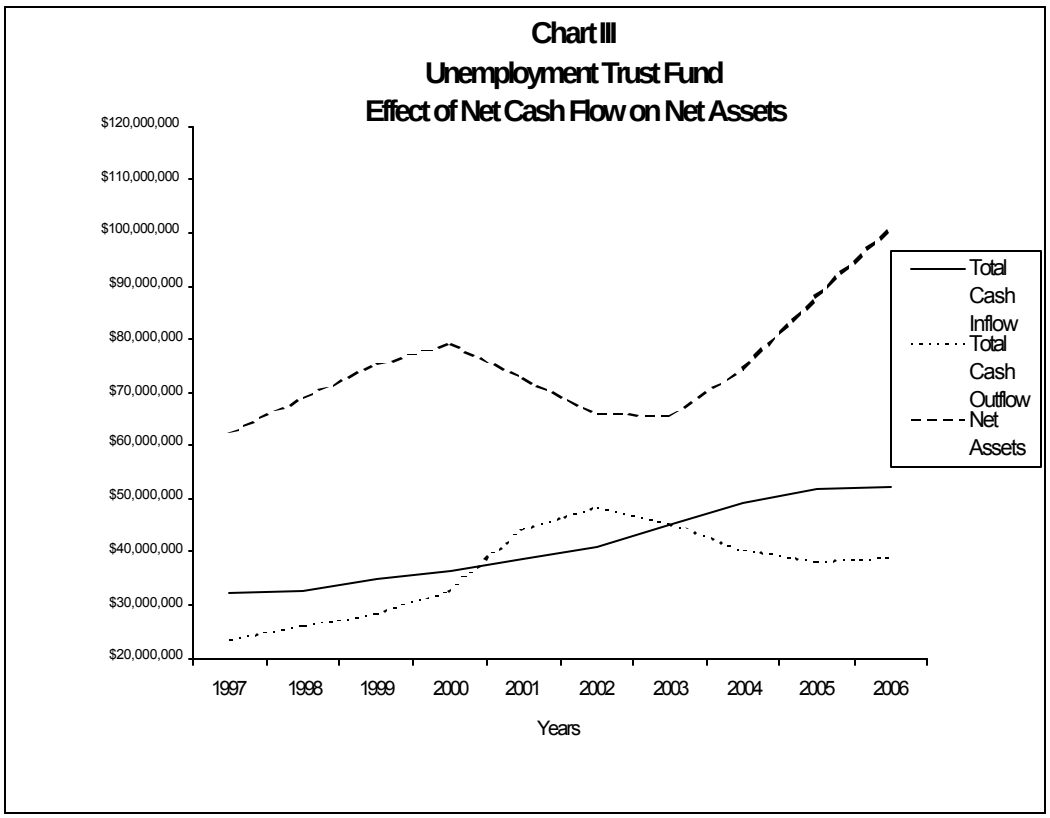

155. *Effect on UTF Assets of Mild Recession* - Chart III shows the projected effects of moderate recession on the cash inflow and outflow of the UTF. Under this scenario, which utilizes a rising unemployment rate peaking at 7.4 percent in FY 2002, net cash outflows are projected to begin in FY 2001, increasing to a maximum of $7.0 billion in FY 2002. Net cash inflow is reestablished in FY 2004 with a drop in the unemployment rate to 6.4 percent.

156. *Effect on UTF Assets of Deep Recession* - Chart IV shows the effect of severe recession on the cash inflow and outflow of the UTF. This scenario assumes a rising unemployment rate peaking at 10.2 percent in FY 2002. Under this scenario, net cash outflows are projected to begin early in FY 2000, increasing to $22.5 billion in FY 2002. During this two-year period, the net assets of the UTF decrease from $76.7 billion to $35.0 billion, a decline of $41.7 billion (54 percent). While aggregate UTF balances remain positive, state accounts without sufficient reserve balances to absorb negative cashflows would be forced to borrows funds from the FUA to meet benefit payment requirements. State borrowing demands could also deplete the FUA, which borrows from the ESAA and the

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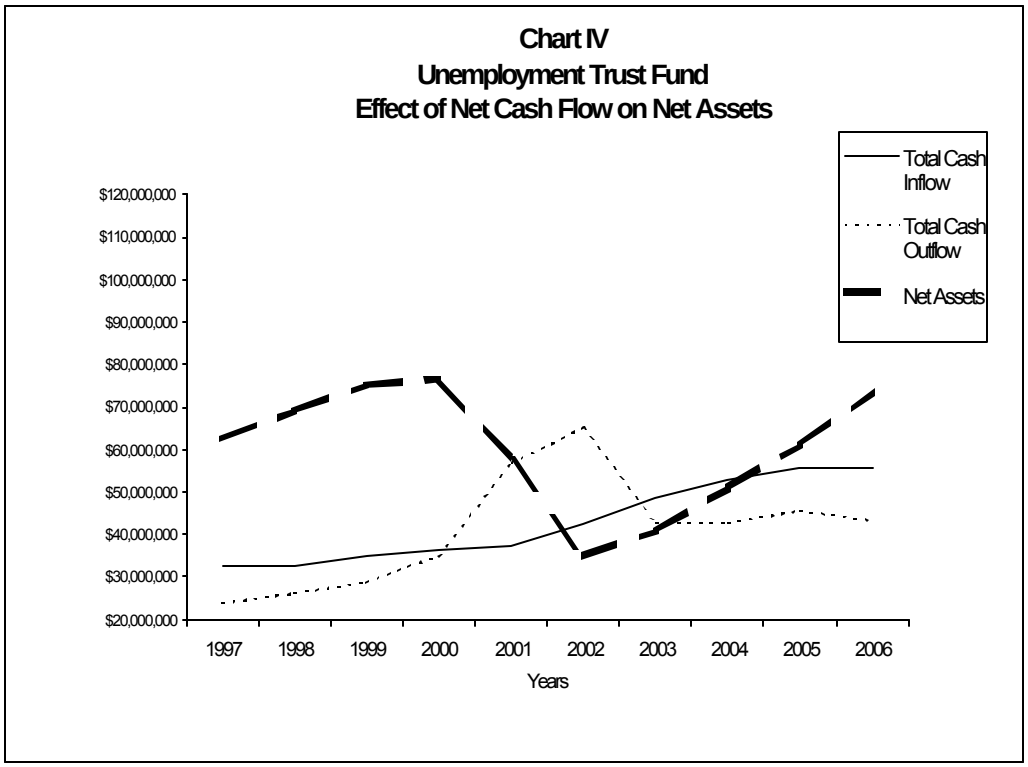
EUCA until they were depleted. The FUA would then require advances from the general fund of the U.S. Treasury to provide for state borrowing. (See discussion of state solvency measures *infra*.)

157. Net cash inflows are reestablished early in FY 2003, with a drop in the unemployment rate to 7.82 percent. By the end of FY 2006, this positive cashflow has replenished UTF account balances to $73.6 billion, or to within $3.0 billion of their FY 2000 peak. This example demonstrates the counter-cyclical nature of the UI program, which experiences net cash outflows during periods of recession, to be replenished through net cash inflows during periods of recovery.



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158. Tables containing the yearly cash inflow, interest earnings, and cash outflow for each scenario are presented in the following pages.

U. S. DEPARTMENT OF LABOR
REQUIRED SUPPLEMENTAL STEWARDSHIP INFORMATION
CASH INFLOW AND OUTFLOW OF THE
UNEMPLOYMENT TRUST FUND EXCLUDING THE FEDERAL EMPLOYEES COMPENSATION ACCOUNT
FOR THE TEN YEAR PERIOD ENDED SEPTEMBER 30, 1996

(1) EXPECTED UNEMPLOYMENT RATE

`(Dollars in thousands)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,410,218	$ 82,183,369	$ 89,188,172	$ 96,242,575	$ 102,591,615	$ 108,232,958	$ 113,075,913
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,011,000	27,927,000	28,666,000	29,217,000	29,792,000	30,439,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,300,000	6,332,000	6,428,000	6,474,000	6,545,000	6,616,000	6,690,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,273,600	33,444,000	34,425,000	35,215,100	35,864,400	36,517,800	37,220,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,670,414	4,924,397	5,227,889	5,326,384	5,503,356	5,656,406	5,711,029
Total cash inflow	32,498,928	32,830,610	34,937,192	36,944,014	38,368,397	39,652,889	40,541,484	41,367,756	42,174,206	42,931,429
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,875,000	26,443,000	27,619,400	28,831,233	30,329,870	31,765,260	33,267,761	34,821,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,456,087	3,474,974	3,498,455	3,591,026	3,687,876	3,787,445	3,889,713
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,136	3,035	3,011	2,984	3,017	3,033	3,016
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575

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Total cash outflow	23,804,116	26,191,475	28,661,753	30,170,863	31,363,594	32,598,486	34,192,444	35,726,413	37,331,251	38,989,661
Excess of total cash inflow ex. int. over total cash outflow	4,950,484	2,459,325	1,861,847	2,102,737	2,080,406	1,826,514	1,022,656	137,987	(813,451)	(1,769,261)
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,275,439	6,773,151	7,004,803	7,054,403	6,349,040	5,641,343	4,842,955	3,941,768
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,410,218	$ 82,183,369	$ 89,188,172	$ 96,242,575	##########	$ 108,232,958	$ 113,075,913	$ 117,017,681
Total unemployment rate	5.09%	5.12%	5.38%	5.47%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%

U. S. DEPARTMENT OF LABOR
REQUIRED SUPPLEMENTAL STEWARDSHIP INFORMATION
CASH INFLOW AND OUTFLOW OF THE
UNEMPLOYMENT TRUST FUND EXCLUDING THE FEDERAL EMPLOYEES COMPENSATION ACCOUNT
FOR THE TEN YEAR PERIOD ENDED SEPTEMBER 30, 1996

(2) MILD RECES SIONARY UNEMPLOYMENT RATE

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,427,203	$ 78,997,497	$ 72,977,460	$ 65,947,568	$ 65,595,389	$ 74,470,094	$ 87,923,108
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,889,000	31,018,000	35,304,000	39,150,000	41,096,000	40,839,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	34,129,000	37,265,000	41,603,100	45,587,400	47,667,800	47,479,400
Interest on Federal securities	3,744,328	4,179,810	4,485,592	4,324,625	4,389,403	3,957,469	3,737,486	3,670,448	4,053,078	4,639,297

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Total cash inflow	32,498,928	32,830,610	35,009,192	36,467,225	38,518,403	41,222,469	45,340,586	49,257,848	51,720,878	52,118,697
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,930,015	29,083,333	40,393,938	44,027,625	41,544,306	36,305,687	34,175,845	34,832,298
State administrative costs	3,357,406	3,561,582	3,513,672	3,541,887	3,875,374	3,956,055	3,877,026	3,804,276	3,816,045	3,861,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,716,768	32,896,931	44,538,440	48,252,361	45,692,765	40,383,143	38,267,864	38,971,582
Excess of total cash inflow ex. interest over total cash outflow	4,950,484	2,459,325	1,806,832	(754,331)	(10,409,440)	(10,987,361)	(4,089,665)	5,204,257	9,399,936	8,507,818
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,292,424	3,570,294	(6,020,037)	(7,029,892)	(352,179)	8,874,705	13,453,014	13,147,115
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,427,203	$ 78,997,497	$ 72,977,460	$ 65,947,568	$ 65,595,389	$ 74,470,094	$ 87,923,108	##########
Total unemployment rate	5.09%	5.12%	5.38%	5.60%	6.57%	7.43%	7.07%	6.42%	5.62%	5.50%

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U. S. DEPARTMENT OF LABOR
REQUIRED SUPPLEMENTAL STEWARDSHIP INFORMATION
CASH INFLOW AND OUTFLOW OF THE
UNEMPLOYMENT TRUST FUND EXCLUDING THE FEDERAL EMPLOYEES COMPENSATION ACCOUNT
FOR THE TEN YEAR PERIOD ENDED SEPTEMBER 30, 1996

(3) DEEP RECESSIONARY UNEMPLOYMENT RATE

(Dollars in thousands)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,247,218	$ 76,661,227	$ 57,496,183	$ 34,990,203	$ 40,790,676	$ 51,029,964	$ 61,156,933
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,001,000	33,246,000	40,275,000	44,151,000	46,310,000	45,904,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	33,241,000	39,493,000	46,574,100	50,588,400	52,881,800	52,544,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,313,207	4,254,058	3,108,756	2,055,502	2,331,404	2,840,149	3,202,881
Total cash inflow	32,498,928	32,830,610	34,937,192	36,455,807	37,495,058	42,601,756	48,629,602	52,919,804	55,721,949	55,747,281
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	25,038,000	31,171,000	52,201,000	60,454,000	38,737,870	38,517,260	41,302,761	38,980,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,599,087	4,189,974	4,385,055	3,819,826	3,890,076	4,016,245	4,004,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,824,753	35,041,798	56,660,102	65,107,736	42,829,129	42,680,516	45,594,980	43,262,997

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Excess of total cash inflow ex. interest over total cash outflow	4,950,484	2,459,325	1,698,847	(2,899,198)	(23,419,102)	(25,614,736)	3,744,971	7,907,884	7,286,820	9,281,403
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,112,439	1,414,009	(19,165,044)	(22,505,980)	5,800,473	10,239,288	10,126,969	12,484,284
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,247,218	$ 76,661,227	$ 57,496,183	$ 34,990,203	$ 40,790,676	$ 51,029,964	$ 61,156,933	$ 73,641,217
Total unemployment rate	5.09%	5.12%	5.38%	6.65%	9.07%	10.15%	7.82%	7.28%	7.05%	6.43%

159. ***States Minimally Solvent*** - Another measure of the sufficiency of accumulated UTF assets to meet future benefit payment requirements analyzes the adequacy of each state's accumulated net assets or reserve balance to provide a defined level of benefits over a defined period of time. To be considered minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs based on the highest levels of benefit payments experienced by the state over the last 20 years. A ratio of 1.0 or greater indicates a state is minimally solvent. States below this level are the most vulnerable to exhausting their funding in a recession. States exhausting their reserve balance must borrow funds from the FUA to make benefit payments. During periods of high sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury general fund.

160. Chart V presents the state-by-state results of this analysis at September 30, 1996, in descending order, by ratio. As the table illustrates, 23 states failed to meet the minimum solvency test of 1.0 at September 30, 1996.

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Chart V

Minimally Solvent		Not Minimally Solvent	
State	Ratio	State	Ratio
Virgin Islands	2.89	Maryland	0.99
New Mexico	2.43	Alaska	0.94
New Hampshire	2.18	Nevada	0.94
Vermont	2.17	Alabama	0.90
Georgia	1.96	Kentucky	0.71
Mississippi	1.93	Arkansas	0.64
Oklahoma	1.86	Ohio	0.63
Utah	1.84	Pennsylvania	0.62
Delaware	1.74	Massachusetts	0.58
Wyoming	1.65	Michigan	0.57
Kansas	1.63	Minnesota	0.56
Puerto Rico	1.6	Maine	0.54
Virginia	1.58	North Dakota	0.54
Indiana	1.57	California	0.53
Florida	1.55	Illinois	0.50
Iowa	1.39	Rhode Island	0.47
Nebraska	1.37	Missouri	0.45
North Carolina	1.32	Dist. of Col.	0.45
Arizona	1.28	West Virginia	0.42
Idaho	1.26	Texas	0.33
South Carolina	1.24	Connecticut	0.31
Louisiana	1.23	New York	0.13
Oregon	1.2		
Wisconsin	1.18		
Montana	1.13		
Colorado	1.08		
Tennessee	1.08		
Washington	1.07		
Hawaii	1.06		
South Dakota	1.06		

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Governmentwide Entity Perspective

(Note: This pro forma illustration is a partial display featuring Social Security and Medicare and is not intended to be the full consolidated presentation wherein all social insurance programs would be summarized and consolidated in accordance with par. 32.)

Stewardship Information

Consolidated Statement of Social Insurance
75-Year Projection[1] as of September 30, 1996
(trillions of dollars)
[HYPOTHETICAL DATA]

		+ - - - - - - Prior Year- - - - - |			
	1996	1995	1994	1993	1992
Actuarial present value of future benefit payments[2] during the 75-year period to or on behalf of:					
Current participants who have not yet attained retirement age[3]	$ X	$ X	$ X	$ X	$ X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Current participants who have attained retirement age[3]	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Subtotal - benefit payments for the 75-year period	X	X	X	X	X

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		+ - - - - - - Prior Years - - - - - |				
		1996	1995	1994	1993	1992
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:						
Current participants who have not yet attained retirement age[3]		Y	Y	Y	Y	Y
OASDI		[Y]	[Y]	[Y]	[Y]	[Y]
HI		[Y]	[Y]	[Y]	[Y]	[Y]
SMI		[Y]	[Y]	[Y]	[Y]	[Y]
Other		[Y]	[Y]	[Y]	[Y]	[Y]
Current participants who have attained retirement age[3]		Y	Y	Y	Y	Y
OASDI		[Y]	[Y]	[Y]	[Y]	[Y]
HI		[Y]	[Y]	[Y]	[Y]	[Y]
SMI		[Y]	[Y]	[Y]	[Y]	[Y]
Other		[Y]	[Y]	[Y]	[Y]	[Y]
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y	
OASDI		[Y]	[Y]	[Y]	[Y]	[Y]
HI		[Y]	[Y]	[Y]	[Y]	[Y]
SMI		[Y]	[Y]	[Y]	[Y]	[Y]
Other		[Y]	[Y]	[Y]	[Y]	[Y]
Subtotal - contributions and tax income for the 75-year period		Y	Y	Y	Y	Y
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period[4]		$X	$X	$X	$X	$X

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Notes to the Statement:

[1] The projection period for new entrants covers the next 75 years. The projection period for current participants (or 'closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years a in few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

[2] "Benefit payments" include administrative expenses.

[3] The actuarial net present value of the excess of future benefit payments to current participants (that is, to the "closed group" of participants) over future contributions and tax income from them or paid on their behalf is calculated by subtracting the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

[4]The fund balance--which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over all past cash outflow within the program--for fiscal year 1996 is $ X_1 trillion. The fund balances for 1995-2, in trillions, were $\$X_2$, X_3, X_4, X_5, respectively. The accumulated excess of cash inflow over outflow at the valuation date consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

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Program Description

161. As discussed in Note X to the *CFS*, a liability of $75 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of Old-Age, Survivors, Disability Insurance (OASDI), Medicare (HI and SMI), and other social insurance benefits due to recipients or service providers for periods ended on or before September 30, 1996. Most of this amount was paid in October 1996.

162. While no liability has been recognized on the balance sheet for future payments beyond the amount due as of September 30, actuarial estimates of future program activities have been prepared for the social insurance programs. Long-term actuarial views are a critical element in assessing the financial condition of social insurance programs. In addition, social insurance programs must be assessed as a large and growing part of the governmentwide financial entity where they impact the balance between future government obligations and resources.

163. By projecting receipts from all sources and outlays for all federal programs for all purposes -- as is the goal when analyzing trends in the federal budget, and as shown for the short-term in the Current Services Estimate, which shows the current and six future years (see page XX of this report) -- it is possible to examine whether there will be sufficient resources to support all the government's ongoing responsibilities. It is also possible to see the interrelationship among the various types of government receipts (e.g., income taxes, payroll taxes, exchange revenue) and outlays (e.g., social insurance, national defense), where increases/decreases in one area of the budget can be offset by decreases/increases in other areas. Another perspective for assessing the financial condition of the government is its relationship to the national economy as measured by the GDP.

164. The actuarial present values and projections presented here for Social Security and Medicare, which are by far the largest social insurance programs, use the best estimate of the programs' actuaries of future costs over periods ranging up to 75 years. Estimates extending so far into the future, however, are inherently uncertain; and the uncertainty is greater for the later years in the period.

165. As shown in Chart 1, under current policies Social Security cash outflow will exceed inflow from the public in about 2012.

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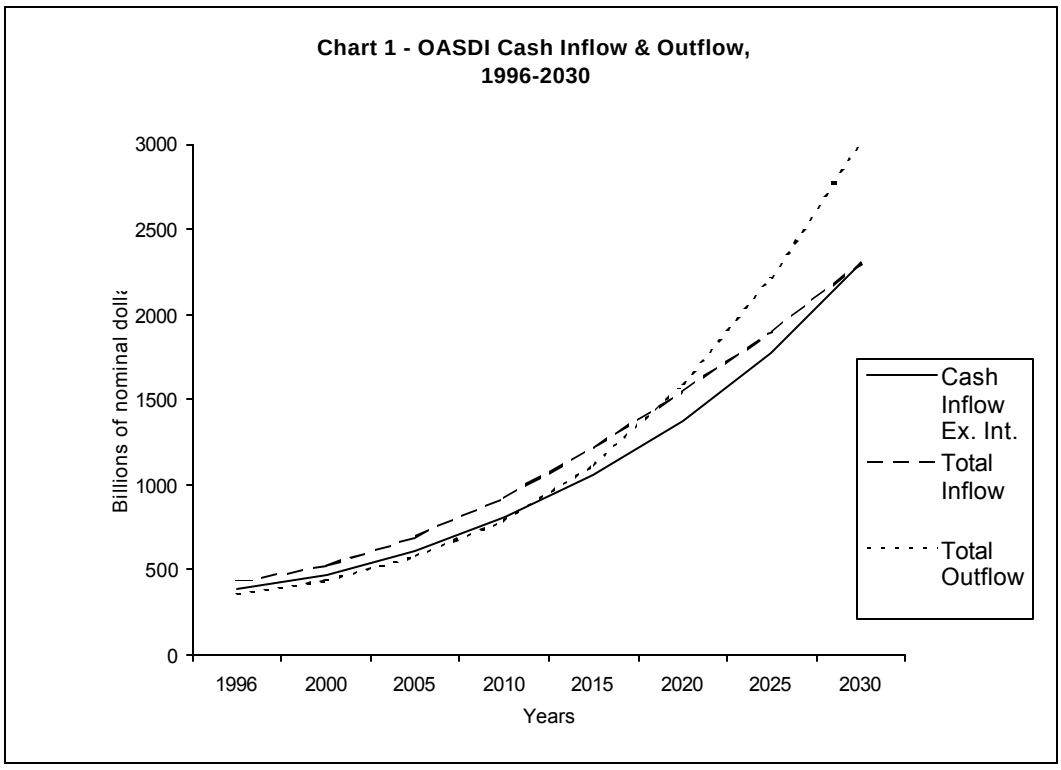

Data from Tables B1, B3, C1, 1996 OASDI Trustees' Report.

166. The Medicare Hospital Insurance (HI) program cash outflow exceeded annual cash inflow in FY 1996. Using the actuaries' best estimate, the HI program will be insolvent in 2001, as shown in Chart 2 below. Projected HI payroll tax will meet a declining share of cash outflow under present law. Tax receipts are expected to equal 84 percent of cash outflow in 1997 and 74 percent in 2001 and would cover less than one-third of costs 75 years from now.

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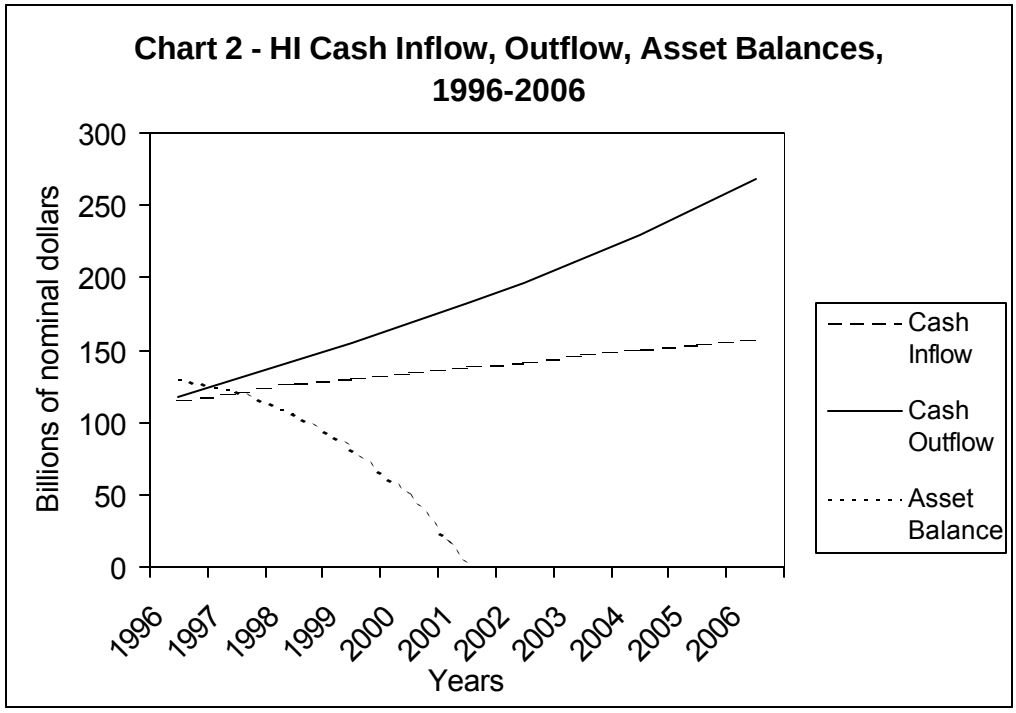

Data from Table II D3, 1997 HI Trustees' Report.

167. The Medicare Supplementary Medical Insurance (SMI) is funded by premiums paid by participants and annual general fund appropriations. Current law provides for annual calculations of expected cost. Premiums, which currently cover approximately 25 percent of the program's cost, are expected to pay 16 percent by 2006 and decline further thereafter.

168. SMI benefits have been growing rapidly. Expenditures have increased 45 percent over the past five years. During this period the program grew about 14 percent faster than the economy as a whole, despite efforts to control costs.

169. As presently constructed, the HI program receives most of its income from the 1.45 percent payroll tax that employees and employers each pay, for a total of 2.9 percent of taxable payroll. Chart 3 below illustrates the cost rate of this program relative to its income rate as a percentage of taxable payroll.

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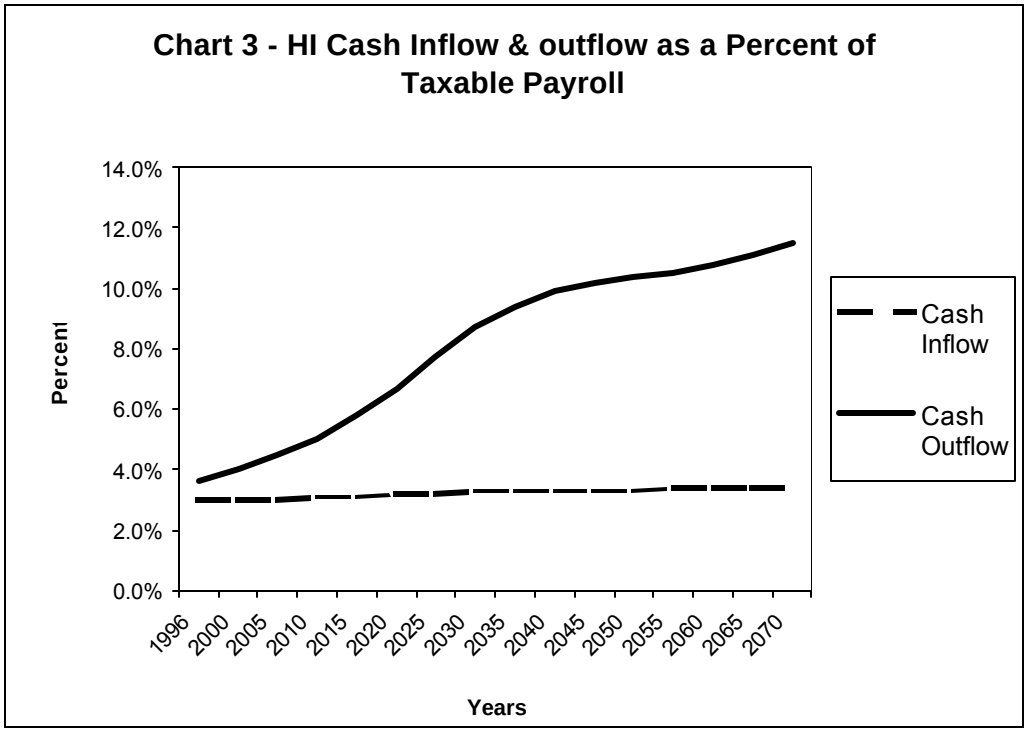

Data from Table III A.2, 1997 OASDI Trustees' Report.

170. Medicare is currently paying and, from 2012 forward, OASDI would pay more to the public than they receive in taxes thereby increasing the government's financing needs. Compared to a situation in which taxes or other financing sources equalled cash outflow, the government will have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.

171. ***Growing Disparity Between Rates of Income and Outgo*** - The excess of OASDI and HI cash outflow over inflow and the decreasing percent of SMI cost covered by premiums is due to the increasing cost of existing medical care; the increased utilization of existing and new health care techniques; and, in later years, the retirement of the "baby boom" generation and the relatively small number of people born during the subsequent period of low birth rate. For example, the OASDI Trustees' best estimate shows a long-term actuarial deficit over the next 75 years of 2.17 percent of taxable payroll -- in other words, a tax increase today of 1.09 percent of taxable payroll each for employees and employers, over the 6.2 percent they each now pay would produce enough revenue to pay benefits under current law, over 75 years.[6] Increasing the payroll tax from 12.4 to 14.6 represents a payroll tax increase of about 17 percent. The 2.17 percent deficit represents, in terms of present value, an excess of $3.1 trillion of expenditures over contribution.

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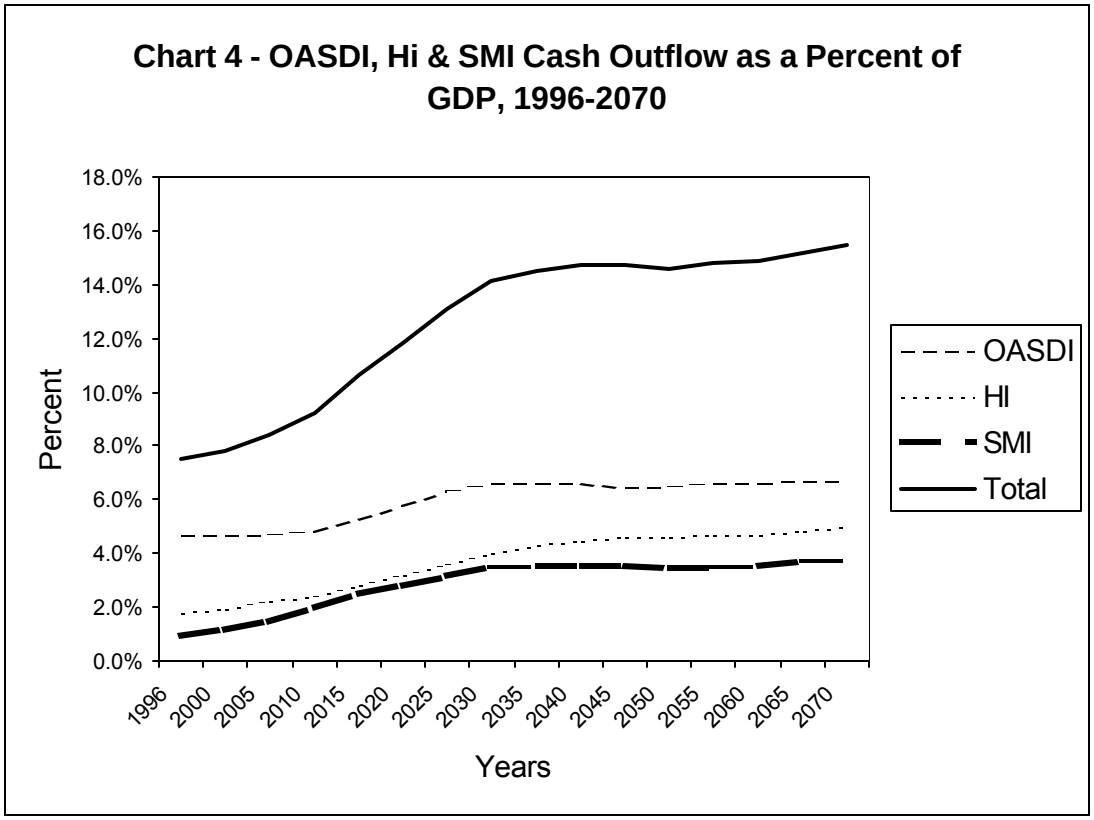
172. ***Social Insurance in Relation to the National Economy*** - The security of benefits and the distribution of financing costs for social insurance programs cannot be determined solely on the basis of the financial and actuarial status of the programs by themselves. Sustainability from the governmentwide entity perspective is better measured in terms of a healthy relationship between social insurance programs -- and, indeed, the entire budget -- and the national economy, as measured by the GDP. Relative to the national economy, federal spending for OASDI, HI, and SMI was 7 percent of GDP in 1996 -- $550 billion. By 2030, when most baby boomers will have retired, these programs are projected to consume nearly 100 percent more of GDP than they do today -- 14 percent, as shown in Chart 4.



Data from Table III C1, 1996 OASDI Trustees' Report and Table III B1, 1997 Hi Trustees' Report.

173. This projected increase needs to be understood in the context of other projected future claims on future

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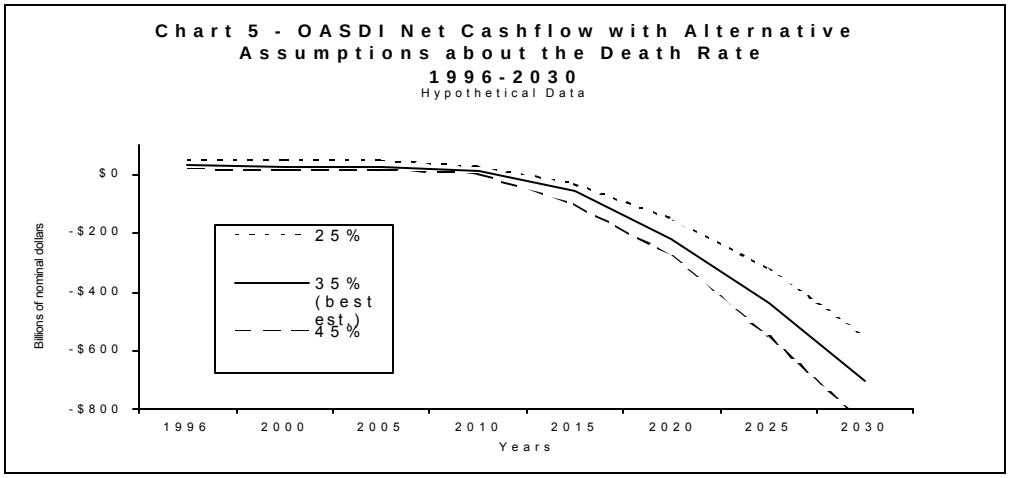
resources including general assistance programs (e.g., Medicaid) and other federal programs. Nearly all of the increase between now and 2030 in the OASDI, HI, and SMI programs will occur between 2010 and 2030, as retired baby boomers become eligible for those programs. In terms of the number of workers to beneficiaries in the combined OASDI and HI programs, a decline will occur from about 3.5 per beneficiary in 1995 to 2 per beneficiary in 2030.

174. ***Sensitivity Analysis***[21] - The future cashflow of the OASDI, Medicare, and other social insurance programs depends on many economic and demographic assumptions. Precise long-range projections of these factors is impossible.

175. This section illustrates the sensitivity of the long-range projections to changes by analyzing six key individual assumptions. For this analysis the "best estimate" cost assumptions are used as the reference point, and each assumption is varied within it individually.

176. *Death Rate* - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during 1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.

Data for "best estimate" is from Tables III B1, B3, C1, 1996 OASDI Trustees Report.



177. *Real Interest Rate* -- The total excess of OASDI cash outflow over inflow on the basis of the best estimate cost assumptions is $3.0 trillion over the valuation period of 1996-2070. If the annual real interest rate for

[21] [Please note: this section provides examples of some of the sensitivity analysis that would be provided at the consolidated level. The consolidated entity would summarize the sensitivity analyses from the individual social insurance entities.]

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Treasury securities is changed from the 2.3 percent used for the best estimate to 1.5 percent, the excess of cash outflow would increase to $3.8 trillion; if the rate were changed to 3 percent, the excess of cash outflow would decrease to $2.5 trillion.

178. *Birth Rate* - Table 1 shows the effect of using birth rates of 1.6 and 2.2 children per woman, instead of the 1.9 rate used for the best estimate projection, on the total excess OASDI cash outflow over inflow over the period 1996-2070. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions Valuation Period: 1996-2070

Valuation Period: 1996-2070	Ultimate Birth Rate Per Woman (trillions of dollars)		
	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	$3.7	$3.0	$2.5

179. *Net Immigration* -- Table 2 below shows the total excess of OASDI cash outflow over inflow with various assumptions about the magnitude of net immigration.

Table 2- Estimated OASDI Actuarial Balances with Various Net Immigration Assumptions

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Valuation Period: 1996-2070	Net immigration per year (trillions of dollars)		
	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over inflow	$3.2	$3.0	$2.9

180. *Real-Wage Differential* - Table 3 below shows the total excess OASDI cash outflow over inflow with various assumptions about the real-wage differential. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the Consumer Price Index.

Table 3- Estimated OASDI Actuarial Balances with Various Real-Wage Assumptions Valuation Period: 1996-2070

	Ultimate percentage in wages-CPI (trillions of dollars) *[The first value in each of the pairs below is the assumed ultimate annual percentage increase in average wages in covered employment. The second value is the assumed ultimate annual percentage increase in the CPI. the difference between the two values is the real-wage differential.]*		
Wages-CPI	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Excess cash outflow over inflow	$3.9	$3.0	$2.3

181. *Health Care Cost Trend* -- Chart 6 below shows the estimated HI and SMI net cash outflow using a health care cost factor 1 percent above and 1 percent below that used for the "best estimate" projection. Factors such as wage increases and price increases may simultaneously affect both HI payroll tax income and the costs incurred by hospitals and other providers of medical care to HI and SMI beneficiaries. Other factors, such as the utilization of services by beneficiaries or the relative complexity of the services provided, can affect provider costs without affecting HI payroll tax income. The sensitivity analysis shown in Chart 6 illustrates the financial effect of any combination of such factors that results in aggregate provider costs increasing by 1 percent faster or slower than the "best estimate" assumptions.

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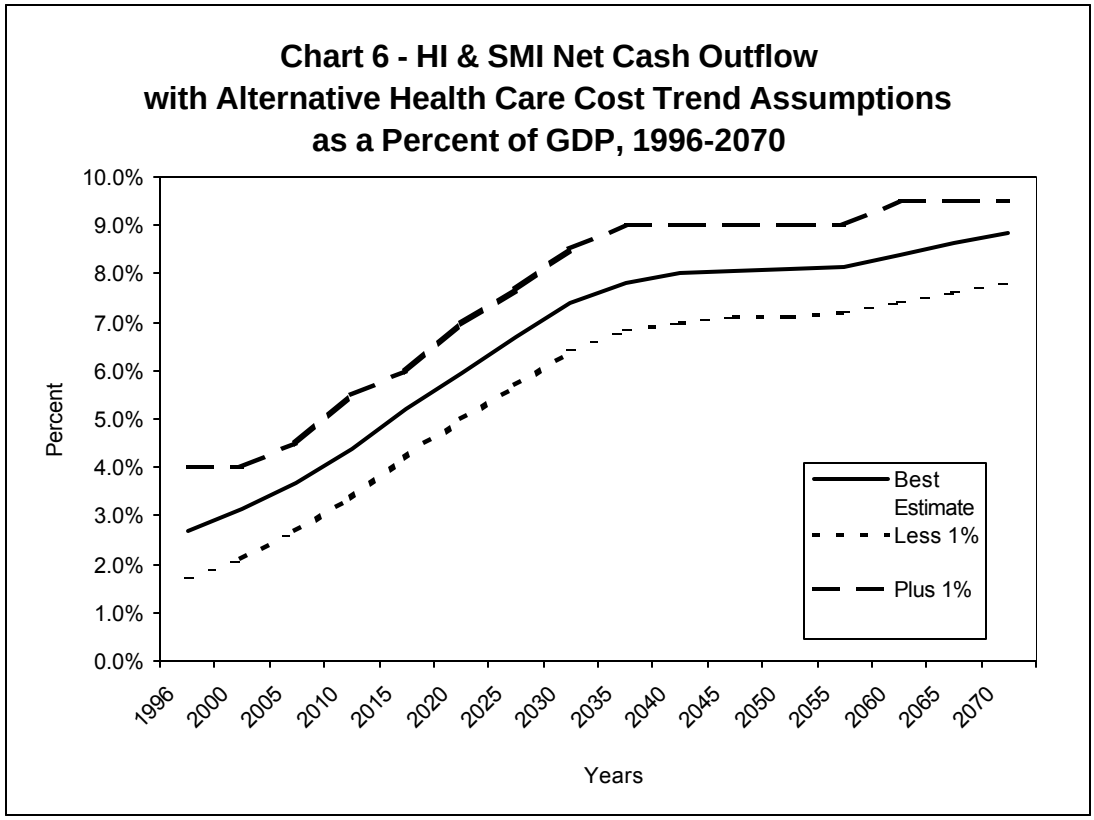

Data for "best estimate" is from Table III B1, 1997 HI Trustees' Report.

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APPENDIX C - HISTORICAL BACKGROUND

182. **Practice Prior to Federal Accounting Standards Advisory Board (FASAB)** - Although this statement is applicable to other social insurance programs, Social Security historically has been the primary focus when considering accounting for social insurance. Over the decades, the debates about Social Security have to some extent paralleled debates in the nonfederal accounting community about how to apply accrual concepts in accounting. During this time, a continual evolution in accounting practice has led to increased recognition on the face of the financial statements and disclosure in notes to financial statements of formerly unreported commitments such as pensions and other postretirement benefits such as health care.

183. Since the 1950s, the Treasury Department and the Office of Management and Budget (OMB) have been furnishing reports on federal contingencies and commitments. From the early 1950s, the reports showed, among other commitments, the face value of loan guarantees and federal insurance but not the actuarial status of social insurance programs.

184. In 1967, Congress began requiring a commitments and contingencies report (*Liabilities and Other Financial Commitments of the United States Government*) that was to include liabilities of federal annuity programs and their actuarial status. The programs in that report included most of the social insurance programs that are the subject of these accounting standards: Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance. The report was tied with the regular business-type reporting of federal agencies required by the Treasury Department (e.g., balance sheets, operating statement, supplemental schedules).

185. From 1976 until 1985, the "prototype" *Consolidated Financial Statements of the United States Government* (*CFS*) recognized a liability for Social Security using a calculation similar to that called for in APB 8 (1966), which defined a variety of acceptable actuarial methods for measuring pension expense and required that any accumulated, unfunded pension expense be recognized as a liability. However, the expense shown on the *CFS* operating statement included only cash benefit payments and not what the *CFS* called the "noncash amount" -- or the change in the unfunded liability.

186. After 1966 the importance of information about pensions grew due to increases in the number of plans and amounts of pension assets and obligations. Significant changes occurred in both the legal environment (e.g., Employee Retirement Income Security Act) and the economic environment (e.g., higher inflation and interest rates).

187. APB 8 was superseded by FASB Statement of Financial Accounting Standards (SFAS) No. 87, *Employer's Accounting for Pensions*, published in December 1985. FASB noted the years of accounting controversy over measuring costs and liabilities resulting from defined benefit pension plans. After considering the range of comments on its *Preliminary Views* document and on its exposure draft, FASB concluded that, although it did not recognize the full projected benefit obligation on the balance sheet, SFAS 87 represented a worthwhile improvement in financial reporting. SFAS 87 made accounting for pensions more independent of the financing

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arrangements, provided more standardization in measurement of the pension expense and liability, and required at least a "minimum liability" to be recognized in employers' balance sheets.

188. The Social Security liability was de-recognized in the *CFS* for 1985; but a similar closed group (to new entrants)**,**[7] "liability type" number continued to be disclosed in a footnote along with the open group, "cashflow" or "financing type" number. The closed group population includes all current participants, that is, retirees and covered workers. The "open group" includes all current participants plus all future participants over the next 75 years. Disclosure of the closed group number was discontinued in the *CFS* after 1994.

FASAB Exposure Drafts on Liabilities & Stewardship

189. Social insurance was addressed in the Board's exposure draft (ED) on *Accounting for the Liabilities of the Federal Government* in November 1994. The *Liabilities* ED proposed defining a federal liability in terms generally similar to the definition used by privately owned entities in the United States: a probable and measurable future sacrifice of resources based on a past transaction or event. However, to accommodate the unique circumstances of the Federal Government, both the *Liabilities* ED and the subsequent Statement of Federal Financial Accounting Standards No. 5 distinguished between exchange and **non**exchange transactions and provided distinct accounting for liabilities resulting from these two types of transactions.

190. Private sector accounting concepts and standards distinguish between reciprocal transactions (such as payments to an employee for services rendered) and non reciprocal transactions (such as contributions pledged to a not-for-profit entity). This is generally analogous to the federal distinction between exchange and nonexchange transactions. Private sector accounting standards, however, do not recognize liabilities differently based upon whether they arise from reciprocal or non reciprocal transactions.

191. For nonexchange transactions, the *Liabilities* ED provided that a liability would be recognized for any unpaid amounts due and payable as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, whether or not such amounts have been reported to the federal entity (e.g., estimated Medicare payments due to health providers for service that has been rendered and that will be financed by the federal entity but that have not yet been reported to the federal entity).

192. After much debate, social insurance benefits were classified as nonexchange transactions. The *Liabilities* ED proposed that such programs recognize the following as expense in the statement of net cost: (1) the benefits and expenses paid during the year (except those accrued at the end of the prior year) and (2) the benefits and expenses due and payable at the end of the year. The latter were to be recognized as liabilities on the balance sheet. The *Liabilities* ED noted that the FASAB contemplated a federal reporting model encompassing extensive disclosure and supplementary reporting and that the Board was addressing such reporting for social insurance in a separate project. Also, the *Liabilities* ED contained an alternative view

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whereby a minimum liability -- representing the actuarial present value of total lifetime benefits due to be paid to people eligible to receive social insurance benefits at the balance sheet date -- would be recognized on the balance sheet.

193. The Board considered the responses to the *Liabilities* ED in conjunction with its continuing development of supplementary information for social insurance programs. The majority of respondents favored the alternative view, that is, recognition of a minimum liability. Because the *Liabilities* ED had focused on balance sheet presentation and did not contain any proposed supplementary disclosures and because the magnitude and complexity of the issues were so great, the Board chose to issue a standard on liabilities without any additional requirements for social insurance and to expose the supplementary information for comment. In August 1995, the Board released for comment proposed required supplementary information for social insurance programs in the exposure draft on *Supplementary Stewardship Reporting* ("*Stewardship* ED").

194. The *Stewardship* ED did not change the recognition point for expenses and liabilities published in the *Liabilities* ED. However, it proposed the following three liability-type measures to be reported as required supplementary information accompanying the financial statements: (1) a "minimum liability" (present value of benefits due to all currently eligible to receive them) and (2) the actuarial net present value of benefits and payments to (a) the closed group (that is, current program participants) and (b) the "open group" (current and future program participants) for the next 75 years. In addition, it proposed a "money's worth" measure (data showing the change over time in the ratio of the net present value of actual or estimated average aggregate lifetime benefits paid to and contribution received from and on behalf of similarly aged participants).

195. The response to the *Stewardship* ED's required supplementary stewardship information package regarding social insurance was generally favorable. The majority of respondents said that the information was either very useful or useful. Others, including representatives of the administrative agencies for Social Security and Medicare, objected to reporting any information other than that based on the open group methods and assumptions. Also, opposition arose from the agency administering unemployment insurance and Black Lung benefits, stating that although its programs should be included as social insurance, the RSSI package designed for Social Security did not fit its programs because they involved short-term benefits or had other unique aspects.

196. After deliberating the issues, the Board concluded in May 1996 that additional investigation and further deliberation were required. The Board noted:

- the strength of feelings on the issues (with one side firmly believing that the closed group estimate is a liability that should be recognized on the consolidated balance sheet of the Federal Government and, at the opposite pole, others who firmly believe that the closed group estimate is meaningless, could be misleading, and should not be disclosed at all in federal financial reports);

- the magnitude and complexity of the issues; and

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- that changes to social insurance programs were being studied and discussed frequently and seriously within government and by the public.

197. The Board directed the staff to continue researching social insurance accounting, focusing especially on identifying the following:

- the characteristics of such programs, the appropriate display of information in the financial statements, and any additional information that should be required;

- the means for measuring financial data in such information; and

- the desirability of other indicators (ratios of data to Gross Domestic Product (GDP) or "covered payroll") to describe the status of programs.

The Board instructed the staff to be mindful of developments in the policy studies of Social Security in structuring its research and its recommendations.[22] In early 1997, the Board began again to deliberate the issues. The standard is a product of this project.

[22] SFFAS No. 8, *Supplementary Stewardship Reporting*, par. 117. The studies included the 1994-96 Social Security Advisory Council whose report, published in January 1997, reflected the lack of consensus on long-term financing for Social Security. The Council members agreed on how to define the size of the financing problem (by using the Social Security Administration actuaries' "best estimate" projection to derive an actuarial deficit of 2.17 percent of payroll over the next 75 years). They also agreed that two long-range goals should be (1) to eliminate the 2.17 percent 75-year deficit and (2) to have the fund in stable condition at the end of the 75-year period. However, the Council offered three sharply different models for the future of Social Security. These models did contain some common features (e.g., all three would increase from 35 to 38 the number of years used to compute benefits and tax Social Security benefits in the same way that contributory defined-benefit pensions are treated under the federal income tax). In addition to the Advisory Council, academics and scholars were studying, for example, the Chilean and United Kingdom experiments with privatization of public pension plans.

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APPENDIX D - GLOSSARY

Actuarial balance - The difference between the summarized cost rate and the summarized income rate over a given valuation period.

Actuarial present value - The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions.

Actuarial status - The status of a program based on statistical calculations and actuarial assumptions about future economic, demographic, and other conditions and events.

Assumptions -

> ***Actuarial:*** Assumptions as to the occurrence of future events affecting projected costs, such as mortality, withdrawal, disability, and future interest rates.
>
> ***Hospital assumptions:*** Assumptions related to medical treatment including differentials between hospital labor and nonlabor indices compared to general economy labor and nonlabor indices; rates of hospital admission; the trend toward treating less complicated cases in outpatient settings; and continued improvement in the classification of patients according to type of treatment, age, diagnosis, etc.
>
> ***Social Security*:** Values relating to future trends in certain key factors. Demographic assumptions include fertility, mortality, net immigration, marriage, divorce, retirement patterns, disability incidence and termination rates, and changes in the labor force. Economic assumptions include unemployment, average earnings, inflation, interest rates, and productivity. Projections are normally provided based on the following three sets of economic assumptions
>
> > • the "low cost" set (Alternative I) that assumes relatively rapid economic growth, low inflation, and demographic conditions favorable to the plan;
> >
> > • the "intermediate cost" set (Alternative II) that represents the trustees' "best estimate" of future trends; and
> >
> > • the "high cost" set (Alternative III) that assumes slow economic growth, more rapid inflation, and demographic conditions unfavorable to the plan.

Black Lung benefits program - The Black Lung program consists of two parts: Part B and Part C. Recipients who filed claims from 1970 to mid-1973 are covered by Part B; all other recipients are covered by Part C.

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• Part B is currently administered by the Social Security Administration (SSA). Former coal miners and their dependents are eligible for monthly cash benefits if the miner is totally disabled or died due to black lung disease. Benefits under Part B are reduced if the beneficiary receives state workers' compensation, unemployment compensation, or state disability compensation. Certain pension benefits are subject to an excess-earnings test. The program is wholly funded by annual appropriations from the general fund.

• Part C is administered by the U.S. Labor Department, although some services are provided by SSA on a reimbursable basis. The program serves a declining population. Increased mechanization of coal mining operations and the industry's improved health and safety regulations have resulted in very few new entrants into the program. Most current beneficiaries entered the program in the 1970s. Former coal miners who have black lung disease are eligible for Part C benefits if a responsible mine owner cannot be determined. Two-thirds of Part C benefits are funded by earmarked excise taxes on coal and one-third by general fund revenues. The latter takes the form of "repayable advances" rather than appropriations.

Closed group - See "Closed group (to new entrants)."

Closed group (to new entrants) - Those persons who, as of a valuation date, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

Constant dollar - A dollar value adjusted for changes in the average price level. A constant dollar is derived by dividing a nominal dollar amount by a price index. The resulting constant dollar value is that which would exist if prices had remained at the same average level as in the base period. Any changes in such constant dollar values would therefore reflect only changes in the real volume of goods and services, not changes in the price level. Constant dollar figures are commonly used to compute the real value of the Gross Domestic Product and its components and to estimate the real level of federal receipts and outlays.

Contributions - Also referred to as "taxes," "payroll taxes," or "premiums," these terms refer to amounts paid into social insurance programs. The payments can be paid by (1) employers and employees based on wages from employment covered under a program; (2) the self-employed based on net earnings from self-employment; (3) states based on wages of state and local government employees; and (4) policyholders based on coverage under certain programs.

Cost rate - The ratio of expenditures for the program to the taxable payroll for the year.

Covered employment - All employment and self-employment creditable for purposes of the social insurance program. For Social Security, almost every kind of employment and self-employment is covered. In a few employment situations, coverage must be elected by the employer. Covered employment for HI includes all federal employees,

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whereas covered employment for OASDI includes some, but not all, federal employees.

Covered worker - A person having earnings creditable for a social insurance program. For Social Security, "creditable earnings" are based on earnings taxable under the program. The number of HI covered workers is slightly larger than the number of OASDI covered workers because of different coverage status for federal employment.

Disclosure - Reporting information in notes or narrative regarded as an integral part of the basic financial statements.

Exchange transaction - A transaction that arises when each party to the transaction sacrifices value and receives value in return.

Gross Domestic Product - The total dollar value of all goods and services produced by labor and property located in the United States, regardless of who supplies the labor or property.

Income rate - The ratio of contributions and tax income to taxable payroll for the year.

Medicare - A national, federally administered health insurance program authorized in 1965 to cover the cost of hospitalization, medical care, and some related services for most people over age 65, people receiving Social Security Disability Insurance payments for two years, and people with End-Stage Renal Disease. Medicare consists of two separate but coordinated programs: Part A, Hospital Insurance (HI) and Part B, Supplementary Medical Insurance (SMI). All persons entitled to HI are eligible to enroll in the SMI program on a voluntary basis by paying a monthly premium. Health insurance protection is available to Medicare beneficiaries without regard to income.

Nominal dollars - The dollar value assigned to a good or service in terms of prices current at the time the good or service is required. This contrasts with the value assigned to a good or service measured in constant dollars.

Nonexchange transaction - A transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return.

Present value - The value of future cashflows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest.

Open group population - Those persons who are participating or who eventually will participate, during a specified period, in a social insurance program as contributors or beneficiaries. They include, for example, current workers, retirees, survivors, disabled persons, and new participants entering the workforce or becoming beneficiaries, including those who will be born or immigrate to the United States in the future.

Railroad Retirement program - A federal program somewhat similar to Social Security, designed for workers in the

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railroad industry. The provisions of the Railroad Retirement Act provide for a system of coordination and financial interchange between the Railroad Retirement program and the Social Security program.

Recognition (or Recognize) - The process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. "Recognition" includes both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item.

Required Supplementary Stewardship Information (RSSI) - RSSI is information reported outside the principal financial statements that is an essential part of an entity's financial reporting; therefore the statement contains recommendations for its measurement and presentation.

Social Security Act - The Social Security Act governs most operations of the Social Security program. The original Social Security Act is Public Law 74-271, enacted August 14, 1935. With subsequent amendments, the Social Security Act consists of 20 titles, of which four have been repealed. The OASDI program is authorized by Title II of the Social Security Act.

Taxable payroll - Taxable wages and taxable self-employment income. When multiplied by the combined employee-employer tax rate, it yields the total amount of taxes incurred by employees, employers, and the self-employed for work during the period.

Trust funds - Accounts that are designated by law as trust funds, for receipts earmarked for specific purposes and the associated expenditure of those receipts. Collections may come from the public (e.g., earmarked taxes or user charges) or from intra-budgetary transfers. More than 150 Federal Government trust funds exist, of which the largest and best known finance several major benefit programs (including Social Security and Medicare) and certain infrastructure spending (the Highway and the Airport and Airway trust funds).

Trustees, Boards of, OASDI and Medicare - Boards established by the Social Security Act to oversee the financial operations of the Old-Age, Survivors, and Disability Insurance ("Social Security" or OASDI), the Hospital Insurance (HI), and the Supplementary Medical Insurance (SMI) trust funds. The Boards are composed of six members, four of whom serve automatically by virtue of their positions in the Federal Government: the Secretaries of Treasury (the managing trustee), Labor, and Health and Human Services and the Commissioner of Social Security (since March 1995). The other two members are appointed by the President and confirmed by the Senate to serve as public representatives to serve 4 year terms.

Unemployment Insurance (UI) - The UI program was created in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. The UI program is administered through a unique system of federal-state partnerships, established in federal law but executed by state officials through conforming state laws. The Federal Government provides broad policy guidance and program direction through the oversight of the

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U.S. Department of Labor. The UI program is financed by federal and state unemployment taxes. Federal unemployment taxes are used to pay for the UI administrative costs, to pay the federal share of extended UI benefits, and to maintain a loan account from which states may borrow to pay UI benefits. State UI taxes are used exclusively for the payment of regular UI benefits and the state's share of extended benefits. In addition to the federal tax, individual states finance their UI programs through state tax contributions from subject employers on the wages of covered employees. (Three states also collect contributions from employees.) Within federal guidelines, state tax rates are assigned in accordance with an employer's experience with unemployment. Actual tax rates vary greatly among the states.

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Kenneth J. Winter (beginning 1/1/99)

- -

Wendy M. Comes, Executive Director

Project Staff:
Richard Fontenrose
Robert W. Bramlett

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 3B18
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

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[1] See the glossary (Appendix B) for definitions of terms used in the statement. Terms defined in the glossary are in **boldface** the first time they appear in the text.

[2] "Interest on intragovernmental borrowing" refers to interest earned by the social insurance program on obligations of the U.S. Government.

[3] SFFAC No. 1, *Objectives of Federal Financial Reporting*, ~~Original Statements~~, Vol. 1, pp. 21-22, pars. 52, 53, 55, and 60.

[4] [Please note: the standard does not require information on the year when the assets would be exhausted as the program is currently structured (see par. 117). This information illustrates that management can provide data in addition to that required by the standard where it feels doing so would be useful to readers of the report.]

Federal Accounting Standards Advisory Board
Accounting for Social Insurance
August 1999

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[5] [Please note: the standard does not require information on the total amount of securities held at the balance sheet date. This information illustrates that management can provide data in addition to that required by the standard when it feels doing so would be useful to readers of the report.]

[6] [Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 3.]

[7] "Closed group" will be used synonymously with "closed group (to new entrants)."

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FASAB

Federal Accounting Standards Advisory Board

Amendments To Accounting Standards For Direct Loans and Loan Guarantees

In Statement of Federal Financial Accounting Standards No. 2

Statement of Federal Financial Accounting Standards No. 18

May 2000

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (the FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators and executives, analysts from private firms, academe, and other organizations), Congress, executive branch agencies, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," amended on October 1, 1999.

"Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.financenet.gov/fasab.htm

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EXECUTIVE SUMMARY

I. This Statement presents amendments to certain portions of Statement of Federal Financial Accounting Standards No. 2, Accounting for Direct Loans and Loan Guarantees, (SFFAS No. 2), which was issued in August 1993. The objective of these amendments is to improve financial reporting for subsidy costs and performance of Federal credit programs.

II. During 1998 and early 1999, the Board discussed issues related to reporting the credit subsidy expense and credit subsidy reestimates in general. The Board concluded that certain portions of SFFAS No. 2 should be amended so that more useful information on credit programs' subsidy costs and performance will be provided to citizens, Congress, program managers, and other users of Federal financial information. The amendments were proposed for public comment in an Exposure Draft published in March 1999. After considering comments, the Board decided to adopt the following amendments:

a. **Report subsidy reestimates in two distinct components: the interest rate reestimate and the technical/default reestimate.**

The former is a reestimate due to a change in interest rates from the rate assumed in budget preparation and used in calculating the subsidy expense to the rates that are prevailing at the time the direct or guaranteed loans are disbursed. The latter is a reestimate due to changes made in projected cash flows under the terms of the direct loans or loan guarantees after reevaluating all the risk factors as of the financial statement date, except for the effect of interest rate reestimates.

b. **Display a reconciliation between the beginning and the ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, reported in an entity's balance sheet.**

The reconciliation displays activities that affect the subsidy cost allowance or the loan guarantee liability, such as the subsidy expense for direct or guaranteed loans disbursed during the reporting period, subsidy reestimates, fees received, interest supplements paid, loans written off, claim payments made to lenders, recoveries obtained, and other adjustments.

c. **Provide a description of program characteristics and disclose: (i) the amounts of direct or guaranteed loans disbursed in each program during the reporting year, (ii) the estimated subsidy rates for the total subsidy and**

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the subsidy components at the program level in the current year's budget for the current year's cohorts, (iii) events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates, and (iv) events and changes in conditions that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date.

Reporting entities should discuss how those events and changes have affected or would affect credit programs' subsidy costs, subsidy reestimates, and the subsidy rates estimated in the budget.

III. In addition to requiring reconciliation for the balances of direct loan allowance and loan guarantee liability on an entity-wide basis as prescribed in this statement, the Board recognizes that reconciliation on a program-by-program basis can better reveal information relevant to program performance. Since the program-by-program reconciliation was not proposed for public comment in the March 1999 ED, the Board has not received input on this option. Because the proposal appears to have merit, the Board has decided to issue an exposure draft to propose program-by-program reconciliation for major programs in addition to the entity-wide reconciliation.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION 5
- PURPOSE 5
- BACKGROUND 5
- EFFECTIVE DATE 7

ACCOUNTING STANDARDS
FOR DIRECT LOANS AND LOAN GUARANTEES 8
- SUBSIDY REESTIMATES - AN AMENDMENT TO SFFAS No. 2 8
- RECONCILIATION 9
- DISCLOSURE AND DISCUSSION 9

APPENDIX A: BASIS FOR CONCLUSIONS 11
- SUBSIDY REESTIMATES 11
- RECONCILIATION 13
- DISCLOSING SUBSIDY RATES 17
- DISCLOSURE AND DISCUSSION 19
- THE EFFECTIVE DATE 23
- VOTE FOR APPROVAL 24

APPENDIX B: ILLUSTRATIVE REPORTING FORMATS 25

APPENDIX C: THE ACCOUNTING STANDARDS
IN SFFAS No. 2 27

GLOSSARY 36

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_18.pdf.

INTRODUCTION

PURPOSE

1. The purpose of this Statement is to amend accounting standards for direct loans and loan guarantees by adding the following requirements: (a) report subsidy reestimates in two components: interest rate reestimates and technical/default reestimates, (b) display in a note to financial statements a reconciliation between the beginning and ending balances of loan guarantee liability and the subsidy cost allowance for direct loans, and (c) provide disclosure and discussion for changes in program subsidy rates, subsidy expense, and subsidy reestimates.

BACKGROUND

2. During 1998 and 1999, the Board held discussions on what improvements could be made to financial reporting for credit subsidy rates, subsidy expense, and subsidy reestimates.[3] During the discussions, the Board directed its staff to conduct a survey in two issue areas: (a) How difficult is it for agencies to prepare and report subsidy data, and (b) What subsidy data are useful to users of Federal agency financial reports.

3. In June 1998, representatives of the Small Business Administration and the Department of Education made presentations to the Board on their experience and capabilities for preparing subsidy cost data for direct loans and loan guarantees. The presentations indicated that to meet the budgeting requirements, agencies must have systems and procedures to estimate for each cohort of direct loans or loan guarantees the subsidy rates, subsidy expense, and subsidy reestimates in components as currently required in preparing the budget. The presentations indicated that if a sound system is in place, the information on subsidy rates, subsidy expense, and subsidy reestimates could be retrieved and aggregated on a program or entity basis to meet the financial reporting requirements.

[3] The discussions were initiated by the Credit Reform Task Force of the Accounting and Auditing Policy Committee (AAPC) which proposed that paragraph 25 in SFFAS No. 2 be amended to require disclosure of subsidy rates estimated in the budget for the current year cohorts in lieu of reporting the dollar amounts of the subsidy components. That proposal was discussed in the March 1999 ED. The Board accepted the Task Force proposal for disclosing subsidy rates, but did not remove the requirement for reporting the dollar amounts of subsidy expense components.

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4. A questionnaire on data usefulness was sent to congressional staff members who had been involved in Federal credit programs. Oral and written responses were received from a number of the staff members and were presented to the Board at its October 1998 meeting. All of those who responded indicated that for appropriation and oversight purposes, they needed more rather than less detailed data on subsidy costs for direct loans and loan guarantees. They preferred that subsidy data be reported by component in both rates and dollar amounts. Furthermore, they said that they would like to compare initial budget expectations with current reestimates and to know causes that explain changes in subsidy rates.

5. The Board agreed that the subsidy cost information reported by Federal credit agencies could be improved by adopting the following requirements: (a) report subsidy reestimates by component, (b) display in a note to financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, and (c) provide disclosure and discussion that would help the reader understand the changes in Federal credit programs' subsidy costs and performance. These requirements were proposed in the Exposure Draft issued in March 1999 (the March 1999 ED).

6. The Board received comments from twelve respondents. Of those respondents, ten were from Federal agencies (including the CFO Council of the Federal Government), and two were from the private sector. They were generally in favor of the Board's proposals to improve financial reporting for credit programs' subsidy costs and performance. However, some of them expressed different views on some of the proposals, which are addressed in Appendix A, Basis for Conclusions. After considering the comments, the Board decided to issue in this final statement all of the amendments proposed in the March 1999 ED.

7. The Board considered and agreed with the view that reconciliations for direct loan allowance and loan guarantee liability on a program-by-program basis can better reveal variations in program characteristics and performance. Since the program-by-program reconciliation was not proposed for public comment in the March 1999 ED, the Board has not received input on this option. Because the proposal appears to have merit, the Board will issue an exposure Draft to propose reconciliation for major programs in addition to the entity-wide reconciliation prescribed in

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this statement.

EFFECTIVE DATE

8. The accounting standards prescribed in this statement are effective for periods beginning after September 30, 2000. Earlier implementation is encouraged.

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ACCOUNTING STANDARDS
FOR DIRECT LOANS AND LOAN GUARANTEES

SUBSIDY REESTIMATES - AN AMENDMENT TO SFFAS No. 2

9. Paragraph 32 in SFFAS No. 2 is amended to read:

Credit programs should reestimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees as required in this standard. There are two kinds of reestimates: (a) interest rate reestimates, and (b) technical/default reestimates [4]. Entities should measure and disclose each program **s** reestimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the reestimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

(A) An interest rate reestimate is a reestimate due to a change in interest rates from the interest rates that were assumed in budget preparation and used in calculating the subsidy expense to the interest rates that are prevailing during the time periods in which the direct or guaranteed loans are disbursed. Credit programs may need to make an interest rate reestimate for cohorts from which direct or guaranteed loans are disbursed during the reporting year. If the assumed interest rates that were used in calculating the subsidy expense for those cohorts differ from the interest rates that are prevailing at the time of loan disbursement, an interest rate reestimate for those cohorts should be made as of the date of the financial statements.

(B) A technical/default reestimate is a reestimate due to changes in projected cash flows of outstanding direct loans and loan guarantees after reevaluating the underlying assumptions and other factors that affect cash flow projections as of the financial statement date, except for any effect of the interest rate reestimates explained in (a) above. In making technical/default

[4] The term “technical/default reestimate” used in this statement is identical in meaning to the term “technical reestimate” used in OMB Circular A-11, as revised in July 1999.

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reestimates, reporting entities should take into consideration all factors that may have affected various components of the projected cash flows, including defaults, delinquencies, recoveries, and prepayments. The technical/default reestimate should be made each year as of the date of the financial statements.

RECONCILIATION

10. In a note to the financial statements, reporting entities should display a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported in the entities' balance sheet. The reconciliation is accomplished by adding to or subtracting from the beginning balance the dollar amounts of the following items: (a) the subsidy expense recognized in the four components as defined in paragraphs 25 through 29 for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy reestimates as defined in paragraph 32, and (c) other adjustments. For direct loans, the other adjustments include loan modifications, fees received, loans written off, foreclosed property or other recoveries acquired, and subsidy allowance amortization. For loan guarantees, the other adjustments include loan guarantee modifications, fees received, interest supplements paid, claim payments made to lenders, foreclosed property or other recoveries acquired, and interest accumulated on the loan guarantee liability. The requirement to display reconciliation applies to direct loans and loan guarantees obligated or committed on or after October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. Reporting entities are encouraged but not required to display reconciliations for direct loans and loan guarantees obligated or committed prior to October 1, 1991, in schedules separate from the direct loans and loan guarantees obligated or committed after September 30, 1991.

DISCLOSURE AND DISCUSSION

11. The disclosure and discussion requirements are prescribed in paragraphs 11(A) through 11(C):

    (A) Reporting entities should provide a description of the characteristics of the programs that they administer, and should disclose for each program: (a) the total amount of direct or guaranteed loans disbursed for the current reporting year and the

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preceding reporting year, (b) the subsidy expense by components as defined in paragraphs 25 through 29, recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy reestimates by components as defined in paragraph 32 for those years.

(B) Reporting entities should also disclose, at the program level, the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs, estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts. Each subsidy rate is the dollar amount of the total subsidy or a subsidy component as a percentage of the direct or guaranteed loans obligated in the cohort. Entities may use trend data to display significant fluctuations in subsidy rates. Such trend data, if used, should be accompanied with analysis to explain the underlying causes for the fluctuations.

(C) Reporting entities should disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates. The disclosure and discussion should also include events and changes that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date. Changes in legislation or credit policies include, for example, changes in borrowers' eligibility, the levels of fees or interest rates charged to borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed.

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APPENDIX A: BASIS FOR CONCLUSIONS

SUBSIDY REESTIMATES

12. Paragraph 32 in SFFAS No. 2, as amended, requires that entities measure and disclose reestimates in two components separately; namely, the interest rate reestimate and the technical/default reestimate. The former is a reestimate made for differences between interest rate assumptions at the time of budget formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rates for the years of disbursement.[5] The later is a reestimate due to changes in projected cash flows as reflected in the direct loan allowance and loan guarantee liabilities at the beginning of each fiscal year, after reevaluating the underlying assumptions and other factors that affect cash flow projections as of the financial statement date, except for any effect of interest rate reestimates.

13. As explained in the March 1999 ED, the rationale for separating the two reestimate components lies in the fact that interest rate reestimates and technical/default reestimates differ in nature. The interest rate reestimate depends on how close the assumed interest rate, which is initially used in the budget, is to the actual interest rates prevailing at the time of loan disbursement. The interest rate reestimate does not in itself indicate changes in the quality of loan assets or the overall risk of loan guarantees, nor does it have any implication for the quality of the agency's subsidy estimation process. The technical/default reestimate, on the other hand, reflects the latest developments in risk and program characteristics and thus it indicates changes in the quality of loan portfolio or the overall risk of loan guarantees. In some instances, a large technical/default reestimate may indicate that the credit program management should find ways to improve its subsidy estimation process and/or its portfolio management. Because of the difference in the nature of the two components, separate reporting would provide better information to users of the financial reports.

14. All of the 12 respondents to the March 1999 ED agreed with the Board's proposal for reporting subsidy reestimates in those two components. The

[5] See OMB Circular A-11, sec. 85.5 (a), revised in July 1999. The interest rate reestimate does not involve any change in original assumptions other than the interest rates.

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respondents believe that reporting the two reestimate components separately will provide information to reveal the causes of the reestimates. They believe that such information can help program managers improve credit program performance and subsidy estimation methodology.

15. Although in support for the proposal, one respondent commented on the controllability argument. Since it was discussed in the March 1999 ED that the magnitude of an interest rate reestimate is beyond agencies' control, the respondent pointed out that some default factors, such as changes in economic conditions and natural disasters, are also beyond the control of credit programs. While it was stated in the March 1999 ED that "the assumed rate is determined by the Administration and is beyond the control of the agency," that statement does not imply that credit programs can control changes in economic conditions or all of the other events that would impact default rates. However, the Board believes that a reliable assessment of the economic changes and other risk factors in making default subsidy reestimates, whether or not controllable by the agency, can help credit programs better manage program costs and performance.

16. Another respondent stated that analyses performed by his agency indicated that in past years, changes in interest rates produced relatively minor changes in that agency's overall subsidy rates. Thus, the respondent suggested that the Board consider whether it is cost-beneficial to separate out the interest rate reestimates.

17. The interest rate reestimates vary in magnitude from year to year. For some years, the assumed and the actual rates may be fairly close, whereas in other years they differ significantly and could produce a material effect on the overall subsidy rate. For example, the subsidy reestimate data provided USDA Rural Development Water and Waste Direct Loan program indicated that for fiscal years 1992 through 1994, the amounts of interest rate reestimates exceeded the amounts of technical/default reestimates. In 1995, the interest rate reestimate accounted for 84 percent of the total subsidy reestimate. In more recent years, the impact of interest rate reestimates was relatively small. In any case, we do not believe one can rely on the past experience for any particular year to make a conclusion about interest variations in future years.

RECONCILIATION

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18. It is prescribed as an accounting standard in this statement that reporting entities display in a note to financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported in the entities' balance sheet.

19. During its discussions about the subsidy expense and subsidy reestimates, the Board held the view that it is not adequate or desirable to report annual subsidy expense and reestimates in an isolated fashion. The Board concluded that additional information is needed to provide a full picture about a credit program's performance. The Board believes that the reconciliation can be used as an effective vehicle to provide such information.

20. As explained in the March 1999 ED, an advantage of displaying the reconciliation is to show in one place the activities that affect the subsidy cost allowance or the loan guarantee liability. In addition to the subsidy expense and reestimates, which are based on projections of future cash flows, the reconciliation schedule also displays data on actual performance, such as fees received, loans written off, claim payments made to lenders, and foreclosed property, loans receivable, or other recoveries acquired during the reporting year. These actual performance data and the data on subsidy cost estimates would be a useful tool to begin assessing the actual performance of a reporting entity's lending or loan guarantee activities against its budget expectations.

21. The Board noted as another advantage that the reconciliation process would enhance credit agencies' internal control. To comply with the requirement, entities must make the subsidy data elements consistent, accurate, and thus reconcilable. In conjunction with credit agencies' loan monitoring systems, the reconciliation process can serve as a tool to foster a discipline in organizing data related to subsidy costs and performance in a systematic manner.

22. A majority of the respondents supported the Board's proposal for displaying the reconciliation. They believed that the reconciliation will provide useful information to Congress, program managers, and other users of financial statements. One respondent stated that once required as a part of the financial statements, the reconciliation will be subject to validation through audit and thus will become a reliable source of

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information for those who make decisions and evaluate results for credit activities.

23. Several respondents, however, expressed disagreements or reservations about the proposed reconciliation. Some of them commented that compiling the reconciliation data would be a burdensome process. We believe that performing the reconciliation would initially require some staff training and computer programming. However, the effort will be worthwhile because the process will help agencies organize the necessary data in an orderly manner. When properly programmed, the reconciliation process can become a routine and systematic process. In fact the reconciliation requires no more data than those that are necessary in deriving the ending balances of the subsidy cost allowance and loan guarantee liability from their beginning balances of a reporting period. Thus, all the data necessary for the reconciliation should be available and verifiable if the ending balances are accurate.

24. It should be noted that it is not unusual to require reconciliation in credit activities. In its Industry Guide No. 3, the Securities and Exchange Commission (SEC) requires bank holding companies to provide an analysis of the allowance of loan losses in their financial statements.[6] The analysis is equivalent to the reconciliation of the subsidy cost allowance required in this statement. The SEC Guide requires that the beginning and ending balances of the allowance be reconciled with charge-offs (loans written off), recoveries, and additions charged to operations (equivalent to subsidy reestimates). The charges-offs and recoveries are displayed by type of loans (such as consumer installments, commercial, real estate, and lease financing, as so forth). A similar requirement is prescribed by the Financial Accounting Standards Board (FASB) in paragraph 20, FAS No. 114, as amended by FAS 118, for impaired loans accounted for on a present value basis:

> For each period for which results of operations are presented, a creditor also shall disclose the activity in the total allowance for credit losses related to loans, including the balance in the allowance at the beginning and end of each period, additions charged to operations, direct write-downs

[6] SEC Accounting Rules, & 8303, 1984 Commerce Clearing House, Inc. [Additional reference: Securities Act Guide 3 adopted in Release No. 34-12784, amended by Release Nos. 33-6221, 33-6383, FR-11, FR-13 and FR-27]

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charged against the allowance, and recoveries of amounts previously charged off. The total allowance for credit losses related to loans includes those amounts that have been determined in accordance with FASB Statement No. 5, Accounting for Contingencies, and with this Statement.

25. Some of those who disagreed with the reconciliation proposal recognized merits in reconciling subsidy cost allowance for direct loans and liability for loan guarantees, but doubted whether the reconciliation on an entity basis would provide useful information. They pointed out that the programs their agencies administer vary in characteristics and subsidy rates, and that the reconciliation at the entity level will aggregate the program data and, as a result, will not reveal the characteristics and operating results of individual programs.

26. The Board was aware that programs administered by an agency often differ in characteristics and subsidy rates. The Board agrees with the view that the entity-wide reconciliation in itself would not reveal variations in program performance. The Board thus decided to issue an exposure draft, soon after issuing this statement, to propose a display of a program-by-program reconciliation for major programs. Nevertheless the Board sees value in the entity-wide reconciliation itself. With respect to the subsidy cost allowance and the loan guarantee liability reported on an entity's balance sheet, the entity-wide reconciliation shows changes in those balances. Those changes indicate the entity's aggregate performance results for all the credit activities under the entity's management.

27. The Board considered two primary reasons for adopting the entity-wide reconciliation in this statement, rather than postpone it until the program-by-program reconciliation is proposed and considered. First, by making the entity-wide reconciliation effective as early as possible, agencies can begin to get their personnel and systems resources ready for implementing the requirement without further delay. Second, by requiring the display of the entity-wide reconciliation, it is likely that program-by-program reconciliation data would be available for users. This is based on the rationale that in order to display the entity level reconciliation, the reporting entity would normally first reconcile the balances of individual programs. If they do so, program managers as well as auditors will have access to the program reconciliation data to validate the entity-wide reconciliation and to use the program-based data in program analysis and evaluation. If requested by Congress, special reports for any particular

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program can also be made available to Congress.

28. One respondent pointed out that loan guarantee programs sometimes acquire guaranteed loans for direct collection upon paying default claims for those loans. He asked whether the subsidy cost allowance of those loans should be reconciled in a separate schedule. Under credit reform accounting, guaranteed loans acquired by the loan guarantee program upon paying default claims are carried at their present value and the present value is reestimated annually before the loans are collected or written off. The amount of those loans and their allowance are reported in Note 7 in OMB Bulletin 97-01, Form and Content of Agency Financial Statements. Since the acquired loans do not represent a primary line of business for loan guarantee programs, the Board does not believe that a display of reconciliation for those acquired loans should be required.

29. One respondent asked whether the reconciliation requirement applies to pre-credit reform direct loans and loan guarantees as well as post-credit reform direct loans and loan guarantees. The Board considered the issue and concluded that the reconciliation requirement applies only to post-credit reform direct loans and loan guarantees, i.e., direct loan and loan guarantees obligated or committed after September 30, 1991. One of the principal objectives for the reconciliation requirement is to provide information that can be used to compare initial budget expectations with operating results. This is achievable with direct loans and loan guarantees that were obligated or committed after September 30, 1991, because under credit reform, budgeting and financial reporting for credit activities are performed on the same present value basis. This is not the case with pre-credit reform direct loans and loan guarantees.

30. However, aside from the basic objective discussed above, the other advantages of the reconciliation are valid for both pre and post- credit reform direct loans and loan guarantees. Those advantages include: (a) revealing information on activities that affect the balances, and (b) enhancing accounting integrity and internal control. Agencies are encouraged, but not required, to reconcile the direct loan allowance and loan guarantee liability balances for direct loans and loan guarantees obligated or committed prior to October 1, 1991. Since the measurement bases differ between pre and post-credit reform direct loans and loan guarantees, agencies should use separate reconciliation schedules for pre and post-credit reform direct loans and loan guarantees.

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DISCLOSING SUBSIDY RATES

31. A disclosure provision has been prescribed in this statement to require that reporting entities disclose, at the program level, the rates for the total estimated subsidy cost and the subsidy cost components in the current year's budget for the current year's cohorts. Each rate equals the amount of the total subsidy or a subsidy component divided by the amount of direct or guaranteed loans obligated in the cohort for the reporting year. The Board members believed that the budget subsidy rates for the reporting year are highly important because they represent budget expectations that reflect the most recent program characteristics.

32. The standard provides that reporting entities may use trend data to display significant fluctuations in a program's subsidy rates. To avoid excessive and purposeless presentation of historical data, the use of trend data should be limited to the subsidy rate for the total subsidy or for a subsidy component of a particular program that has experienced significant fluctuations in recent years. The presentation of trend data should be accompanied by analysis to explain causes of the fluctuations.

33. A majority of the respondents supported the proposal for disclosing the estimated subsidy rates for cohorts of the current year. The arguments for the proposal they presented include: (a) those subsidy rates estimated in the current year's budget "give the reader the most up-to-date information on cohorts as established by appropriation law," (b) those rates reflect the most recent program characteristics, and (c) the subsidy rates reported for a number of recent years can form a trend for comparison and analysis.

34. One respondent requested clarification for the phrase "in the current year's budget for the current year's cohorts." The required disclosure is for budget subsidy rates for the cohorts of the current reporting year, i.e., the year for which the financial reports are published. For example, in the financial reports for the 2001 fiscal year, the budget subsidy rates in the FY 2001 budget for the FY 2001 cohorts should be complied and disclosed at the program level. The standard does not require disclosure of subsidy rates for cohorts of previous years, although some of the cohorts may continue to disburse loans during the current reporting year. However, as provided in the standard, entities may use trend data to display significant fluctuations in subsidy rates over a number of the most recent years.

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35. Those who were opposed to the disclosure for subsidy rates presented the following arguments: (a) budget subsidy rates for all credit programs are published in the Federal Credit Supplement to the Budget of the U.S. Government, and it is unnecessary to duplicate the same data in financial reports, (b) the inclusion of budget subsidy rates in financial reports would appear to invite calculation of subsidy costs by applying the subsidy rates to disbursements, and such calculation could produce confusing results, and (c) the subsidy rates in the budget are estimated before all the data concerning the reporting year are available, and are subject to changes.

36. The Board was aware that the budget subsidy rates are published in the Federal Credit Supplement to the Budget of the U.S. Government. However, the inclusion of those subsidy rates in the financial reports will provide the reader of the financial statements with an easy access to the budget data. The Board was also aware that one cannot calculate the subsidy expense for the current year by applying the estimated subsidy rates of the current year cohorts to the amount of direct or guaranteed loans disbursed during the current year. Such calculation may give erroneous results because some of the loans disbursed during the current year may belong to previous years' cohorts. The disclosure of budget subsidy rates was initially proposed by the AAPC Credit Reform Accounting Task Force. When proposing the disclosure, the AAPC Credit Reform Accounting Task Force suggested that the disclosure be accompanied by a narrative explaining in conceptual terms how the total subsidy rate differs from the total subsidy expense recognized in the financial statements. The Board believes that it is necessary to have such a narrative to avoid confusion between the subsidy rates of the current year cohorts and the subsidy expense recognized for the current reporting year.

37. It is true that the estimated subsidy rates for a program in the current year's budget reflect budget expectations for that program, and do not reflect the program's operating results for the current reporting year. The actual performance of a program can be viewed from such data as subsidy reestimates, loans written off, default claims paid, and fees received. One of the purposes for the disclosure of the budget subsidy rates is to provide an indication of budget expectations of the most recent cohorts.

38. The Board believes that the disclosure for the subsidy rates for the

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cohorts of the current reporting year will prove beneficial as they are important indicators for management's latest expectations reflecting the programs' current characteristics. The disclosure requirement is adopted because the advantages of the disclosure outweigh its disadvantages.

DISCLOSURE AND DISCUSSION

39. The Board holds the view that merely reporting the figures for the subsidy expense and subsidy reestimates would not provide complete and understandable information to users of Federal agency financial reports. The Board believes that to make the figures meaningful, significant events and changes in assumptions underlying the cost estimates should be disclosed and their impact should be discussed. The disclosure and discussion should help explain the subsidy cost data. In other words, the Board believes that it is necessary to tell the stories behind the figures.

40. Reporting entities are required to provide a description of the programs that they administer and disclose at the program level the amounts of direct or guaranteed loans disbursed during the reporting year. This information would provide the reader with an indication of the programs' characteristics and the magnitude of their credit activities. With the information on amounts disbursed, analysts can calculate the subsidy expense, or one of its components, as a ratio to the amount of the loans disbursed and can compare the ratios among programs or over time.

41. Reporting entities are required to disclose events and changes that have had a significant and measurable effect on subsidy costs. These would include changes in economic conditions and risk factors, changes in legislation and policies regarding direct loans or loan guarantees, and changes in methodologies and assumptions used in making subsidy estimates and reestimates. Credit agencies are also required to disclose and discuss events and changes that have occurred and are more likely than not to have a significant impact on subsidy rates, subsidy expense, and subsidy reestimates but the effects of which are not measurable at the reporting date. These include events and changes that have occurred after the reestimation cut off date and will be taken into consideration in making reestimates for the following year. Reporting entities should discuss how those events and changes have or would have impacted the various components of subsidy expense, subsidy rates, and subsidy reestimates.

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42. The Board noted in particular that changes in legislation and credit policies could significantly alter a program's characteristics and thus affect its subsidy rates. These changes include, for example, changes in borrowers' eligibility, the level of fees or interest rates charged borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed. If such a change occurs during a reporting year, the reporting entity should disclose and explain the nature of the change and discuss its impact on program characteristics and its estimated subsidy rates.

43. Most respondents supported the Board proposal. They believed that to make the reported financial figures meaningful, significant events and changes in assumptions underlying those figures should be disclosed and their effect should be discussed. Some of the respondents provided examples of events that can affect default rates. For example, drought, flood, tornadoes, and other natural disasters may affect some regions or some sectors of the economy, and consequently, affect borrowers' ability to make loan payments. Those respondents also noted that changes in economic conditions, such as interest and employment rates, could an also have a significant impact on credit risks and performance. Some of them stated that legislative and policy changes could have a direct impact on the costs and performance of certain affected programs. They contend that without disclosing those events and changes and discussing their impact, the reader cannot fully understand the financial figures, such as subsidy rates, expenses, and reestimates.

44. One respondent noted that the same type of disclosure and discussion that is now required for credit subsidies is not usually required for many other operating costs, such as employees salary, rent, and computer service costs. The respondent questioned why the disclosure and discussion for credit activities are more critical than other costs reported in the statement of net cost. To address this issue, we can provide at least two reasons for this difference. First, unlike salary, rent, or the costs of other services, the credit subsidy costs are under a greater degree of uncertainty, as they are exposed to many risk factors external to the government. Many factors discussed in the March 1999 ED and by other respondents, such as changes in interest and employment rates and disastrous events, would cause the subsidy costs to vary from their estimates in the budget. Second, unlike most other cost items, the credit subsidy costs are reported in present values of future cash flows projected over the life of the underlying direct loans and loan guarantees. To a large extent, the reliability of the subsidy cost information depends on

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the factors considered in making the cash flow projections. The reliability is also affected by the quality of the agency's data and its estimation methodology. The narrative disclosure and discussion would help the user to understand the factors that cause significant changes in the subsidy costs during the reporting year, which do not usually occur in salary, rent, or other operating costs.

45. Two respondents, however, were opposed to the narrative disclosure and discussion requirement on the grounds that it would be burdensome for entities with varied programs to present the required information. These respondents may have come under a mis-perception about the disclosure and discussion requirement. They may have perceived that the standard would require an excessively detailed description of all the technical aspects of the subsidy estimation methodologies and assumptions, and an extensive analysis of all risk factors in the programs and even sub-programs administered by the reporting entity. Thus, they concluded the requirement is extremely burdensome. However, such detailed disclosure and discussion were not intended. It was stated in paragraph 50 of the March 1999 ED:

> While the Board members believe that the proposed disclosure and discussion are necessary, they prefer that entity financial reports would not be overwhelmed with detailed numbers and ratios that may overburden the reader of the financial reports. The Board members believe that to the extent possible, the narrative discussion should be written in non-technical language so that the average reader can understand the data and the explanations.

46. The primary emphasis of the disclosure and discussion requirement is on significant changes in subsidy rates and reestimates. The disclosure and discussion should be focused on events that have occurred and have caused those significant changes. In addition, the disclosure and discussion should also include events that have occurred and are more likely than not to have a significant impact on subsidy rates and reestimates but the effects for which are not measurable at the reporting date.

47. Some respondents believed that the narrative disclosure and discussion should more appropriately belong to the Management Discussion and Analysis (MD&A) section of financial reports. The Board disagrees with this view. The narrative disclosure and discussion required in this statement should be specifically tailored to address credit subsidy

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activities. As such, it differs from the MD&A requirements in breadth, depth, and detail. The Board believes that the disclosure and discussion required in this statement belong in a note to financial statements, such as Note 7 in OMB Bulletin 97-01, the Form and Content of Agency Financial Statements, in which all the data on direct loan assets, loan guarantee liabilities, subsidy rates, subsidy expenses, and reestimates are reported. By including the narrative disclosure and discussion in the same note, the reader would find all the information in one place. However, this does not preclude entity management from including a discussion and analysis to highlight credit activities in MD&A, so long as entity management determines that such a discussion and analysis meets the MD&A requirements in SFFAS 15.

48. Audit efforts for information provided in a footnote to financial statements differ from those for information provided in MD&A. MD&A is regarded as required supplementary information (RSI) and is subject to less stringent audit than basic financial statements and their notes.[7] The Board believes that program subsidy data should be reported in a note to agency financial statements because they are directly related to information reported in the financial statements. Those program subsidy data should be audited as basic financial information. Based on the preceding paragraph, it might appear that including the narrative disclosure and discussion in the same footnote with the subsidy data (instead of in MD&A) would expand the audit burden associated with credit subsidies. However, since the auditor already needs to test the reliability of the estimates and reestimates in the context of auditing the basic program subsidy data[8], the Board believes that there would be no substantial increase in audit burden from including the narrative disclosure and discussion in a footnote instead of in MD&A. In fact, the process of generating the required disclosure and discussion for the footnote should provide information on risk factors underlying the subsidy estimates and reestimates and thus should facilitate the audit of the basic subsidy data.

[7] See Statement of Recommended Accounting Standards No. 15, Management Discussion and Analysis, (April 1999) par. 18.

[8] For example, *Federal Financial Accounting and Auditing Technical Release No. 3*, Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act (July 1999), requires auditors to identify significant external and internal factors that may affect the credit subsidy estimates and reestimates. External factors include economic conditions, current political climate, and relevant legislation. Internal factors include the size of the agency's budget and accounting staff qualifications of key personnel, turnover of key personnel, and system capabilities.

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49. One respondent commented that there may not be a basis to audit future events and their effect disclosed in the narrative. The required disclosure is for events that have occurred, but does not include events that are anticipated to occur. Also, the provision does not require quantifying the effect of an event that has occurred but whose effects cannot be measured at the reporting date.

THE EFFECTIVE DATE

50. In the March 1999 ED, it was proposed that the amendments be made effective for periods beginning after September 30, 1999. Two respondents requested that the effective date be made for periods beginning after September 30, 2000. They argued that many agencies were still having difficulties in implementing existing credit reform requirements and that the new requirements would require revisions in accounting procedures and systems. The CFO Council stated that many agencies are busy with resolving Y2K problems, and would not be able to initiate new systems changes until some time in year 2000.

51. There were arguments against postponing the effective date. First, the requirements prescribed in this statement do not require any new data. For example, the data needed for the reconciliation schedules should be in the system. Without that data, agencies could not report the ending balances of the subsidy cost allowance and the loan guarantee liability at the end of each fiscal year. Second, the proposed effective date, beginning with fiscal year 2000, provides adequate time because financial statements for that year will be issued in early calendar year 2001.

52. On the other hand, the Board recognizes that staff training and computer re-programming may be necessary to implement the new requirements. Therefore, the Board considered and granted a delay for the effective date to periods beginning after September 30, 2000. However, the Board emphasizes that this should not be considered a precedent for postponing implementation of adopted accounting standards. The Board encourages early implementation of the standards.

VOTE FOR APPROVAL

53. The accounting standards prescribed in this statement are approved by the Board unanimously.

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APPENDIX B: ILLUSTRATIVE REPORTING FORMATS

The following two schedules illustrate the reconciliation between beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees.

A: Schedule for Reconciling Subsidy Cost Allowance Balances

In thousands of dollars

Beginning Balance, Changes, and Ending Balance	FY 2000	FY 2001
Beginning balance of the subsidy cost allowance	$	$
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
(a) Interest subsidy costs		
(b) Default costs (net of recoveries)		
(c) Fees and other collections		
(d) Other subsidy costs		
Total of the above subsidy expense components		
Adjustments:		
(a) Loan modifications		
(b) Fees received		
(c) Foreclosed property acquired		
(d) Loans written off		
(e) Subsidy allowance amortization		
(f) Other		
Ending balance of the subsidy cost allowance before reestimates		
Add or subtract subsidy reestimates by component		
(a) Interest rate reestimate		
(b) Technical/default reestimate		
Total of the above reestimate components		
Ending balance of the subsidy cost allowance		

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B: Schedule for Reconciling Loan Guarantee Liability Balances

In Thousands of dollars

Beginning Balance, Changes, and Ending balance	FY 2000	FY 2001
Beginning balance of the loan guarantee liability	$	$
Add: subsidy expense for guaranteed loans disbursed during the reporting years by component:		
(a) Interest subsidy costs		
(b) Default costs (net of recoveries)		
(c) Fees and other collections		
(d) Other subsidy costs		
Total of the above subsidy expense components		
Adjustments:		
(a) Loan guarantee modifications		
(b) Fees received		
(c) Interest supplements paid		
(d) Foreclosed property and loans acquired		
(e) Claim payments to lenders		
(f) Interest accumulation on the liability balance		
(g) Other		
Ending balance of the loan guarantee liability before reestimates		
Add or subtract subsidy reestimates by component:		
(a) Interest rate reestimate		
(b) Technical/default reestimate		
Total of the above reestimate components		
Ending balance of the loan guarantee liability		

Note: The schedules provided in this Appendix are for illustration only. These schedules, with their format and content, are not a part of the accounting standards.

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APPENDIX C: THE ACCOUNTING STANDARDS IN SFFAS No. 2

The following standards are prescribed in SFFAS No. 2. The texts of the paragraphs, and paragraph numbers reproduced in this Appendix are the same as those that appear in SFFAS No. 2. (The original footnote numbers are indicated in the footnotes) The shaded paragraph is affected by SFFAS No. 18.

Explanation

21. These standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The standards apply to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category.

Accounting Standards

Post-1991 Direct Loans

22. Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

Post-1991 Loan Guarantees

23. For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

24. For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate

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of marketable Treasury securities with a similar maturity term applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

25. For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

26. The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.

27. The default cost of direct loans or loan guarantees results from any anticipated deviation, other than prepayments, by the borrowers from the payments schedule in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. Projected net recoveries include the amounts that would be collected from the borrowers at a later date or the proceeds from the sale of acquired assets minus the costs of foreclosing, managing, and selling those assets.

28. The present value of fees and other collections is recognized as a deduction from subsidy costs.

29. Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

Subsidy Amortization and Reestimation

30. The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed. The amortized amount is recognized as an increase or decrease in interest income.

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31. Interest is accrued and compounded on the liability of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed. The accrued interest is recognized as interest expense.

32. The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the reestimation should take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates should be recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required.

Criteria for Default Cost Estimates

33. The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent reestimates. Default costs are estimated and reestimated for each program on the basis of separate cohorts and risk categories. The reestimates take into account the differences in past cash flows between the projected and realized amounts and changes in other factors that can be used to predict the future cash flows of each risk category.

34. In estimating default costs, the following risk factors are considered: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; (6) newly developed events that would affect the loans' performance; and (7) improvements in methods to reestimate defaults.

35. Each credit program should use a systematic methodology, such as an econometric model, to project default costs of each risk category. If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category.

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36. Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based. To document actual experience, a data base should be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Revenues and Expenses

37. Interest accrued on direct loans, including amortized interest, is recognized as interest income. Interest accrued on the liability of loan guarantees is recognized as interest expense. Interest due from Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

38. Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

Pre-1992 Direct Loans and Loan Guarantees

39. The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1992, are recognized when it is more likely than not that the direct loans will not be totally collected or that the loan guarantees will require a future cash outflow to pay default claims. The allowance of the uncollectible amounts and the liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors discussed in the previous section should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

40. Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required.

Modification of Direct Loans and Loan Guarantees

41. The term modification means a federal government action, including new

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legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

42. Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Existing contracts may be altered through such means as forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered reestimates, or workouts as defined below, or are permitted under the terms of existing contracts.

43. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection.

44. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms. Workouts are actions taken to maximize repayments of existing direct loans or minimize claims under existing loan guarantees. The expected effects of work-outs on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

A. Modification of Direct Loans

45. With respect to a direct or indirect modification of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the pre-modification

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value[9] of the loans over their post-modification value[10]. The amount of the modification cost is recognized as a modification expense when the loans are modified.

46. When post-1991 direct loans are modified, their existing book value is changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the original discount rate (the rate that is originally used to calculate the present value of the direct loans, when the direct loans were disbursed).

47. When pre-1992 direct loans are directly modified, they are transferred to a financing account and their book value is changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans. When pre-1992 direct loans are indirectly modified, they are kept in a liquidating account. Their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification.

48. The change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the modification adjustment transfer[11] paid or

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9(Original Footnote No. 3) The term "pre-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

10 (Original footnote No. 4) The term "post-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

11(Original footnote No. 5) OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the decrease in book value, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

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received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

B. Modification of Loan Guarantees

49. With respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification liability[12] of the loan guarantees over their pre-modification liability[13]. The modification cost is recognized as modification expense when the loan guarantees are modified.

50. The existing book value of the liability of modified post-1991 loan guarantees is changed to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (the rate that is originally used to calculate the present value of the liability when the guaranteed loans were disbursed).

51. When pre-1992 loan guarantees are directly modified, they are transferred to a financing account and the existing book value of the liability of the modified loan guarantees is changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. When pre-1992 direct loan guarantees are indirectly modified, they are kept in a liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification.

52. The change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of

[12](Original footnote 6) The term "post-modification liability" is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).

[13] (Original footnote NO. 7) The term "pre-modification liability" is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

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modification will normally differ, due to the use of different discount rates or the use of different measurement methods. The difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer[14] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

C. Sale of Loans

53. The sale of post-1991 and pre-1992 direct loans is a direct modification. The cost of modification is determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.

54. For a loan sale with recourse, potential losses under the recourse or guarantee obligations are estimated, and the present value of the estimated losses from the recourse is recognized as subsidy expense when the sale is made and as a loan guarantee liability.

55. The book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[15] For sales of post-1991 direct loans, the modification adjustment transfer[16] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

D. Disclosure

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[14](Original footnote 8) OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the increase in liability, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

[15](Original footnote No. 9) If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.

[16](Original footnote No. 19) See footnote No. 7 for an explanation for "modification adjustment transfer".

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56. Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or lose related to the modification.

Foreclosure of Post-1991 Direct and Guaranteed Loans

57. When property is transferred from borrowers to a federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

58. If a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the estimated amount of the claim is recognized as a special contra valuation allowance.

59. At a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted at the original discount rate.

60. When assets are acquired in full or partial settlement of post-1991 direct loans or guaranteed loans, the present value of the government's claim against the borrowers is reduced by the amount settled as a result of the foreclosure.

Write-off of Direct Loans

61. When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

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GLOSSARY

Included in this Glossary are terms that are used in this Statement. Most of the terms were also defined in the Glossary of SFFAS No. 2, but some of them have been updated based on the recent version of OMB Circular A-11. Readers are advised to rely on the latest OMB Circulars A-11 and A-34 for proper usage of federal budgetary terms and their definitions.

Book value - The net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

Cohort - A budget term which refers to all direct loans or loan guarantees of a program for which a subsidy appropriation is provided for a given fiscal year, even if disbursements occur in subsequent years. For direct loans and loan guarantees for which a subsidy appropriation is provided for one fiscal year, the cohort will be defined for that fiscal year. For direct loans and loan guarantees for which multiple year or no-year appropriations are provided, the cohort is defined by the year of obligation.

Credit program - For the purpose of this Statement, a federal program that makes loans and/or loan guarantees to nonfederal borrowers.

Direct loan - A disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds with or without interest. The term includes the purchase of, or participation in, a loan made by a non-Federal lender.

Direct loan obligation - A binding agreement by a Federal agency to make a direct loan when specified conditions are fulfilled by the borrower.

Econometric model - An equation or a set of related equations used to analyze economic data through mathematical and statistical techniques. Such models may be devised in order to depict the essential quantitative impact of alternative assumptions or government policies. (Dictionary of Banking and Finance, Jerry M. Rosenberg, Ph.D., Wiley & Sons, New York, 1982, hereafter cited as Rosenberg's Dictionary)

Foreclosure - A method of enforcing payment of a debt secured by a mortgage by seizing the mortgaged property. Foreclosure terminates all rights that the mortgagor has in the mortgaged property upon completion of due process through the courts. (Treasury Financial Manual Supplement)

Interest method - A method used to amortize the premium or discount of an investment in

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bonds, or, as used in this Statement, to amortize the subsidy cost allowance of direct loans. Under this method, the amortization amount of the subsidy cost allowance equals the effective interest minus the nominal interest of the direct loans. The effective interest equals the present value of the direct loans times the effective interest rate (the discount rate). The nominal interest equals the nominal amount (face amount) of the direct loans times the stated interest rate (the rate stated in the loan agreements).

Interest rate reestimate - A reestimate for the subsidy cost of direct loans or loan guarantees due to a change in the interest rates used in present value calculations from the assumed interest rates used in budget preparations to the interest rates that are applicable to the periods in which the direct or guaranteed loans are disbursed.

Loan guarantee - Any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender, except for the insurance of deposits, shares, or other withdrawable accounts in financial institutions.

Loan guarantee commitment - A binding agreement by a federal agency to make a loan guarantee when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement.

Modification - A federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans (or direct loan obligations), or the liability of loan guarantees (or loan guarantee commitments). Direct modifications are such actions that change the subsidy cost by altering the terms of existing contracts, selling loan assets, and purchasing loans under guarantee from a private lender. Indirect modifications change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. (According to OMB Circular A-11, the term modification does not include a Government action that is assumed in the baseline cost estimate, as long as the assumption is documented and has been approved by OMB. For example, modification does not include routine administrative workouts of troubled loans or loans in imminent default, and the borrower's or the Government's exercise of an option that is permitted within the terms of an existing contract, such as prepaying the loan. OMB Circular A-11, sec. 85.3 (n) July 1999)

Modification adjustment transfer - A non-expenditure transfer from a credit program to the Treasury, or vice versa, to offset the difference between the amount appropriated for the cost of modification of direct loans (or loan guarantees) and the change in the book value of direct loans (or loan guarantee liabilities).

Nominal (or face or par) value or amount - The amount of a bond, note, mortgage, or other

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security as stated in the instrument itself, exclusive of interest or dividend accumulations. The nominal amount may or may not coincide with the price at which the instrument was first sold, its present market value, or its redemption price. Often referred to as the stated value. (Adapted from Kohler's Dictionary for Accountants, 6th ed., hereafter cited as Kohler's Dictionary)

Present value (PV) - The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest. (Adapted from Kieso and Weygandt, Intermediate Accounting, 7th ed., p. 264.)

Recourse - The rights of a holder in due course of a financial instrument (such as a loan) to force the endorser on the instrument to meet his or her legal obligations for making good the payment of the instrument if dishonored by the maker or acceptor. The holder in due course must have met the legal requirements of presentation and delivery of the instrument to the maker of a note or acceptor of a draft and must have found that this legal entity has refused to pay for or defaulted in payment of the instrument. (Rosenberg's Dictionary)

Reestimate - Revisions of the subsidy cost allowance for outstanding direct loans or the liability of outstanding loan guarantees, through reestimating the subsidy costs of those direct loans and loan guarantees. See “interest rate reestimate” and “technical/default reestimate.”

Restatement (of direct loans or loan guarantees) - For the purposes of this Statement, refers to establishing a new book value of a direct loan or the liability of a loan guarantee.

Risk category - Subdivisions of a cohort of direct loans or loan guarantees into groups of loans that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all direct loans or loan guarantees within a cohort that share characteristics predictive of defaults and other costs.

Subsidy cost - The cost of a grant of financial aid, usually by a governmental body, to some person or institution for particular purposes. (Kohler's Dictionary)

> **Credit subsidy cost** is the estimated long-term cost to the government of direct loans or loan guarantees calculated on a net present value basis, excluding administrative costs.
>
> **Direct loan subsidy cost** is the estimated long-term cost to the government of direct loans, calculated on a present value basis, excluding administrative costs. The cost is the net present value of estimated cash flows at the time the direct loans are disbursed. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the loans’ cash flows, applicable to the time when the loans are disbursed.

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Loan guarantee subsidy cost - The estimated long-term cost to the government of loan guarantees calculated on a present value basis, excluding administrative costs. The cost is the net present value of estimated cash flows at the time the guaranteed loans are disbursed by the lender. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the cash flows projected under the terms of the loan guarantees, applicable to the time when the guaranteed loans are disbursed.

Technical/default reestimate - A reestimate of the subsidy cost of direct loans or loan guarantees based the latest projections on defaults, delinquencies, recoveries, and prepayments, and other cash flow components.

Write-off - An action to remove an amount from an entity's assets. A write-off of a loan occurs when an agency official determines that the loan will not be collected or, after all appropriate collection tools have been used, that the loan is uncollectible. Active collection on an account ceases, and the account is removed from an entity's receivables. (Treasury Financial Manual Supplement)

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*Term expired in April 2000.

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:
Richard Mayo
Lucy Lomax

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.financenet.gov/fasab.htm

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Federal Accounting Standards Advisory Board

Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2

Statement of Federal Financial Accounting Standards No. 19

March 2001

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (the FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," amended on October 1, 1999.

"Mission Statement of the Federal Accounting Standards Advisory Board."

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
Www.financenet.gov/fasab.htm

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EXECUTIVE SUMMARY

I. This Statement presents technical amendments to certain portions of Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), which was issued in August 1993. These amendments were proposed for public comment in an Exposure Draft titled *Credit Program Reconciliation and Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statements of Federal Financial Accounting Standards No. 2 and No. 18,* issued in May 2000. (Hereinafter referred to as the May 2000 ED.)

II. The technical amendments serve the following purposes:

(A) Clarify that the cash flow discount method used in the accounting standards prescribed in SFFAS No. 2 is consistent with the method required in the Federal Credit Reform Act of 1990, as amended in July 1997.

(B) Clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS No. 2*. The adjusted interest rate is used for amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure.

(C) Clarify the measurement principle for the default costs of direct loans and loan guarantees. Briefly, the default cost of direct loans is measured at the present value of projected deviations due to defaults by the borrowers from payment schedules for principal, interest, and fee payments in the loan contracts, minus projected net recoveries. However, the measurement of default costs does not include prepayments. The default cost of loan guarantees is measured at the present value of projected claim payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus projected net recoveries.

III. In the May 2000 ED, the Board proposed that entities display a program-by-program reconciliation for major credit programs between the beginning and ending balances of subsidy cost allowance for direct loans

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and the liability for loan guarantees. The Board decided not to adopt this proposal based on cost-benefit considerations.

(Continued on next page.)

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TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION 4

TECHNICAL AMENDMENTS TO SFFAS NO. 2 6
Cash Flow Discount Method 6
Effective Interest Rate 6
Measuring Default Costs 7

APPENDIX A: BASIS FOR CONCLUSIONS 8
Program-by-Program Reconciliation 8
Technical Amendments 9
Effective Date 11

APPENDIX B: THE ACCOUNTING STANDARDS IN SFFAS NO. 2 13

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_19.pdf.

INTRODUCTION

Background and Purposes

1. In this Statement the Board adopts a number of technical amendments to certain portions of the Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), which was issued in August 1993. These amendments were proposed for public comment in an Exposure Draft (ED) issued in May 2000. The title of that ED is "*Credit Program Reconciliation and Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statements of Federal Financial Accounting Standards No. 2 and No. 18.*" (Hereinafter the ED is referred to as the May 2000 ED.)

2. The technical amendments serve the following purposes:

   (A) Clarify that the cash flow discount method used in the accounting standards prescribed in SFFAS No. 2 is consistent with the method required in the Federal Credit Reform Act of 1990, as amended in July 1997.

   (B) Clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS No. 2*.

   (C) Clarify the measurement principle for the default costs of direct loans and loan guarantees.

3. The Board received nine responses to the ED. All of the respondents were in support for the technical amendments, except for two respondents who commented on the proposed technical amendments related to the measurement of default costs. Based on the comments, the Board made a minor modification to the proposed measurement of default costs for direct loans. This modification is discussed in this Statement's Appendix A, Basis for Conclusions.

4. In addition to the technical amendments, the Board proposed a standard in the May 2000 ED, requiring that entities display a program-by-program reconciliation for major credit programs between the beginning and ending balances of subsidy cost allowance for direct loans and the liability

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for loan guarantees. The Board decided not to adopt that proposal based on cost-benefit considerations.

Effective Date

5. The technical amendments adopted in this Statement are effective for periods beginning after September 30, 2002. Early implementation of the amendments is encouraged.

(Continued on next page.)

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TECHNICAL AMENDMENTS TO SFFAS NO. 2

Cash Flow Discount Method

6. The amendments in (a) and (b) below are made to clarify that the accounting standards in SFFAS No. 2 are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990. Sec. 502 (5)(E) of the Act, as amended, provides that "In estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."

   (a) In paragraph 24, SFFAS No. 2, the phrase "with a similar maturity term" is changed to "with similar maturity to the cash flows."

   (b) In footnotes 3, 4, 6, and 7, SFFAS No. 2, the phrase "the remaining maturity" is replaced with the phrase "the remaining cash flows."

Effective Interest Rate

7. The following amendments are made to clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS No. 18. The adjusted rate should be used for amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure.

   (a) In paragraph 30, SFFAS No. 2, the first sentence is changed to:

   "The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was used to calculate the present value of the direct loans when the direct loans were disbursed, after adjusting for the interest rate re-estimate."

   (b) In paragraph 31, SFFAS No. 2, the first sentence is changed to:

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"Interest is accrued and compounded on the liability for loan guarantees at the interest rate that was used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed, after adjusting for the interest re-estimate."

(c) In paragraph 46, SFFAS No. 2, the phrase in the parentheses is changed to "the rate that was originally used to calculate the present value of the direct loans, when the direct loans were disbursed, after adjusting for the interest rate re-estimate."

(d) In paragraph 50, SFFAS No. 2, the phrase in the parentheses is changed to "the rate that was originally used to calculate the present value of the liability, when the guaranteed loans were disbursed, after adjusting for the interest rate re-estimate."

(e) In paragraphs 57 and 59, SFFAS No. 2, the words "adjusted for the interest rate re-estimate" are added immediately after the words "the original discount rate."

Measuring Default Costs

8. Paragraph 27 in SFFAS No. 2 is replaced with the following two paragraphs:

(a) The default cost of direct loans results from projected deviations by the borrowers from the payment schedules for principal, interest, and fee payments in the loan contracts. However, the measurement of default costs does not include prepayments. The default cost is measured at the present value of projected payment deviations due to defaults minus projected net recoveries. Projected net recoveries include the amounts that would be collected from borrowers at a later date or the proceeds from the sales of acquired assets minus the costs of foreclosing, managing, and selling the assets.

(b) The default cost of loan guarantees results from paying lenders' claims upon default of the guaranteed loans. The default cost of loan guarantees is measured at the present value of projected payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus projected net recoveries as defined in paragraph 8(a).

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APPENDIX A: BASIS FOR CONCLUSIONS

Program-by-Program Reconciliation

9. In the May 2000 ED, the Board proposed a standard requiring that entities display a program-by-program reconciliation for major credit programs between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees. Nine respondents to the ED commented on the proposal. Five of them supported the proposal and the remaining four were opposed to the proposed standard.

10. Those who supported the proposal believed that the display of a program-by-program reconciliation would enhance disclosure for program costs and performance. One of the respondents said that the program-by-program reconciliation would reveal actual program performance information, such as direct loans written off, default claims paid, fees received, and interest supplements paid. Reporting this kind of information on a program-by-program basis is not required by the existing standards. If the data were reported, they could be useful in analyzing a program's operating results and providing feedback to the program's budget expectations. Another respondent pointed out that when program data are aggregated, increases and decreases in program costs would offset each other. Thus, without a display of program-by-program reconciliation, entity-wide reconciliation alone would not disclose variations in program performance.

11. Among those who were opposed to the proposal, the Chief Financial Officer (CFO) of US Department of Agriculture (USDA) said that the proposed standard was unnecessary because USDA has reported subsidy costs by credit areas. The USDA CFO and several other respondents expressed their concern that the proposed display of program-by-program reconciliation would make the disclosure too lengthy and complex and thus reduce its information value to the users of general-purpose financial reports.

12. After considering the comments, the Board decided not to adopt the proposed standard. The Board concluded that SFFAS No. 2 and SFFAS No. 18 already require sufficient program information. Paragraph 32 in

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SFFAS No. 2, as amended by SFFAS No. 18, requires that entities disclose each program's interest rate re-estimates and technical/default re-estimates. More extensive disclosure is required in SFFAS No. 18. Paragraph 11(a) in SFFAS No. 18, for example, requires that entities provide a description of the characteristics of the programs that they administer. It also requires disclosure of the amount of direct or guaranteed loans disbursed for each program during the reporting year as well as each program's subsidy expense, and subsidy re-estimates. Paragraph 11(b) requires disclosure of each program's subsidy rates for direct loans and loan guarantees in the current year's cohort. Furthermore, paragraph 11(c) requires that reporting entities disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy re-estimates. The Board believes that in the process of producing the program-based information required by paragraph 11(c), an entity will naturally describe important changes in the actual performance of its credit programs; e.g., default claims paid, loans written off, etc. Thus, the Board concluded that the program-based disclosure and discussion required by the existing standards should provide sufficient information about credit activities at the program level. In addition, although the incremental cost of producing the program-based reconciliation would be quite small for most agencies, the Board believes that requiring the display of program-based reconciliation would add length and complexity to the financial reports that are already detailed and complex. As a result of these benefit and cost considerations, the Board concluded that requiring the display of a program-by-program reconciliation was not justified.

Technical Amendments

13. The Board adopted three groups of technical amendments to SFFAS No. 2. The first group affects paragraph 24 and footnotes 3, 4, 6, and 7 of SFFAS No. 2. These amendments clarify that the accounting standards are consistent with the cash flow discount method required by the Federal Credit Reform Act of 1990, as amended in July 1997.[1] As required in Section 502 (5)(E) of the Act, the amended standards require using as

[1] Office of Management and Budget (OMB) has implemented the amendment in Circular A-11, Preparation and Submission of Budget Estimates, July 1999 and in its recent release of a new credit subsidy calculator.

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the discount rate the average interest rate on Treasury securities of similar maturity to the cash flows of a direct loan or loan guarantee. None of the respondents to the ED objected to these amendments.

14. The second group of amendments affects paragraphs 30, 31, 46, 50, 57, and 59 of SFFAS No. 2. These amendments are related to interest rate re-estimates. The amendments clarify that the effective interest rate of a cohort of direct loans and loan guarantees is the interest rate adjusted by the interest rate re-estimate, as defined in paragraph 9(a), SFFAS No. 18. The adjusted rate should be used for amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure. None of the respondents to the ED objected to these amendments.

15. The third group of amendments, proposed in ED paragraphs 10(A) and 10(B), concerns the measurement of default costs discussed in paragraph 27, SFFAS No. 2. ED paragraph 10(A) addressed the default costs of direct loans. The proposed amendment in that paragraph would include the effect of short-term delinquencies in the “other costs” category, rather than the “default costs” category.

16. The USDA CFO and IG objected to the exclusion of short-term delinquencies from default costs. They said that the Commodity Credit Corporation (an USDA unit) uses the Inter-Agency Country Risk Assessment System (ICRAS) to estimate default costs. The ICRAS, used for lending to foreign countries, includes short-term delinquencies in measuring default costs. Thus, the proposed amendment would create a difference from that practice.

17. The Board understands that practices differ among lending institutions in treating delinquencies. They may or may not regard a payment delay within a certain time frame as default. The Board is of the view that the variation would not distort the measurement of credit subsidy costs, if each practice is followed consistently. In this regard, it is better that the accounting standard leaves some leeway for the agencies that are responsible for developing subsidy estimate models and methodologies. Thus, the Board deleted the words related to “delinquencies” in paragraph 8(a) of this Statement on default costs of direct loans.

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18. Paragraph 8(b) of this Statement addressed the measurement of default costs for loan guarantees. The paragraph reads as follows:

> The default cost of loan guarantees results from paying lenders' claims upon default of the guaranteed loans. The default cost of loan guarantees is measured at the present value of projected payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus projected net recoveries as defined in paragraph 10(A).

19. **T**he USDA CFO commented on the requirement for including uncollected fees and "interest supplements not paid" in measuring default costs. The USDA CFO stated that although those cash flow components are specified in the OMB credit subsidy calculator, OMB would give agencies flexibility in implementation with regard to those cash flow components. The USDA CFO pointed out that realigning those cash flow components might entail substantial changes in agencies' credit subsidy models. She also indicated problems with private lender restrictions and workload increases. She suggested that agencies be allowed flexibility to determine whether those cash flow components are to be included in default costs.

20. The Board believes the amended standard provides a sound methodology for measuring the default costs for loan guarantees. Uncollected fees are a direct result of default itself and therefore should be included in measuring the default costs. The interest supplements not paid are also a direct result of defaults. When a guaranteed loan is in default, the government pays the default claim to the lender and stops paying interest supplement for that loan. Thus, the interest supplements that are saved due to default should be subtracted from the default costs. The Board concluded that the categorization of these cash flow components should be uniform across the government so that they can be comparable among programs. However, as discussed in the following paragraph, the Board has decided to delay the implementation of the technical amendments for one year. This delay should help resolve some of the problems raised by the USDA CFO.

Effective Date

21. The proposed effective date for the technical amendments was for periods beginning after September 30, 2001, which means FY 2002. The Board realized that that the subsidy expenses to be reported for FY 2002

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would be based on the budget submission for that year. However, there would not be sufficient time to implement the amendments for the FY 2002 budget. Therefore, the Board decided to make the effective date for periods beginning after September 30, 2002, and the Board encourages earlier implementation.

Board Approval

23 This Statement was approved by the Board with a vote of eight members in approval of its issuance. One member submitted a written dissent, which is available for inspection at the FASAB office.

(Continued on next page.)

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APPENDIX B: THE ACCOUNTING STANDARDS IN SFFAS No. 2

Presented in this Appendix are the standards originally prescribed in SFFAS No. 2. The paragraphs and their numbers reproduced in this Appendix are the same as those that appear in SFFAS No. 2, and are presented here for reference purposes only. The shaded words, paragraphs, and footnotes are those that have been amended by SFFAS No. 18[2] or by this Statement.

Explanation

21. These standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The standards apply to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category.

Accounting Standards

Post-1991 Direct Loans

22. Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

Post-1991 Loan Guarantees

23. For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

24. For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term

[2] SFFAS NO. 18 amended paragraph 32 in SFFAS No. 2.

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applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

25. For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

26. The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.

27. The default cost of direct loans or loan guarantees results from any anticipated deviation, other than prepayments, by the borrowers from the payments schedule in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. Projected net recoveries include the amounts that would be collected from the borrowers at a later date or the proceeds from the sale of acquired assets minus the costs of foreclosing, managing, and selling those assets.

28. The present value of fees and other collections is recognized as a deduction from subsidy costs.

29. Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

Subsidy Amortization and Reestimation

30. The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed. The amortized amount is recognized as an increase or decrease in interest income.

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31. Interest is accrued and compounded on the liability of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed. The accrued interest is recognized as interest expense.

32. The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the reestimation should take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates should be recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required.

Criteria for Default Cost Estimates

33. The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent reestimates. Default costs are estimated and reestimated for each program on the basis of separate cohorts and risk categories. The reestimates take into account the differences in past cash flows between the projected and realized amounts and changes in other factors that can be used to predict the future cash flows of each risk category.

34. In estimating default costs, the following risk factors are considered: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; (6) newly developed events that would affect the loans' performance; and (7) improvements in methods to reestimate defaults.

35. Each credit program should use a systematic methodology, such as an econometric model, to project default costs of each risk category. If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category.

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36. Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based. To document actual experience, a database should be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Revenues and Expenses

37. Interest accrued on direct loans, including amortized interest, is recognized as interest income. Interest accrued on the liability of loan guarantees is recognized as interest expense. Interest due from Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

38. Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

Pre-1992 Direct Loans and Loan Guarantees

39. The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1992, are recognized when it is more likely than not that the direct loans will not be totally collected or that the loan guarantees will require a future cash outflow to pay default claims. The allowance of the uncollectible amounts and the liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors discussed in the previous section should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

40. Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required.

Modification of Direct Loans and Loan Guarantees

41. The term modification means a federal government action, including new legislation or administrative action, that directly or indirectly alters the

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estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

42. Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Existing contracts may be altered through such means as forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered reestimates, or workouts as defined below, or are permitted under the terms of existing contracts.

43. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection.

44. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms. Workouts are actions taken to maximize repayments of existing direct loans or minimize claims under existing loan guarantees. The expected effects of workouts on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

A. Modification of Direct Loans

45. With respect to a direct or indirect modification of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the pre-modification value[3] of the loans over their post-modification value[4]. The amount of the modification cost is recognized as a modification expense when the loans are modified.

[3] The term "pre-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[4] The term "post-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

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46. When post-1991 direct loans are modified, their existing book value is changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the original discount rate (the rate that was originally used to calculate the present value of the direct loans, when the direct loans were disbursed).

47. When pre-1992 direct loans are directly modified, they are transferred to a financing account and their book value is changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans. When pre-1992 direct loans are indirectly modified, they are kept in a liquidating account. Their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification.

48. The change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the modification adjustment transfer[5] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

B. Modification of Loan Guarantees

49. With respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification liability[6] of the loan guarantees over their

[5] OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the decrease in book value, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

[6] The term "post-modification liability" is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).

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pre-modification liability[7]. The modification cost is recognized as modification expense when the loan guarantees are modified.

50. The existing book value of the liability of modified post-1991 loan guarantees is changed to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (the rate that was originally used to calculate the present value of the liability when the guaranteed loans were disbursed).

51. When pre-1992 loan guarantees are directly modified, they are transferred to a financing account and the existing book value of the liability of the modified loan guarantees is changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. When pre-1992 direct loan guarantees are indirectly modified, they are kept in a liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification.

52. The change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. The difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer[8] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

C. Sale of Loans

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[7] The term "pre-modification liability" is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[8] OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the increase in liability, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

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53. The sale of post-1991 and pre-1992 direct loans is a direct modification. The cost of modification is determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.

54. For a loan sale with recourse, potential losses under the recourse or guarantee obligations are estimated, and the present value of the estimated losses from the recourse is recognized as subsidy expense when the sale is made and as a loan guarantee liability.

55. The book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[9] For sales of post-1991 direct loans, the modification adjustment transfer[10] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

D. Disclosure

56. Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or lose related to the modification.

Foreclosure of Post-1991 Direct and Guaranteed Loans

57. When property is transferred from borrowers to a federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

[9] If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.

[10] See footnote No. 7 for an explanation for "modification adjustment transfer".

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58. If a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the estimated amount of the claim is recognized as a special contra valuation allowance.

59. At a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted at the original discount rate.

60. When assets are acquired in full or partial settlement of post-1991 direct loans or guaranteed loans, the present value of the government's claim against the borrowers is reduced by the amount settled as a result of the foreclosure.

Write-off of Direct Loans

61. When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

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Robert N. Reid
Nelson Toye
Kenneth J. Winter

*Term expired in December 2000.

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:
Richard Mayo
Lucy Lomax

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.financenet.gov/fasab.htm

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Federal Accounting Standards Advisory Board

ELIMINATION OF CERTAIN DISCLOSURES RELATED TO TAX REVENUE TRANSACTIONS BY THE INTERNAL REVENUE SERVICE, CUSTOMS, AND OTHERS

Amending SFFAS 7
Accounting for Revenue and Other Financing Sources

Statement of Federal Financial Accounting Standards No. 20

September 2001

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended October 1, 1999.*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.financenet.gov/fasab.htm

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EXECUTIVE SUMMARY

a. Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, became effective in fiscal year 1998 and included detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. The two entities collecting the vast majority of federal taxes are the Internal Revenue Service (IRS) and the U.S. Customs Service (Customs).

b. The Board is issuing this standard to rescind paragraph 65.2 of SFFAS 7. Absent very detailed explanations, the provisions of paragraph 65.2 could result in information being given to readers of the financial statements that they might misinterpret. The Board believes that paragraph 65.2 would not accomplish what it purports to accomplish, and would impose costs unnecessarily on both the preparer and auditor without a significant benefit. The Board's reasoning is explained more fully in Appendix A, Basis for Conclusions.

c. This amendment is effective for periods beginning after September 30, 2000.

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TABLE OF CONTENTS

Section	Page No.
Executive Summary	i
Introduction	1
Accounting Standards	2
Appendix A: Basis for Conclusions	3
Appendix B: SFFAS 7, Paragraph 65.2	10

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_20.pdf.

INTRODUCTION

PURPOSE

1. This standard rescinds paragraph 65.2 of Statement of Federal Financial Accounting Standards (SFFAS) 7 and makes other conforming changes.

BACKGROUND

2. SFFAS 7 became effective in fiscal year 1998 and included, along with other provisions, detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. Paragraph 65.2 of that standard required disclosure of "revenue-related transactions affecting the beginning and end-of-period balances of accounts receivables, accounts payable for refunds, and the allowance for uncollectible amounts."

3. Subsequent to the issuance of the standard questions arose as to the usefulness of the information as well as to the practicality of producing it. After discussing the issues and options, the Board issued, in November 1998, an exposure draft of a standard rescinding paragraph 65.2. Ultimately, the Board agreed that more study was needed, and in January 1999 it deferred the effective date of paragraph 65.2 until October 1, 2000 (SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures)*.

4. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7.* Based on comments received and further consideration, the Board is now rescinding paragraph 65.2.

EFFECTIVE DATE

5. This amendment is effective for periods beginning after September 30, 2000.

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ACCOUNTING STANDARD

6. Paragraph 65.2 of SFFAS 7 is repealed and rescinded.

7. Other conforming changes:

   a. The last sentence of paragraph 107 of SFFAS 7 is changed to delete "65.2 and" from the parenthesis.
   b. The last sentence of footnote 41, paragraph 187.1 of SFFAS 7 is changed to delete "in its disclosures required by para. 65.2".

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APPENDIX A: BASIS FOR CONCLUSIONS

8. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

9. The Board issued an exposure draft in November 1998 proposing to rescind paragraph 65.2. Comments were received during a minimal comment period that ended December 12, 1998. In January 1999, the Board deferred the effective date of paragraph 65.2, SFFAS 7, until October 1, 2000.[1]

10. In December 1998, the Board agreed that further study was needed regarding the relevance of the information discussed in paragraph 65.2. Additionally, the Board was concerned about the relatively short exposure period (approximately 30 days) for the ED. The Board decided to defer the effective date for implementing paragraph 65.2 and revisit the issue of eliminating the requirement at a later date.

11. Following the decision to defer the disclosure requirement, the Board did not take up research on the issue immediately. In December 1999, the Board reviewed its agenda and weighed whether it should devote scarce resources to this issue or simply allow the provisions of paragraph 65.2 to take effect for fiscal year 2001 financial statements. To assist in making this decision, the Board sent a letter to the Internal Revenue Service (IRS) asking what additional information might be available to aid the Board in considering the issue.

12. The IRS responded with additional information based on its two additional reporting years' experience with SFFAS 7 requirements. In addition, the IRS provided a briefing to the Board regarding its collections process and systems modernization. The IRS renewed the request that the Board rescind the provisions of paragraph 65.2. Its auditor, the General Accounting Office, supported this rescission.

13. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7*, that proposed to eliminate paragraph 65.2. Because of the interest in the relevance of this information, the Board mailed copies to potential users, for example,

[1] SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures, Amending SFFAS 7* Accounting for Revenue and Other Financing Transactions, January 1999.

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Congresspersons and staff directors of key committees. The Board received comment letters on the exposure draft from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others		2
Auditors	2	1
Preparers and financial managers	4	

Responses to the Exposure Draft

14. The respondents were closely divided with the majority supporting the proposed elimination of paragraph 65.2. It is important to note that the Board did not rely on the number in favor or opposed to a given position. Information about the majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The Board summarizes the respondents' arguments below.

Respondents Supporting the ED

15. Several respondents stated that paragraph 65.2 disclosures would not be useful, and could be misleading, to general purpose readers. A respondent stated that any attempt to reconcile the elements required by paragraph 65.2 could be misleading due to timing differences between assessments and collections and the definitions of revenue receipts and taxes receivable.

16. Some respondents said that the IRS currently provides sufficient detailed information about federal tax revenues, unpaid assessments, and refunds in its annual financial report through footnote disclosures, supplementary information and in its management's discussion and analysis (MD&A). Other respondents said that the disclosure requirements of paragraph 65.2 far exceed what should be required in general purpose financial statements. Another respondent concurring with the elimination of paragraph 65.2 stated that FASAB clearly documented its case in the ED's basis for conclusions.

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Respondents Opposing the ED

17. Other respondents had a different view. One respondent stated that the disclosure in SFFAS 7 was intended to overcome some of the practical limitations of the tax collection system and make the tax revenue recognition closer to what would be reported with fuller accrual accounting. He submitted that the information required in paragraph 65.2 is relevant and useful in assessing the efficiency and effectiveness of the tax system, not merely the administrative practices, and can be explained satisfactorily so as not to be misleading.

18. Several respondents stated that insufficient evidence has been offered regarding the lack of relevance and understandability of the information to warrant eliminating the paragraph 65.2 disclosures, and doing so would weaken SFFAS 7. These respondents recommended extending the deferral period for the standard, further research, and a hearing, as necessary, prior to the issuance of a final standard. One respondent stated that the ED did not convincingly explain why the information called for in paragraph 65.2 is so complex that it could not be clearly explained. The respondent stated that SFFAC 1, par. 158, provides that general purpose financial reports should not exclude essential information merely because it is difficult to understand or because some report users choose not to use it.

The Board's Discussion

19. In conjunction with re-deliberating the issues presented in the exposure draft and carefully considering the respondents' comments, the Board notes that SFFAS 7 represents a major accomplishment in establishing federal accounting standards. SFFAS 7 presents standards for classifying, recognizing, and measuring resource inflows as well as concepts for financial reporting and makes other significant contributions. Many provisions of that statement are now fundamental to federal accounting. However, the Board believes that paragraph 65.2 of SFFAS 7 is flawed because the information required therein might be misinterpreted, would not accomplish what it purports to accomplish, and would be difficult to produce.

Information that Could Be Misinterpreted

20. Paragraph 65.2 requires disclosure of information about the beginning and ending balances of accounts receivable and related accounts, as well as material types of revenue transactions that relate to the collecting entity's custodial responsibilities. The minimum information required would include

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"assessments by the entity," "penalties," "interest," and "abatements." In the two exposure drafts on this issue (November 1998 and November 2000) the Board has discussed the complexity of the assessment and abatement process. The Board has discussed the various IRS-initiated tax collection actions, including compliance assessments; the enforcement work-in-process status of the assessment database; the possible timing difference between the period to which the tax relates, the eventual assessment of the tax and penalties and interest, and the final collection or abatement of the assessment; and other complicating factors. Many assessments, penalties, and interest are made for enforcement purposes, are often overstated due to incomplete information, and are subject to change based on receipt of additional information from the taxpayer. Thus, they do not always precede a receivable[2] in an accounting sense. The Board believes that the user could misinterpret assessment reporting because increases or decreases in assessments do not lead necessarily to increases or decreases in receivables or revenue. Further, developing meaningful categories of assessments that would permit a user to analyze whether enforcement assessments are likely to lead to revenues would not be cost-beneficial when one considers the remaining reporting required under SFFAS 7 as amended.

21. The Board also has discussed the complications of the abatement process. Abatement is a reduction or cancellation of an assessed tax. Abatements are made for myriad reasons and in some cases there is no correlation between the original assessment and the final reason for the abatement. For example, taxpayers can carry back losses to prior years and reduce prior year taxes that were correctly assessed by the IRS. Such reductions are classified as abatements but are not the same as abatements where the tax assessment itself was in error.

22. Moreover, taxpayers also file amended returns that can require abatement of the original amount they reported, including taxpayer requests to abate particular types of penalty assessments due to reasonable causes. For example, during 1998 a new law required the IRS to disallow certain dependents and credits claimed if the taxpayer did not include a social security number for a dependent child or a taxpayer identification number for a child-care provider. In each case the IRS posted an assessment, accrued penalties and interest pending provision of the information, and subsequently abated the assessment when the taxpayer provided the required verification. This change in law increased the total assessments, interest, penalties, and

[2] Per SFFAS 7, paragraph 53, accounts receivable should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment process to the extent the amount is measurable.

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abatements to enforce a reporting requirement rather than to collect additional tax revenue. One could be misled since both assessments and abatements were "overstated" in the sense that it was anticipated at the time of assessment that, in the majority of cases, the assessment would be abated.

23. There are many different reasons for abatements with varying transactions potentially covering 10 years of assessments, each affecting the balances to be disclosed under paragraph 65.2. The Board believes that reporting on total assessments, including penalties and interest thereon, and abatements could be misinterpreted in the context of disclosures purporting to be transactions affecting the beginning and ending balances of accounts receivable and related accounts. Moreover, the Board believes that attempts to reconcile the elements required in paragraph 65.2 could be misinterpreted due to timing differences between assessments and collections and the definitions of revenue receipts and taxes receivable.

24. The Board concludes that the paragraph 65.2 information is not relevant for reconciling the beginning and ending balances of accounts receivable and related accounts, which paragraph 65.2 purports to do. Some of the required information is beyond the scope of those accounts since activity does not result in or relate to revenue or receivables, precedes the recognition of taxes receivable, or relates solely to tax administration or enforcement.

25. When considering whether to retain paragraph 65.2, the Board considered the materiality of taxes receivable. The IRS' taxes receivable are not large in relation to annual tax revenue. For FY2000, approximately $20 billion in IRS receivables represent three days of collections.

Other Information Required

26. The Board calls attention to other SFFAS 7 paragraphs and to other FASAB standards that require disclosures and supplemental information that the Board believes accomplish the objectives of SFFAS 7 as stated in paragraph 187.1 and elsewhere. Paragraph 65.1 requires disclosure of factors affecting collectability and timing of categories of accounts receivable and the amounts involved. Paragraph 65.3 requires disclosure of cumulative cash collections and refunds by tax year and tax type. Paragraph 67 requires supplemental information about the estimated realizable value of compliance assessments and pre-assessment work-in-process; about other claims for tax refunds that are not yet accrued but are likely to be accrued when administrative actions are completed; and, about the amount of assessments that the entity still has statutory authority to collect but that have been written off and thus excluded

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from accounts receivable. SFFAS 15, *Management's Discussion and Analysis*, requires discussion, among other things, of performance goals, objectives, results, systems, controls, and legal compliance.

Conclusion

27. The Board actively sought comments from potential users. In addition to the FASAB distribution list, the Board sent the ED to all those who had commented on the prior ED of November 1998 and to potential decision-makers, including especially House and Senate committees and sub-committees. Also, in setting February 16, 2001, as the cut-off date for comments, the Board provided an extended period for respondents to submit comments. Despite the Board's efforts to reach users the response to the ED did not demonstrate a demand from users to have the information. Only one respondent said the information was useful and necessary. Other respondents who oppose eliminating paragraph 65.2 at this time said that the Board did not offer enough evidence regarding relevance and understandability to warrant eliminating paragraph 65.2, not that they themselves found it useful or relevant and for what purposes. Due to the cost of the information, the availability of other information on this topic, the requests from the preparer and auditor communities, and lack of a response from users of the information, the Board does not believe the paragraph should be retained.

28. The Board believes that sufficient evidence has been produced to conclude that the information required by paragraph 65.2 could be misinterpreted by users of general purpose financial statements and that it does not accomplish what it purports to accomplish. The Board does not exclude essential information merely because it is difficult to understand or because some report users choose not to use it. In this instance, however, the complexity of the tax collection process in conjunction with the context of accounts receivable reconciliation renders paragraph 65.2 defective and, therefore, not relevant. The objective of SFFAS 7 is to tell users what is happening at the tax collection entities, and the Board believes the standard is achieving this objective without paragraph 65.2, and that paragraph 65.2 could in fact be misinterpreted. This amendment of SFFAS 7 is limited to the problem of disclosures in paragraph 65.2 being misinterpreted.

Vote for Approval

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29. The amendment of SFFAS 7 prescribed in this statement is approved by a vote of seven members in favor and one member dissenting (only eight members voted due to a vacancy on the Board). The dissent is available for review at the FASAB offices.

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APPENDIX B: Paragraph 65 of SFFAS 7

65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

65.1 Accounts **receivable.** Factors affecting collectibility and timing of categories of accounts receivable and the amounts involved.

65.2 Material **revenue-related transactions.** Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.

65.3 Cumulative **cash collections and refunds by tax year and type of tax.** Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes.

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FASAB Board Members

David Mosso, Chairman

Barry Anderson
Philip T. Calder
Joseph L. Kull
James M. Patton
Robert N. Reid
Nelson Toye
Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:
Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

□□□

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FASAB
Federal Accounting Standards Advisory Board

U.S. General Accounting Office
441 G Street, NW, Suite 3B18
Washington, DC 20548

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Federal Accounting Standards Advisory Board

Reporting Corrections of Errors and Changes in Accounting Principles

Amending SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*

Statement of Federal Financial Accounting Standards No. 21

October 2001

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended October 1, 1999.*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814

Mailstop 6K17V

Washington, DC 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.financenet.gov/fasab.htm

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EXECUTIVE SUMMARY

I. This Statement amends the standard on Prior Period Adjustments contained in Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources* (SFFAS No. 7), which was issued in April 1996.

II. Paragraph 76 of SFFAS No. 7, entitled Prior Period Adjustments, addresses accounting changes and errors that affect prior period financial statements. It does not permit reporting entities, when presenting prior period financial statements for comparative purposes, to restate prior period financial statements to show the effect of the accounting errors.

III. The unforeseen result is that reporting entities that have material errors in their prior period financial statements are unable to present them for comparative purposes without creating both a dilemma for auditors and confusion for users. The dilemma for the auditors is that they would have to qualify their opinion on the prior period financial statements whether or not they had been restated. If prior period statements were presented that contained a material error, auditors would have to qualify their opinion. On the other hand, if prior period statements were presented and balances had been corrected for an error, auditors would still have to qualify their opinion because such restatement would not be in accordance with the existing standard. The confusion for the user derives from the difficulty inherent in comparing the financial statements for two or more periods when the effect of the error is not shown in the prior periods' financial statements.

IV. To correct this situation, the amendment requires that when material errors are discovered in prior period financial statements, all statements presented must be restated to correct the error.

V. The Board has retained the current requirement that prior period financial statements not be restated for changes in accounting principles, unless otherwise specified in the transition instructions section of a new FASAB

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standard. The language addressing the requirements, however, has been revised to improve clarity and to require certain disclosures.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY……..1

INTRODUCTION……..…….4

ACCOUNTING STANDARD……..……..6

APPENDIX A: BASIS FOR CONCLUSIONS……..…..……..…...8

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INTRODUCTION

1. Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources,* became effective for fiscal year 1998. It includes a section describing how reporting entities should handle prior period adjustments.

2. The Section on Prior Period Adjustments states:

> 76. Prior period adjustments should be limited to corrections of errors and accounting changes with retroactive effect, including those occasioned by the adoption of new federal financial accounting standards, and should be recognized and measured under applicable standards. Adjustments should be recognized as a change in cumulative results of operations (rather than as an element of net results of operations for the period). Prior period financial statements should not be restated for prior period adjustments recognized in the current period.

3. When SFFAS No. 7 was issued, the Board believed that having reporting entities restate prior period financial statements for prior period adjustments would create an unnecessary burden at a time when FASAB was still establishing a basic framework of standards.

4. However, disallowing restatement of prior period financial statements has had the effect of preventing reporting entities from presenting comparative financial statements when the prior period financial statements contain a material error that is discovered in the current period.

5. The Board has amended the standard to require that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period.

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6. The Board has chosen to retain the current methodology that prior period financial statements not be restated for changes in accounting principles, unless otherwise specified in the transition instructions section of a new FASAB standard. The language addressing the requirements, however, has been revised to improve clarity and to require certain disclosures.

7. The language in the standard has also been revised to distinguish between corrections of errors and changes in accounting principles. A change in accounting principle should be identified as such and no longer reported as a prior period adjustment.

Effective Date

8. This amendment would be effective for periods beginning after September 30, 2001, with earlier implementation encouraged.

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ACCOUNTING STANDARD

9. Paragraph 76 of SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, Section Prior Period Adjustments, is superceded and replaced by Paragraphs 10 through 14 below.

Corrections of Errors

10. "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared."[1] When errors are discovered after the issuance of financial statements, and if the financial statements would be materially misstated absent correction of the errors, corrections should be made as follows:

    (a) If only the current period statements are presented, then the cumulative effect of correcting the error should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position.

    (b) If comparative financial statements are presented, then the error should be corrected in the earliest affected period presented by correcting any individual amounts on the financial statements. If the earliest period presented is not the period in which the error occurred and the cumulative effect is attributable to prior periods, then the cumulative effect should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position for the earliest period presented.

    (c) The nature of an error in previously issued financial statements and the effect of its correction on relevant balances should be disclosed.

[1] Accounting Principles Board Opinion No. 20, par. 13.

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Financial statements of subsequent periods need not repeat the disclosures.

11. Prior period financial statements should only be restated for corrections of errors that would have caused any statements presented to be materially misstated.

Changes in Accounting Principles

12. A change in accounting principle is a change from one generally accepted accounting principle to another one that can be justified as preferable. For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards.

13. Unless otherwise specified in the transition instructions section of a new FASAB standard, for all changes in accounting principles that would have resulted in a change to prior period financial statements:

    (a) The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.

    (b) Prior period financial statements presented for comparative purposes should be presented as previously reported; and

    (c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure.

The provisions of this statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

14. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

15. The Board received sixteen responses to the ED. All but one respondent were in support of the amendment. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondent's majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondent's comments are summarized below.

	Federal	Non-federal
Users, academics, others		2
Auditors	2	
Preparers and financial managers	12	

16. Seven respondents approved the amendment without further comment. Four approved the amendment but requested clarifying language, which has been incorporated into the standard. Two approved the amendment but would have preferred that the standard allow restatement for changes in accounting principles.

17. One respondent disapproved of the amendment because they believe the amendment will create additional confusion regarding the closing of prior period accounts and the subsequent issuance of financial statements.

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Corrections of Errors

18. When SFFAS No. 7 was issued, the Board believed that having reporting entities restate prior period financial statements for prior period adjustments would create an unnecessary burden at a time when FASAB was still establishing a basic framework of standards. Changes in the federal accounting environment in the ensuing years have lessened these concerns. With the government's increasing ability to produce accurate and sophisticated financial statements, the Board is more concerned with encouraging reporting entities to produce financial statements that are most useful to managers and other users.

19. Although comparative financial statements are not required by any of the accounting standards setting boards, it is generally held that "the presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise."[2]

20. Reporting entities also recognize that presenting comparative statements greatly enhances the overall usefulness of financial statements. Despite the advantages of providing comparative statements, however, at least one governmental entity has been constrained from presenting its prior year statements because they contain a material error.

21. The Board has deliberated on the effects of the existing standard precluding restatement to correct errors on presentation of comparative financial statements. Although it believes that the considerations in effect at the time the existing standard was issued were valid, it has concluded that potentially losing or delaying the benefit of comparative statements now outweighs these considerations.

22. The Board concluded that the standard for Prior Period Adjustments should be amended to specifically require that prior period financial statements presented for comparative purposes be restated to correct material errors, and that restatement should be limited to only material errors.

[2] Accounting Research Bulletin 43, Chapter 2A, paragraph 101.

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Changes in Accounting Principles

23. Although the Board has chosen to retain the current methodology for reporting changes in accounting principle, it has revised the language to improve clarity and to require certain disclosures. The Board may consider exceptions to this decision, if warranted, for accounting standards issued in the future. It may also further examine issues raised by respondents regarding changes in accounting principles.

Other Accounting Changes

24. Although accounting estimates and changes in reporting entity are identified as accounting changes in other accounting literature, the Board did not address these issues because they require further study and were not addressed in paragraph 76 of SFFAS No. 7.

Board Approval

25. This statement was approved by unanimous vote of the Board.

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FASAB Board Members

David Mosso, Chairman

Barry B. Anderson

Philip T. Calder

John A. Farrell

Joseph L. Kull

James M. Patton

Robert N. Reid

Nelson E. Toye

Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:

Andrea Palmer

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366

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Federal Accounting Standards Advisory Board

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Federal Accounting Standards Advisory Board

Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations

Amendment of SFFAS 7, *Accounting for Revenue and Other Financing Sources*

Statement of Federal Financial Accounting Standards No. 22

October 2001

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
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EXECUTIVE SUMMARY

a. Statement of Federal Financial Accounting Standards (SFFAS 7) 7, *Accounting for Revenue and Other Financing Sources*, requires a reconciliation of budgetary and financial accounting information. The reconciliation explains the relationship between budgetary resources obligated by the entity during the period and the net cost of operations as derived from the entity's proprietary accounting system.

b. This standard amends SFFAS 7 by deleting a requirement regarding an element of the reconciliation. SFFAS 7, paragraph 80, requires increases and decreases in receivables from the public related to exchange revenue to be reported as a nonbudgetary resource. This standard deletes this requirement and makes other necessary conforming changes.

c. The effect of this change is that the location of this reconciling item is no longer specified by the standard.

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TABLE OF CONTENTS

Section	Page No.
Executive Summary	i
Introduction	1
Accounting Standards	2
Appendix A: Basis for Conclusions	3
Appendix B: SFFAS 7, Paragraphs 80 and 97	5

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_22.pdf.

INTRODUCTION

1. Statement of Federal Financial Accounting Standards (SFFAS 7) 7, *Accounting for Revenue and Other Financing Sources*, paragraphs 80-82, requires a reconciliation explaining the relationship between budgetary obligations incurred by the entity during the period and the net cost of operations. Paragraphs 95-102 in the concepts section of SFFAS 7 presents the statement of financing (SOF) as the vehicle for reporting the reconciliation.

2. Paragraph 80, SFFAS 7, requires, among other things, increases and decreases in receivables from the public related to exchange revenue to be reported as nonbudgetary resources. The Board is deleting, by means of this amendment, the sentence in paragraph 80 that requires such reporting, and making other conforming changes.

3. The effect of this change is that the location of this reconciling item in the statement of financing is no longer specified by the standard.

Materiality

4. The provisions of this accounting standard need not be applied to immaterial items.

Effective Date

5. This amendment is effective for periods beginning after September 30, 2000.

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ACCOUNTING STANDARD

Changes for SFFAS 7

6. SFFAS 7 is amended as follows:

Delete the following sentence from paragraph 80:

> Further, it should include decreases (increases) in receivables from the public related to exchange revenue when only the cash amount is included in budgetary resources.

Other conforming changes:

- Delete the following sentence from paragraph 97:

  > This amount would also include decreases (increases) in receivables related to revenue accrued from the public because, while the cash collected for exchange revenue is a budgetary resource, the accrual amount is not.

- Delete the following line item from Appendix 1-G, Example Financial Statements Formats, Statement of Financing

  > Exchange revenue not in the budget

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APPENDIX A: BASIS FOR CONCLUSIONS

7. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

8. As stated in previous sections, the Statement of Federal Financial Accounting Standards (SFFAS 7) 7, *Accounting for Revenue and other Financing Sources*, requires budgetary obligations incurred by the entity to be reconciled with the entity's net cost of operations.[1] The concept section of SFFAS 7 presents the statement of financing (SOF) as the vehicle for reporting the reconciliation.[2] A primary objective of the Board in creating the SOF is that readers of the financial statements are able to understand the difference between obligations, as reported in the budget, and the net cost of operations as reported in the statement of net cost.[3]

9. The Board issued an exposure draft in April 2001 proposing to delete the requirement in SFFAS 7, paragraph 80, that "decreases (increases) in receivables from the public related to exchange revenue" be reported as a nonbudgetary resource on the SOF. There are instances where reporting the change in "receivables from the public related to exchange revenue" as a resource, as is currently required by SFFAS 7, may be inappropriate. This amended standard would permit flexibility.

10. The effect of this change is that the location of this reconciling item in the statement of financing is no longer specified by the standard.

Respondents' Comments

11. The respondents' comments are summarized below. The Board does not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considers the arguments in each response and weighs the merits of the points raised.

[1] SFFAS 7, paragraphs 80-82.
[2] SFFAS 7, paragraphs 95-102. See the *Implementation Guide to Statement of Federal Financial Accounting Standards No. 7,* Accounting for Revenue and Other Financing Sources, pars. 72-95 for a discussion and illustrations of the statement of financing.
[3] *Implementation Guide for SFFAS* 7, par. 72.

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	Federal	Non-federal
Users, academics, others	1	3
Auditors	2	1
Preparers and financial managers	7	

12. Nine respondents either said they agreed with or had no objection to the amendment. One respondent agreed with the change but disagreed with the decision to issue the standard allowing flexibility. Four respondents reviewed the exposure draft but chose not to comment or offered a comment beyond the scope of the issue addressed by the exposure draft. Respondents made the following individual comments:

a) placement of the line item should be made mandatory now, rather than allowing flexibility
b) optional presentations reduce understandability
c) adding a brief discussion of the alternative presentations to the basis for conclusions would make the amendment more understandable
d) a reference to the discussion of the SOF in the FASAB's *Implementation Guide to SFFAS 7* (April 1996) would be helpful
e) the SOF is useful; encourage further improvements
f) the title of the SOF should include the word "reconciliation"
g) consider making the SOF supplementary information
h) users would use either budgetary or accrual information, not both, so a reconciliation of obligations and net costs as in the SOF is not useful

Conclusion

13. In light of the comments received from respondents, the Board believes there is support for proceeding with this amendment. The Board considered the comments from several respondents that the basis for conclusions contain a brief discussion of alternative SOF presentations, but continues to believe that such a discussion must be postponed until a fuller review of the statement of financing is undertaken. The SOF is complex, and the narrative and illustrations necessary to present a full discussion of and rationale for the alternatives should be undertaken during a comprehensive updating of the implementation guidance.

Vote for Approval

14. All members of the Board approved this statement.

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APPENDIX B: Paragraphs 80 and 97 of SFFAS 7

The current paragraphs are as follows:

80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different, causing differences in the basis of accounting. To better understand these differences, a reconciliation should explain the relationship between budgetary resources obligated by the entity during the period and the net cost of operations. It should reference the reported "obligations incurred" and related adjustments as defined by OMB Circular A-34. It also should include other financing sources not included in "obligations incurred" such as imputed financing, transfers of assets, and donations of assets not included in budget receipts. Further, it should include decreases (increases) in receivables from the public related to exchange revenue when only the cash amount is included in budgetary resources. The total of these items comprises obligations and nonbudgetary resources.

97. **Nonbudgetary resources** represent the net amount of resources received by the entity that are not included in budgetary resources. These items could include donations of assets, transfers of assets from (to) other federal entities, and financing imputed for cost subsidies. This amount would also include decreases (increases) in receivables related to revenue accrued from the public because, while the cash collected for exchange revenue is a budgetary resource, the accrual amount is not.

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FASAB Board Members

David Mosso, Chairman

Barry Anderson
Philip T. Calder
John A. Farrell
Joseph L. Kull
James M. Patton
Robert N. Reid
Nelson Toye
Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:
Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366

□□□

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FASAB
Federal Accounting Standards Advisory Board

U.S. General Accounting Office
441 G Street, NW, Suite 3B18
Washington, DC 20548

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Federal Accounting Standards Advisory Board

Eliminating the Category National Defense Property, Plant, and Equipment

Rescinding SFFAS No. 11*, Amendments to Property, Plant, and Equipment -- Definitional Changes*
Amending SFFAS No. 8, *Supplementary Stewardship Reporting*
Amending SFFAS No. 6, *Accounting for Property, Plant, and Equipment*

Statement of Federal Financial Accounting Standards No. 23

May 2003

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended January 11, 2002.*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814

Mailstop 6K17V

Washington, DC 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov

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EXECUTIVE SUMMARY

I. Prior to this amendment, the acquisition costs for items classified as national defense (ND) property, plant, and equipment (PP&E) were expensed in the period incurred. In addition, valuation (using either an historical or latest acquisition cost valuation method), condition, and deferred maintenance information for these items was to be presented off-balance sheet.

II. The amendments in this Statement make the following changes. The term “ND PP&E” is rescinded. All items previously considered ND PP&E are classified as general PP&E. Accordingly, the cost of these items should be capitalized and, with the exception of the cost of land and land improvements that produce permanent benefits, depreciated. This Statement also notes that all entities are permitted to use the composite or group depreciation methodology to calculate depreciation.

III. The amendments in this Statement take effect for accounting periods beginning after September 30, 2002.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_23.pdf.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION 1

Background 1

Summary of Amendments 2

Effective Date 3

ACCOUNTING STANDARDS 5

Amendments to Existing Standards 5

Implementation Guidance 6

APPENDIX A: BASIS FOR CONCLUSIONS 9

Introduction 9

Background 9

February 1998 ED 12

September 2001 ED 13

March 2002 ED 14

Concerns with March 2002 ED 17

Valuation and Consumption 17

Contractor Costs 19

Effective Date 20

Board Approval 20

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_23.pdf.

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INTRODUCTION

1. The purpose of this Statement is to amend certain standards with regard to national defense (ND) property, plant, and equipment (PP&E). The standards being amended are contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 11, *Amendments to Accounting for Property, Plant, and Equipment -- Definitional Changes* (December 1998); SFFAS No. 8, *Supplementary Stewardship Reporting* (June 1996); and, SFFAS No. 6, *Accounting for Property, Plant, and Equipment* (November 1995).

Background

2. Pursuant to SFFAS No. 6, costs to acquire, replace or improve ND PP&E[1] were recognized[2] as an expense in the period incurred. Consistent with the treatment of the acquisition cost of ND PP&E, SFFAS No. 6 also required that the total estimated cleanup cost be recognized as an expense and a liability established in the period the ND PP&E item is placed in service. A further requirement of SFFAS No. 6, as amended by SFFAS No. 14, is that deferred maintenance amounts be presented as Required Supplementary Information (RSI).[3]

3. The Supplementary Stewardship Reporting standards in SFFAS No. 8 required presenting a valuation of ND PP&E. The following values were to be presented:

   a. a beginning value balance for ND PP&E;

[1] Originally, ND PP&E was defined in SFFAS No. 6 as Federal mission PP&E. Subsequent to the issuance of SFFAS No. 6, many agencies suggested that the Federal mission PP&E category would be appropriate for agency PP&E not considered by the Board in developing the category. To prevent confusion, inconsistency, and unintended application, the Board replaced the definition of Federal mission PP&E with the definition of ND PP&E currently contained in SFFAS No. 11 to clarify that only DoD and the Maritime Administration's National Defense Reserve Fleet PP&E would be categorized as ND PP&E.

[2] "Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.

[3] This amendment does not change any requirements for deferred maintenance.

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b. the dollar values for ND PP&E acquired during the reporting period;

c. the dollar values for ND PP&E withdrawn during the reporting period;

d. the increase or decrease in values resulting from revaluation of assets using the latest acquisition cost (LAC); and,

e. the end-of-year values by major type or category of ND PP&E.

The values were to have been determined using either an historical or LAC valuation method.

4. In addition to the values, condition information was required. The valuation and condition information was presented as Required Supplementary Stewardship Information (RSSI) – that is, outside of the principal financial statements.

5. Current Board members acknowledge that the stewardship approach was adopted, not as a convenience or temporizing expedient, but as a technically desirable approach. However, an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of the Government Performance and Results (GPRA) Act, combined with the Board's and Department of Defense's (DoD) extensive study and greater understanding about National Defense PP&E, provide a clear indication that the operating performance objective is relevant for ND PP&E. Accordingly, the Board rescinds SFFAS No. 11 and amends SFFAS Nos. 6 and 8.

Summary of Amendments

6. The amendments in this Statement:

a. Rescind the term "ND PP&E" and its definition ;

b. Classify all assets previously considered to be ND PP&E as general PP&E and, the provisions for general PP&E and associated cleanup costs for general PP&E contained in SFFAS No. 6, as amended, are to be applied; and,

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c. Continue to permit the composite or group depreciation methodology to depreciate general PP&E.

Effective Date

7. This Statement is effective for accounting periods beginning after September 30, 2002, with earlier implementation encouraged.

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ACCOUNTING STANDARDS

Amendments to Existing Standards

8. The amendments to accounting standards for assets previously identified as national defense (ND) property, plant, and equipment (PP&E) and implementation guidance are presented in paragraphs 9 through 18 that follow.

9. The amendments affect existing standards, for periods beginning after September 30, 2002 or upon early implementation of this Statement, in the following manner:

   a. SFFAS No. 11 is rescinded in its entirety;

   b. The prefatory box preceding paragraph 52 of SFFAS No. 8 is rescinded;

   c. Paragraphs 52 through 70 of SFFAS No. 8 are rescinded;

   d. Paragraph 21 of SFFAS No. 6 is amended by rescinding the category name "Federal mission property, plant, and equipment;"

   e. Paragraphs 46 through 56 of SFFAS No. 6 and the accompanying heading "Federal mission property, plant, and equipment;" which precedes these paragraphs, are rescinded;

   f. SFFAS No. 6 is amended by adding the following sentence to paragraph 35 as a separate bulleted line item:

      - A composite or group depreciation methodology[4], whereby the costs of PP&E are allocated using the same allocation rate, is permissible.

[4] The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

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Implementation Guidance

Initial Capitalization

10. The initial capitalization amount for assets previously considered ND PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6, as amended, and should be the initial historical cost for the items, including any major improvements or modifications.

11. This standard recognizes that determining initial historical cost may not be practical for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate.

12. If obtaining initial historical cost is not practical, estimated historical cost may be used. Other information such as but not limited to budget, appropriation, or engineering documents and other reports reflecting amounts expended may be used as the basis for estimating historical cost.

13. Alternatively, estimates of historical cost may be derived by estimating the current replacement costs of similar items and deflating those costs, through the use of price-level indexes, to the acquisition year or estimated acquisition year if the actual year is unknown. Other reasonable approaches for estimating historical cost may also be utilized. For example, latest acquisition cost may be substituted for current replacement cost in some situations.

14. A contra asset account--accumulated depreciation--for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS No. 6, as amended.

15. For military equipment that is in service upon implementation of this standard, cleanup cost liabilities should be adjusted, as needed.[5]

[5] Under the provisions of SFFAS No. 6, paragraph 97, a portion of the estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation and a liability accumulated over time as expense is recognized. This adjustment may be needed because the DoD may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS No. 6, as amended.

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Adjustment to Cumulative Results of Operations

16. The cumulative effect of adopting this accounting standard should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position, for the period the change is made.

17. Prior year financial statements presented for comparative purposes should be presented as previously reported.

18. The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosures.[6]

The provisions of this statement need not be applied to immaterial items

[6] SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles,* paragraphs 12 and 13.

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APPENDIX A: BASIS FOR CONCLUSIONS

19. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Introduction

20. The Board issued an exposure draft (ED), *Eliminating the Category National Defense Property, Plant, and Equipment*, to rescind SFFAS No. 11, *Amendments to Property, Plant, and Equipment -- Definitional Changes* and to amend SFFAS No. 8, *Supplementary Stewardship Reporting* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment* in March of 2002. Twenty comment letters were received during a comment period that ended May 20, 2002. The majority of respondents supported the proposals presented in the ED. Concerns raised by the respondents dealt mostly with providing additional guidance for the valuation and consumption of items. Two other concerns dealt with the impact of the Statement on contractor costs and the effective date of the Statement. Background information pertaining to the development of this Statement and discussions on the concerns raised by respondents are addressed in the following paragraphs.

Background

21. The Federal Accounting Standards Advisory Board (FASAB) has studied accounting and reporting approaches for Property, Plant, and Equipment (PP&E) for a number of years. FASAB's initial standards for PP&E began with the development of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and followed with SFFAS No. 8, *Supplementary Stewardship Reporting.*

22. SFFAS No. 6 requires that general PP&E be recognized as assets in the basic financial statements and, except for land and land improvements that produce

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permanent benefits, be charged to expense through depreciation over their useful life. SFFAS No. 6, paragraph 122, states that "allocation of the cost of general PP&E, excluding land, among accounting periods was essential to assessing operating performance." The Board's federal financial reporting objectives concept statement, Statement of Federal Financial Accounting Concepts (SFFAC) No.1, focuses on relating costs to accomplishments in reporting an entity's operating performance. To meet the operating performance objective for general PP&E, the Board sought to provide accounting standards that would result in:

a. relevant and reliable cost information for decision-making by internal users;
b. comprehensive, comparable cost information for decision-making and program evaluation by the public; and,
c. information to help assess the efficiency and effectiveness of asset management.

23. The Board, however, found that for some PP&E, the depreciation effect of the asset on operating performance was not the predominant reporting objective. Instead, stewardship was important. Therefore, three categories of assets (i.e., national defense PP&E (ND PP&E),[7] heritage assets, and stewardship land) are referred to collectively as stewardship PP&E.

24. The purpose of SFFAS No. 8 was to establish standards for reporting on the Federal Government's stewardship over certain resources entrusted to it, and certain responsibilities assumed by it. Among these standards are standards for reporting on stewardship PP&E. "Stewardship PP&E" consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differs from general PP&E in that their values may be indeterminable or may have little meaning

[7] Prior to the issuance of SFFAS No. 11, *Amendments to Accounting for Property, Plant, and Equipment – Definitional Changes*, (amending SFFAS Nos. 6 and 8) the Board referred to ND PP&E as Federal Mission PP&E. The reasons leading to that change are not relevant to this ED but may be understood by reading SFFAS No. 11. This document uses the amended title and definition in referring to the existing provisions.

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(e.g., museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (e.g., ND PP&E) to accounting periods that benefit from the ownership of such assets is not meaningful. Specifically, for ND PP&E the majority of the Board did not believe applying depreciation accounting for these assets would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believed that these assets were developed, used, and retired in a manner that did not lend itself to a "systematic and rational" assignment of costs to accounting periods (i.e., depreciation accounting) and, ultimately, to outputs.

25. Accordingly, one result of SFFAS Nos. 6 and 8 was to remove the PP&E components of ND PP&E from the balance sheet. To accomplish this, SFFAS No. 6 (as amended) required that the cost to acquire ND PP&E components be expensed when incurred. SFFAS No. 8 (as amended), required presenting ND PP&E as stewardship information and included the following information by major type or category of ND PP&E:
    a. a beginning value balance, using either a historical or latest acquisition cost (LAC) valuation method;
    b. the dollar value acquired during the reporting period;
    c. the dollar value withdrawn during the reporting period;
    d. the increase or decrease in value resulting from revaluation of assets using the LAC; and,
    e. the end-of-year value.

26. In addition to presenting values, SFFAS No. 8 required that condition information be presented. The presentation of value and condition information was done off-balance sheet as Required Supplementary Stewardship Information (RSSI). In addition to value and condition, SFFAS No. 6, as amended, required deferred maintenance information to be presented as Required Supplemental Information (RSI) for ND PP&E.

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February 1998 ED

27. In early 1998, the FASAB issued an exposure draft (ED) to amend SFFAS Nos. 6 and 8. The exposure draft was initiated (1) to refine the definition of ND PP&E, and (2) in recognition of the need to provide a transition plan due to the DoD's inability to comply with the provisions of SFFAS No. 8. During the process, the Board reconsidered whether SFFAS No. 8 was an appropriate end goal. Ultimately, the 1998 exposure draft included, among other suggestions, proposals to replace the requirement to present cumulative cost information in the supplementary stewardship report with a requirement to present ND PP&E annual acquisition costs for each of the previous five years (i.e., annual trend information rather than cumulative costs), quantities, and condition information.

28. Besides considering the written comments in response to this 1998 ED, the Board held a public hearing on these proposals to explore further the concerns expressed by some respondents. Because of the divergent views of both respondents and Board members, the Board did not reach a final conclusion on revisions to the reporting requirements for ND PP&E in SFFAS No. 8. The Board's continued deliberations on the proposed standards highlighted the differences of opinion on this subject among the Board members. Since neither the standards in SFFAS No.8 nor the proposed amendments were acceptable to a majority of the Board members, the Board decided that the accounting for and reporting on ND PP&E requirements should be revisited. DoD voluntarily undertook a study to address (1) users information needs relative to ND PP&E, (2) the current systems capabilities within DoD, and (3) an assessment of alternative means to meet the reporting objectives set by the Board.

29. The Board acknowledges that the SFFAS No. 8 stewardship approach was adopted, not as a convenience or temporizing expedient, but as a technically desirable approach. However, an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of

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the Government Performance and Results (GPRA) Act, combined with the Board's and DoD's extensive study and greater understanding about National Defense PP&E, provides a clear indication that the operating performance objective is relevant for ND PP&E.

September 2001 ED

30. In September 2001, the FASAB issued an ED that proposed incremental movement from the stewardship reporting of SFFAS No.8 towards information focused on operating performance. The amendments proposed in that ED would have made the following changes. The definition of ND PP&E would have been amended. ND PP&E would have consisted of 2 separate categories of items within the amended definition: (a) Major End Items and (b) Mission Support Items. Major End Items would have been subject to a presentation of the number of units and condition assessment information by asset type or category. In addition, Major End Items would have been capitalized but not depreciated, while Mission Support Items would have been capitalized and depreciated. Also, data for the ten largest current acquisition programs would have been disclosed.

31. The Board issued the 2001 ED because it believed that the proposals in that ED were the best that could be achieved given the acknowledged shortcomings of DoD accounting and other management information systems, as well as DoD's firm belief that certain information would not be useful for management purposes. The 2001 ED would have achieved one of the current Board's objectives, which was to establish monetary accountability over military assets. However, because the 2001 ED did not require depreciation of some major assets, the September 2001 FASAB ED on NDPP&E fell short of comprehensive PP&E accounting. In addition, it would not have fully achieved the objective of SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, to account for the full cost of programs

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with a focus on relating costs to accomplishments in reporting an entity's operating performance.

March 2002 ED

32. While there were divergent views on the proposals in the September 2001 ED, many respondents believed ND PP&E should be capitalized and depreciated as is general PP&E. Many Board members had wanted to make this change for some time. This caused the Board to reconsider the proposals presented in the September 2001 ED. The outcome from the deliberations was a consensus of the Board to make the proposal in the March 2002 ED to classify, capitalize, and depreciate ND PP&E as general PP&E. The Board believed its proposal would put discipline into the asset management process. Many members of the Board believe depreciation, impairment, deferred maintenance, and condition are interrelated judgments that should result jointly from periodic estimation of the remaining useful service potential of assets. The Board believes periodic analysis of the sources of asset diminution is as important, perhaps more so, for national defense assets than for other assets.

33. The Board also notes that a second purpose of depreciation accounting is to provide information for measuring the full cost of producing outputs (e.g., deterrence, readiness, training). Full cost, including the depreciation of ND PP&E, would be available for use in assessing the operating performance of responsibility segments for producing outputs and to meet the goals of SFFAC No. 1 and SFFAS No. 4. In addition, the Board believes that classifying all DoD PP&E as general PP&E would improve the public's understanding of federal accounting, add consistency to the application of standards throughout the Federal government, reduce the DoD's cost of development and operation of accounting systems, and preclude the standard setting costs that would be necessary to resolve on-off balance sheet questions. Accordingly, the Board proposed to rescind SFFAS No.11 and amend SFFAS Nos. 6 and 8.

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34. Although the September 2001 ED on ND PP&E proposed three special disclosures for ND PP&E, the Board decided not to include them in the March 2002 ED. The three special disclosures proposed in the September 2001 ED were:

    a. unit information by type or category of Major End Item[8];

    b. condition assessment information for Major End Items; and,

    c. actual and planned acquisition program costs and unit information for the ten largest current national defense PP&E[9] acquisition programs.

35. These proposed information requirements were developed and proposed after years of deliberation and with varying recognition and measurement requirements for the principal financial statements. The Board decided not to propose these three special information requirements as part of the March 2002 ED after reviewing responses to the September 2001 ED. The Board concluded that these areas may deserve further study or development for the following reasons:

    a. Unit information as originally proposed was tied to the Major End Item definition. Respondents questioned the definition's effectiveness.

    b. Unit and condition information has been determined to be "sensitive" information[10].

[8] The *Accounting for National Defense PP&E and Associated Cleanup Costs* ED, dated September 2001, defined Major End Items to be: 1) items that launch, release, carry, or fire a particular piece of ordnance, and 2) items that carry weapons systems-related property, equipment, materials, or personnel. Major End Items (a) have an indeterminate or unpredictable useful life due to the manner in which they are used, improved, modified, or maintained and (b) are subject to premature destruction or obsolescence (e.g., aircraft, ships, combat vehicles, etc.) Also, included in this category are vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

[9] SFFAS No. 11 defined ND PP&E as being "PP&E [that] are (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (2) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet."

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c. Many respondents suggested that further research in the area of condition and deferred maintenance presentation is needed to develop consistent and comparable measurement and reporting criteria. However, respondents found condition information to be a useful supplement to deferred maintenance.

d. One respondent suggested that the proposed reporting on the ten largest acquisition programs would confuse users since the cost of assets recognized on the balance sheet would be different from budget cost measurements.

36. Given the resources that have been devoted to resolving the fundamental recognition and measurement guidance for ND PP&E and the substantial efforts underway at DoD to modernize its systems, the Board does not believe it would be useful to withhold this Statement while it deliberates on the merits of any further PP&E information.

37. In the meantime, the Board does not believe the absence of the previously proposed special information requirements would outweigh the benefits to be gained through this Statement. With regard to the stewardship objective and the need for unit information, the Board notes that the stewardship objective is being met for general PP&E without this special disclosure. Through the course of the audit, existence of PP&E and the completeness of PP&E records are verified. This satisfies the basic stewardship function that the double entry system offers.

38. With regard to condition information, the Board notes that deferred maintenance information is currently required. Further, the assessment of useful life needed to assure depreciation is reasonable would result in greater discipline in information associated with the condition of PP&E.

[10] Any information, the loss, misuse, or unauthorized access to which would or could adversely affect the organizational and/or national interest but which does not meet classification criteria specified in DoD 5200.1-R (reference (c)). Source: DoD 5200.1-M; Acquisition Systems Protection Program; 16 March 1994.

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39. The Board expects to revisit these areas as it considers a project on integrating depreciation, impairment, and deferred maintenance reporting and other fixed asset accounting issues at a future date. The effort would be a government-wide undertaking.

Concerns with March 2002 ED

Valuation and Consumption

40. Various respondents suggested that additional guidance be included in this Statement for the valuation and consumption or use of items previously classified as national defense (ND) property, plant, and equipment. Examples of the types of additional guidance suggested include the following:

    a. The cost elements of research, testing, development, and evaluation (RTD&E) should be described and specific guidance provided on capitalization.

    b. Definitions for terms such as modifications, modernizations, and improvements are needed.

    c. More discussion of the desired accounting for the losses of items considered part of a group asset account of ND PP&E during testing, development, or evaluation phases is needed.

    d. More guidance for determining the capitalized costs to be removed from a group asset account when a unit is destroyed, becomes obsolete, or is otherwise disposed of is needed.

    e. The role of subordinate systems needs to be addressed, along with a description of how the costs of the subordinate systems would be relieved of costs assigned to the higher level system.

    f. A discussion of appropriate treatment for the costs of a discontinued subordinate system is needed.

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g. The use of depreciation to reflect the full cost of operating ND PP&E items has to be tailored to the unique attributes and uses of ND PP&E.

h. The useful lives of certain classes of ND PP&E should be defined and measured in units such as operating hours.

i. Additional guidance and criteria is needed regarding the use of composite and group depreciation methodologies.

j. Specific reference to abnormal disposition issues should be added to the standard.

41. In response to these issues, the Board members reiterated that the Board is responsible for promulgating accounting standards and that it is the responsibility of individual entities to set policy and provide operating guidance on how to implement the standards. The Board believes these issues can and should be addressed by individual entities in the context of existing basic principles and practices. Composite and group depreciation methodologies are already considered acceptable methods under generally accepted accounting principles. The existing principles and practices are used by many different industries, including the airline, electrical cooperative, railroad, real estate, and cruise line industries.

42. The Board also expects that many of these concerns raised by respondents will be addressed by DoD as the standards are implemented. One example may be on the cost elements of research, testing, development, and evaluation (RTD&E) to be capitalized. Determining whether to include a particular cost in the capitalized cost of PP&E should be guided by general guidance in SFFAS Nos. 4 and 6 regarding the types of costs to capitalized. In the event, however, that DoD is unable to resolve issues , the Board and its staff will be available to consider implementation guidance.

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Contractor Costs

43. Two respondents raised concerns regarding application of existing general PP&E accounting standards to PP&E formerly classified as National Defense PP&E but held by contractors. Since the current PP&E definition explicitly includes PP&E in the hands of others (paragraph 18), SFFAS Nos. 6 and 8 (as amended) created reporting requirements for general PP&E and National Defense PP&E. Both existing standards require cost information.

44. One respondent, apparently unaware of the aforementioned provisions of SFFAS Nos. 6 and 8, encouraged the Board to develop standards that address this property. The respondent asserted, “accounting control over this property is deplorable.” Information provided by the respondent shows that as early as 1981 issues were raised regarding the need to improve accountability for assets including PP&E provided by the Government at no cost to the contractor for use in contract performance.

45. Another respondent, an industry group including major defense contractors, suggests that the elimination of the National Defense PP&E category “will impose costly accounting change requirements on government contractors that will increase the costs of goods and services acquired by the government.” The respondent raised concerns about (1) application of standards to immaterial items, (2) provisions for accounting for software modifications, (3) requirements for work-in-process reporting, and (4) designation of specific cost elements for capitalization (SFFAS No. 6, para 26). Some aspects of these and other issues raised by the respondent appear to the Board to be based on misinterpretations of the existing standards. Therefore, the Board does not believe there are insurmountable issues raised.

46. Rather, the Board believes that significant efforts are needed to clarify the standards for contractors and to determine specific reasonable policies for providing information. It is clear that, despite the existence of standards for

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contractor held assets since late 1995, little progress has been made in resolving the issue. The Board does not believe that deferral of standards related to vast amounts of PP&E will facilitate resolution of the contractual and administrative details needed to reasonably comply with generally accepted accounting principles.

Effective Date

47. One respondent commented that the effective date, for periods beginning after September 30, 2002, is unrealistic. The Board acknowledges that full implementation of the standards will require time and commitment. The Board understands that DoD is currently developing systems needed to fully implement any PP&E standards, comprehensive training needs to be provided, policies and procedures need to be revised and contractors may need to modify how they do things. However, the Board believes DoD financial statements will be incomplete without consistent and comparable accounting for PP&E. In addition, a practical issue arises. DoD has not yet identified property as National Defense PP&E. Therefore, it would be problematic to determine which components of general PP&E were not yet subject to the provisions of SFFAS No. 6, which became effective for fiscal year 1998.

Board Approval

48. The Board approved this recommendation by a vote of 6 members approving its issuance and 1 member opposing its issuance. Although the Board is comprised of 9 members, only 7 members cast a vote. This is because the term of two Board members had expired and the appointment of successors had not been finalized. The dissent of the Board member who opposed the issuance of this Statement is presented in paragraphs 49 through 51.

49. Mr. Calder dissents from this standard because (1) more guidance on asset capitalization and use of composite or group depreciation methods is needed and (2) additional disclosures are important to meeting reporting objectives for National Defense PP&E.

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50. Mr. Calder believes that deliberations uncovered serious issues regarding identification of costs to be capitalized and application of composite or group depreciation methods to complex weapons systems. Comments showed there is diversity of understanding among financial statement users, preparers and auditors on these issues. He believes additional guidance should have been provided regarding the components of asset cost that should be capitalized; especially the accounting treatment for research, development, testing and evaluation. He does not believe the guidance in this regard in Statement Nos. 4 and 6 is adequate to resolve complex and diverse situations unique to defense assets. He also believes the new statement lacks guidance regarding the appropriate use of composite or group depreciation and could result in unacceptable diversity in its application.

51. In addition, Mr. Calder believes that the statement should have required disclosure of unit information for significant categories of assets and budget/actual data on major acquisitions programs in progress. Unit information has been deliberated at length by the Board over a number of years because some members and commentators believed the unit information is critical to an understanding of whether DoD has assets sufficient to carry out its mission. Information on budget/actual data on major acquisitions programs is considered by many to be vital to assessing performance in acquiring assets through complex and lengthy acquisition programs. In addition, tracking progress against plans would aid in determining the financial status of the programs. These two additional disclosures would enhance users' understanding of the nation's financial condition and future security.

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FASAB Board Members

David Mosso, Chairman
Philip T. Calder
John A. Farrell
Joseph L. Kull
James M. Patton
Robert N. Reid
Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director
Project Staff:
Rick Wascak

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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STAFF IMPLEMENTATION GUIDANCE 23.1

Guidance for Implementation of SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*
Classification of Items Formerly Considered National Defense PP&E

Background

1. Statement of Federal Financial Accounting Standards (SFFAS) 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, rescinded SFFAS 11, *Amendments to Accounting for Property, Plant, and Equipment - Definitional Changes* in its entirety. SFFAS 11 established the definition of National Defense Property, Plant, and Equipment (ND PP&E). Its rescission eliminated the category ND PP&E along with the definition for that term. Implementing guidance contained in SFFAS 23 provides that:

> 10. The initial capitalization amount for assets previously considered ND PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6 [*Accounting for Property, Plant, and Equipment*], as amended, and should be the initial historical cost for the items, including any major improvements or modifications. (Emphasis added.)

2. The above text suggests that all items formerly considered ND PP&E should be classified as PP&E. In addition, par. II of SFFAS 23 provides that "all items previously considered ND PP&E are classified as general PP&E." Par. 6b of SFFAS 23 also refers to classification as general PP&E.

Staff Implementation Guidance

3. **Q: Should par. 10 of SFFAS 23 limit the classification of items previously considered ND PP&E to general PP&E?**

4. A: No. A reasonable approach would be to subordinate SFFAS 23's general implementation guidance to the definitions in accounting standards. That is, assets being recognized due to the implementation of SFFAS 23 should be categorized in accordance with asset definitions in SFFAS 6 and other accounting standards.

5. **Q: SFFAS 23 implementation guidance describes acceptable approaches to valuing those items of ND PP&E to be classified as general PP&E. How should items of ND PP&E not classified as general PP&E be valued?**

6. A: Any items not properly classified as general PP&E should be valued in a manner consistent with the general principles established in SFFAS 23 implementation guidance and the specific measurement guidance provided in accounting standards for the relevant asset class.

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Basis for Conclusions

7. A literal application of SFFAS 23, par. 10 would result in de facto amendments to the PP&E definition contained in SFFAS 6 and any asset definitions promulgated by other standards. That is, all asset definitions other than general PP&E would have to exclude ND PP&E and the general PP&E definition would have to include ND PP&E.

8. Consequences of reading the implementation guidance as amending the definitions remaining in current standards include:

    a. Inconsistency in classification of assets between the components of the Department of Defense and all other federal entities,

    b. Possible inconsistent accounting for the items subject to implementation guidance in SFFAS 23 and items acquired in the future by the Department of Defense, and

    c. Reliance on a definition that has been purged from authoritative publications such as the Original Pronouncements volume.

9. Staff implementation guidance resolves the inconsistency between the definitions and the implementation guidance by subordinating par. 10 of SFFAS 23 to asset definitions in accounting standards.

Effective Date

10. This guidance is effective upon issuance.

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Federal Accounting Standards Advisory Board

Selected Standards for the Consolidated Financial Report of the United States Government

Statement of Federal Financial Accounting Standards No. 24

January 2003

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended December 20, 2002.*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Executive Summary

I. Most Statements of Federal Financial Accounting Standards (SFFAS) do not state whether they apply to the Government as a whole or components thereof, or both. This standard clarifies that all parts of all SFFAS apply to all Federal entities (including the consolidated entity) unless a standard specifically provides otherwise.

II. In addition, certain requirements of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, are not relevant for the Consolidated Financial Report of the United States Government (CFR). SFFAS 7 requires information on budgetary resources and a reconciliation of obligations and other resources used with the net cost of operations. These requirements, while relevant for agencies executing the budget, are not required for the CFR.

III. This standard requires that new statements be presented in the CFR, but not agency or departmental financial statements, regarding net operating revenue (or cost), budget surplus (or deficit), and cash. The new statements are principal CFR financial statements, and they are to be presented on a comparative basis.

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Table of Contents

Section	Page No.
Executive Summary	i
Introduction	1
Accounting Standards	3
Appendix A: Basis for Conclusions	5
Appendix B: Illustrative Statement: Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit)	12
Appendix C: Illustrative Statement: Statement of Changes in Cash Balance From Budget and Other Activities	13
Appendix D: Statement of Budgetary Resources	14
Appendix E: Statement of Financing	16
Appendix F: Glossary	18

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_24.pdf.

Introduction

1. Statements of Federal Financial Accounting Standards (SFFAS) usually do not state explicitly whether they apply to the Government as a whole, its component entities (e.g., departments, agencies, etc.), or both. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, uses the term "entity" generically to refer, depending on the context, to the U.S. Government as a whole, organizational component units of the Government, e.g., an agency, or to other kinds of potential reporting units such as programs.

2. Some have assumed that the standards apply to both component entities and the Government as a whole, unless otherwise stated. SFFAS 1, *Accounting for Selected Assets and Liabilities of the Federal Government*, states that it applies to the Government and its departments and agencies, as does SFFAS 8, *Supplementary Stewardship Reporting*. SFFAC 2, *Entity and Display*, states that Federal entities aggregate into the Government entity, which encompasses all the resources and responsibilities existing within the component entities.

3. This standard clarifies that all existing and future standards apply to all federal entities unless a standard specifically provides otherwise.

4. This standard also exempts the CFR from certain provisions of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requiring information about budgetary resources and a reconciliation of budgetary obligations with the cost of operations from the proprietary accounting system. Such information is relevant and meaningful for entities financed with budgetary resources but not for the Government as a whole.

5. In addition, this standard requires new information for the CFR (but not component entity financial statements) that reconciles the annual proprietary net cost with the unified budget surplus (or deficit), and explains the changes in the Government's cash balance. The information is to be presented in new CFR principal financial statements that are to be presented on a comparative basis.

Materiality

6. The provisions of this accounting standard need not be applied to immaterial items.

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Effective Date

7. This amendment is effective for periods beginning after September 30, 2001.

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Accounting Standard

Standards for the Consolidated Financial Report of the U.S. Government

8. Statements of Federal Financial Accounting Standards (SFFAS) apply to all federal entities, that is, to the Government as a whole and to **component entities**[*], unless provision is made for different accounting treatment in a current or subsequent SFFAS.

Budgetary Information Not Required for the Government as a Whole

9. SFFAS 7, paragraphs 77-82, requires certain information about **budgetary resources** and about the relationship between **budget obligations** and proprietary **net cost of operations**. Such information is reported in the Statement of Budgetary Resources and Statement of Financing, respectively.[1] This information is not required in the consolidated financial report of the Government as a whole, and accordingly such statements are not required.

Reconciliation Information

10. The financial report of the Government as a whole should provide a financial statement reconciling **net operating revenue (or cost)** and the annual **unified budget surplus (or deficit)**. The financial statement should highlight:

    - The components of net operating revenue (or cost) that are not part of the unified budget surplus (or deficit), including the accrued and amortized expenses not included in **budget outlays** and the accrued or other revenue not included in **budget receipts**; and
    - The components of the unified budget surplus (or deficit) that are not part of net operating revenue (or cost), including budget receipts and outlays that are not included in net operating revenue (or cost).

11. Appendix B provides an illustration of how the reconciliation data could be displayed. The illustration is not intended to be prescriptive.

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[*] Terms defined in the glossary appear initially in **boldface**.

[1] See Appendices D and E for illustrations of the statement of budgetary resources and statement of financing from the Office of Management and Budget's Bulletin 01-09, *Form and Content.*

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Information about the Unified Budget Surplus or Deficit and Cash

12. The Government as a whole should provide a financial statement explaining how the annual unified budget surplus or deficit relates to the change in the Government's cash. The financial statement should highlight:

    - The components of the unified budget surplus or deficit that are not part of the annual change in cash, including non-cash budget outlays; and
    - Items affecting the Government's cash balance that are not included in the budget outlays or receipts. The statement should prominently display ~~of~~ the cash inflow and outflow related to the changes in debt held by the public and interest accrued and interest paid on debt held by the public.

13. Appendix C provides an illustration of how this information could be displayed. The illustrations are not intended to be prescriptive.

Principal Financial Statements Presented on a Comparative Basis

14. The financial statements required in paragraphs 10-13 immediately above are **principal financial statements**. These statements and all other principal financial statements in the consolidated financial report of the Government as a whole should be presented on a comparative basis. The current fiscal year amounts should be presented in a column adjacent to the amounts for the previous fiscal year.

Appendix A: Basis for Conclusions

15. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

16. FASAB published the exposure draft *Selected Standards for the Consolidated Financial Report of the United States Government*, in March 2002. The exposure draft included questions about each of the three areas of interest: (1) whether standards should apply to the Government as a whole as well as to component entities; (2) whether the CFR should be exempt from the requirement for a Statement of Budgetary Resources and a Statement of Financing; and (3) whether new statements should be required for the Government as a whole.

17. The Board received 16 responses as follows:

Category	Federal (Civilian)	Federal (Military)	Non-Federal
Users, academics, and others[2]			5
Auditors	1	1	
Preparers and financial managers	8	1	

Standards Apply to the Government as a Whole as Well as to Component Entities

18. In Statement of Federal Financial Accounting Concepts (SFFAC) 1 *Objectives of Federal Financial Reporting*, the Board uses the term "entity" generically to refer, depending on the context, to the Government as a whole, organizational component units of the Government, e.g., an agency, or to other kinds of potential reporting units such as programs.[3] SFFAC 2, *Entity and Display*, states that Federal entities aggregate into the Federal Government entity, which encompasses all the resources and responsibilities existing within the component entities.[4]

19. Although Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities of the Federal Government*,

[2] This category includes professional organizations, academics, and private citizens.
[3] SFFAC 1, fn. 2-3, and par. 212.
[4] SFFAC 2, par. 38.

states that it is applicable to both the Government as a whole and component entities[5], other standards have not explicitly addressed the subject unless different treatment was specified. SFFAS 6, *Accounting for Property, Plant, and Equipment,* refers the reader to SFFAC 2, *Entity and Display*, for guidance on the general applicability of federal accounting standards. SFFAS 8, *Supplementary Stewardship Reporting*,[6] explicitly states that it applies to the Government and its departments and agencies; and sets an effective date for its applicability to component entities but not for the Consolidated Financial Report of the U.S. Government (CFR) because more time is needed to delineate how the stewardship information would be aggregated. SFFAS 8 also requires a "current services assessment" for the CFR but not for individual reports of its component units. Likewise in SFFAS 17, *Social Insurance*, applicability is addressed because certain requirements for component entities are not applicable to, and summarization of certain data is allowed for, the CFR.

20. This standard clarifies that SFFAS apply to all Federal entities unless a current or subsequent standard specifically provides otherwise. All of the respondents who addressed the issue agreed that the FASAB standards should apply to the CFR. Several respondents requested more guidance regarding whether the proposed standard affected the FASAB policy whereby "financial statements [prepared] in accordance with accounting standards published by [the Financial Accounting Standards Board (FASB)] also may be regarded as in accordance with GAAP for those entities that have in the past issued such financial statements."[7] The Board did not intend to change and is not changing this policy at this time.

Consolidated Financial Report Exemption from Requirements to Report Certain Budgetary Information

21. All but one of the respondents who addressed the issue agreed that the CFR should be exempt from certain provisions of SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Budgetary and Financial Accounting, requiring a Statement of Budgetary Resources (SBR) and the Statement of Financing (SOF). One respondent disagreed, saying that the same information, based on one single set of standards, required for components should be required for the CFR, and vice versa. That respondent believes that the CFR should present the SBR and SOF, because such combined budgetary information is relevant and useful to the user of the CFR.

[5] SFFAS 1, par. 14.
[6] SFFAS 8, par. 38-39.
[7] ***FASAB News***, Jan.-March 2000, p. 2.

Likewise, the component entities should be required to prepare the new statements, the necessary changes being made, as well as the SBR and SOF.

22. SFFAS 7 requires entities "whose financing comes wholly or partially from the budget" to provide information on budgetary resources and the status of resources, which is presented in the SBR.[8] It also calls for a reconciliation of budgetary resources obligated by the entity with the net cost of operations, which is presented in the SOF.[9]

23. The Board continues to believe that such information is less relevant or meaningful at the level of the CFR. Resources differ between the Government as a whole and individual component entities. The exchange and non-exchange revenue and borrowing from the public are the main sources of financing for the Government as a whole.[10] For component reporting entities, however, the sources of financing are provided through the budget process and are largely **financing sources** other than revenue. **Appropriations** and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. Budgetary resources are not earned by an entity's operations and have a different character than both exchange revenue and non-exchange revenue.[11] Federal entities report as an asset their fund balance with Treasury, which is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. This is an intra-government item. From the perspective of the Government as a whole, it is not an asset. It represents a commitment to make resources available to federal departments, agencies, programs, etc.[12]

24. The budget process provides the principal basis for planning and controlling obligations and outlays by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and

[8] SFFAS 7 (pars. 77-79) requires information, which is presented in the SBR, that includes (1) total budgetary resources available, (2) the status of the budgetary resources, including obligations incurred, the available **appropriation**, **borrowing** and **contract authority** at the end of the period, any restrictions on the use of unobligated balances of **budget authority**, the amount of any capital infusion during the period, etc.; and (3) **outlays**. In addition, the entities are required to provide this information for each of their major budget accounts as supplementary information.

[9] SFFAS 7 (pars. 80-82) also requires a reconciliation of budgetary obligations and proprietary accounting information, which is presented in the SOF. The reconciliation explains the relationship between (1) budgetary resources obligated by the entity during the period and **other financing sources** such as **imputed financing**, transfers of assets, etc., not included in budget receipts, and (2) the net cost of operations.

[10] "Exchange revenue" arises when an entity provides goods and services for a price. "Non-exchange revenue" arises primarily from the exercise of the government's sovereign power to demand payment from the public, such as taxes, duties, fines, etc.
[11] SFFAS 7, par. 24.
[12] SFFAS 1, par. 31.

appropriating process, to **apportionment**, **allotment**, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than **accrual accounting**, are the bases for budgeting and reporting on budget execution.[13]

25. Accrual accounting is the basis for **proprietary accounting** in the Federal Government. Proprietary accounting and **budgetary accounting** are complementary. Proprietary accounting provides an understanding of the entity's net position and cost of operations during a period. Federal Government financial statements have not been used for planning and control as much as they might be. In part, this is because general purpose financial reports have not presented budget information with the financial statements in a way that helped users relate these two important, but different, types of financial information.[14] The Board's objective in requiring new statements in the CFR addresses this issue.

The Government as a Whole Should Provide Information about Net Operating Revenue (or Cost), the Budget Surplus (or Deficit), and Cash

26. The information now required in two new statements serves the basic objectives of federal accounting. Objective 1[15] provides that federal financial reporting should assist in fulfilling the Federal Government's duty to be publicly accountable for the money raised through taxes and other means, and for their expenditure in accordance with the appropriation laws. Sub-objective 1C provides that federal financial reporting should provide information that helps the reader to determine how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

27. In a new statement of concepts issued contemporaneously with this standard, the Board recognizes that the CFR should be understandable to the average citizen. The new statements required in this standard were designed with this objective in mind.

28. Although budgetary and proprietary accounting information are complementary, both the types of information and the timing of their recognition are different, caused by differences in the basis of accounting.[16]

[13] SFFAS 7, par. 25.
[14] SFFAS 7, par. 26.
[15] SFFAC 1, pars. 112, 119.

29. The new statements required by this standard focus on three important elements: (1) the net operating revenue (or cost) from the proprietary accounting system, (2) the unified budget surplus (or deficit), and (3) the change in the Government's cash during the period. The information is presented in two parts: (1) a reconciliation of the net operating revenue (or cost) to the unified budget surplus (or deficit), and (2) a statement of changes in cash balance from budget and other activities.

30. The purpose of the reconciliation information is to report how the proprietary net operating revenue (or cost) and the unified budget surplus (or deficit) relate to each other. The premise of the reconciliation is that the proprietary and budget accounting bases share much data. The reconciliation presents the differences between the two systems as reconciling items while moving from the proprietary amount to the unified budget surplus or deficit.

31. The primary purpose of the statement of changes in cash balance from budget and other activities is to report how the annual unified budget surplus/deficit relates to the change in the Government's cash balance and debt held by the public. It explains why the unified budget surplus or deficit normally would not result in an equivalent change in the Government's cash balance.

32. All of the respondents who addressed the issue agreed that the new information should be required. Most of these respondents offered some comments on one or both of the proposed illustrations.

33. With respect to the terminology used in the statements, several respondents said that the term "budget" was unclear. One respondent noted that the statements use the unified budget concept, i.e., both on- and off-budget activity is included. The respondent noted that there are several other alternatives approaches, including on-budget only, the President's proposed budget, and the enacted budget. Another respondent noted that, in the non-Federal environment, a budget is a plan, but for the illustrative statements it indicates actual results on a budget accounting basis. Also, several respondents objected to the use of the term "budget surplus" as being inaccurate since there is no surplus on hand to finance future activities at the reporting date, as the statement illustrates; and, that the word "surplus" has been eliminated from private sector accounting terminology.

34. The Board has modified the terminology based on these comments. The word "unified" now accompanies "budget surplus or deficit" wherever that phrase is used. In addition, the word "actual" has been added to the budget line items in

[16] SFFAC 7, par. 80.

the statements.

35. With respect to the term "budget surplus," the Board notes that the term is used pervasively in Federal finance and in the popular media. It is defined comprehensively in budget publications. The Board believes that most users of the CFR have at least a working understanding of the term as an excess of the fiscal year's budget receipts over budget outlays. The statement of changes in cash balance from budget and other activities will illustrate how the surplus (or deficit) and other activity affected the Government's cash balance. The glossary for this standard will provide the definition.

36. With respect to the illustrative statement about changes in the cash balance (Appendix C in the exposure draft of March 2002, Versions A and B therein), most respondents who addressed the question preferred Version B. They said that it would be more understandable to the intended users because its groupings and subtotal were more logical.

37. One respondent said the FASAB should provide detailed authoritative guidance regarding the format of the reconciliation and cash statements before requiring them. The respondent was concerned that the reporting requirements are not fully developed, and that the FASAB should not require such information until it develops and prescribes an authoritative format. The Board weighed the benefits of prescribing the format of the statements against the drawbacks of placing constraints on the Treasury Department's future development of the statements. The Board believes that it is better at this time to be flexible so that the most meaningful display can evolve.

38. Another respondent asked the Board to clarify that the new statements would be principal financial statements. Additional wording to this effect has been added to the standard.

39. Several respondents urged the Board to tie the change in cash on the new statement of changes in cash balance to the balance sheet line item and accompanying note disclosure, and/or to include beginning and ending cash balances on the statement. The Board decided that such information would improve the statement and has included it in the illustration in the standard, but does not believe that it is necessary to require it as part of the standard.

40. One respondent said there should be some direct reference to the stewardship information on the balance sheet similar to the reference to the notes because this would inform the reader about important information not included on the balance sheet. Also, this respondent submitted that the term "National Debt" is

unclear. Although the Board does not view this standard as a vehicle to address these concerns, it acknowledges the need for additional clarity and user friendliness for the CFR. The Board notes that the Treasury Department continues to improve the CFR, including the presentation of stewardship information.

Implementation Date

41. Several respondents said that the FY 2002 implementation date for the statements would afford insufficient time to prepare the new statements. However, since the Treasury Department was a leader in developing the statements and is able to prepare them in FY 2002, and since no additional information is required from component entities, this should not be an issue.

		(Hypothetical data)		
		RECONCILIATION OF NET OPERATING REVENUE (OR COST)		
		AND UNIFIED BUDGET SURPLUS (OR DEFICIT)		
		for the period ending Sept. 30, 20X2		
		(in billions of dollars)		
[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]				
			FY 20X2	FY 20X1
Net operating revenue or (cost)			46.0	(50.0)
Components of net operating revenue (or cost) not part of the of the budget surplus:				
		Add excess of accrual-basis expenses over budget outlays:		
		Civilian & military employee benefits (Note X1)		
		Pensions and retired pay	75.5	74.0
		Retiree health benefits	14.6	14.7
		Other benefits	4.7	4.6
		Subtotal -- civilian & military employee benefits	94.8	93.3
		Veteran compensation (Note X1)	62.5	59.0
		Environmental clean-up (Note X2)	19.6	18.5
		Other benefit programs (Note X3)	4.0	4.5
		Other	18.5	17.5
		Subtotal -- excess of accrual-basis expenses over budget outlays	199.4	192.8
		Add amortized expenses not included in budget outlays:		
		Depreciation (Note X7)	15.4	15.0
		Add other expenses that are not reported as budget outlays:		
		Premiums paid on buyback of Treasury debt (Note X10)	5.5	1.6
		Subtract excess of accrual-basis revenue over budget receipts:		
		Accrued tax revenue (Note X5)	(0.6)	(0.7)
		Other accrued revenue (Note X8)	-	1.0
		Subtract other revenue and gains that are not budget receipts:		
		Other revenue and gains	(2.3)	(2.2)
		Subtotal: components of net operating revenue (cost) not part of budget surplus	217.4	207.5
Components of the budget surplus that are not part of net operating revenue (or cost):				
		Add budget receipts not included in net operating revenue (or cost):		
		Principal repayments on pre-credit reform loans	24.0	24.5
		Decrease in accounts receivable (Note X3)	2.7	3.0
		Subtract budget outlays not included in net operating revenue (or cost):		
		Acquisition of capital assets (Note X7)	(31.6)	(43.0)
		Acquisition of inventory (Note X6)	(11.9)	(12.0)
		Acquisition of other assets	(5.4)	(7.0)
		Subtotal -- components of the budget surplus that are not part of net operating revenue (or cost)	(22.2)	(34.5)
Other:				
		Prior period adjustment (Note X17)	(4.2)	-
Unified budget surplus (deficit) -- actual			237.0	123.0

STATEMENT OF CHANGES IN CASH BALANCE
FROM UNIFIED BUDGET AND OTHER ACTIVITIES
for the Years Ended September 30, 20X2 and 20X1
(in billions of dollars)
[Hypothetical Data]

[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]

	20X2	20X1
CASH FLOW FROM UNIFIED BUDGETED ACTIVITIES		
Total unified budgetary receipts -- actual	2,025.0	1,827.0
Total unified budgetary outlays -- actual	(1,788.0)	(1,703.0)
Unified budget surplus (or deficit) -- actual	237.0	124.0
Adjustments for non-cash outlays included in the unified budget:		
Interest accrued on Treasury debt held by the public	186.0	185.0
Subsidy expense accrued under direct loan & guarantee programs (Note X1)	3.0	4.0
Subtotal - adjustment for non-cash transactions in unified budget	189.0	189.0
CASH FLOW FROM ACTIVITIES NOT INCLUDED IN UNIFIED BUDGET		
Inflows:		
Repayment of principal on direct loans	19.0	15.0
Decrease/(increase) in miscellaneous assets (Note X2)	1.6	(1.6)
Seignorage	2.3	2.2
Outflows:		
Interest paid by Treasury on debt held by the public	(184.4)	(187.8)
New direct loans disbursed	(40.0)	(34.0)
Other direct loan transactions	(0.7)	(1.0)
Premium on buyback of Treasury debt held by the public (Note X3)	(5.5)	-
Default payments on guaranteed loans	(4.3)	(5.0)
Other guaranteed loan transactions	(0.5)	(0.3)
Increase/(decrease) in deposit fund liability balances (Note X4)	(1.2)	0.1
Increase/(decrease) in miscellaneous liabilities (Note X4)	(0.9)	0.5
Cash flow from non-budget activities	(214.6)	(211.9)
Cash Flow from Monetary Transactions		
Decrease in reserve position in the IMF (Note X5)	6.3	1.2
Decrease in loans to the IMF	-	0.5
Increase in special drawing rights (Note X5)	(4.0)	(2.2)
(Increase)/decrease in other monetary assets (Note X5)	(0.9)	0.4
Cash flow from monetary transactions	1.4	(0.1)
Cash Flow from Financing		
Borrowing from the public (Note X6)	2,010.8	2,002.0
Repayment of debt held by the public (Note X6)	(2,233.5)	(2,090.0)
Cash flow from financing	(222.7)	(88.0)
Increase (decrease) in cash balance	(9.9)	13.0
Beginning cash balance (Note X7)	52.7	39.7
Ending cash balance (Note X7)	42.8	52.7

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Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/millions)

	20x2 Budgetary	20x2 Non-Budgetary Credit Program Financing Accounts	20x1 Budgetary	20x1 Non-Budgetary Credit Program Financing Accounts
Budgetary Resources:				
1. Budget authority:				
1a. Appropriations received	$ xxx	$ xxx	$ xxx	$ xxx
1b. Borrowing authority	xxx	xxx	xxx	xxx
1c. Contract authority	xxx	xxx	xxx	xxx
1d. Net transfers (+/-)	xxx	xxx	xxx	xxx
1e. Other	xxx	xxx	xxx	xxx
2. Unobligated balance:				
2a. Beginning of period	xxx	xxx	xxx	xxx
2b. Net transfers, actual (+/-)	xxx	xxx	xxx	xxx
2c. Anticipated Transfers balances	xxx	xxx	xxx	xxx
3. Spending authority from offsetting collections:				
3a. Earned				
1. Collected	xxx	xxx	xxx	xxx
2. Receivable from Federal sources	xxx	xxx	xxx	xxx
3b. Change in unfilled customer orders				
1. Advance received	xxx	xxx	xxx	xxx
2. Without advance from Federal sources	xxx	xxx	xxx	xxx
3c. Anticipated for rest of year, without advances	xxx	xxx	xxx	xxx
3d. Transfers from trust funds	xxx	xxx	xxx	xxx
3e. Subtotal	xxx	xxx	xxx	xxx
4. Recoveries of prior year obligations	xxx	xxx	xxx	xxx
5. Temporarily not available pursuant to Public Law	xxx	xxx	xxx	xxx
6. Permanently not available	xxx	xxx	xxx	xxx
7. Total Budgetary Resources	$ x,xxx	$ x,xxx	$ x,xxx	$ x,xxx

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Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 2 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars /millions)

	20x2 Budgetary	20x2 Non-Budgetary Credit Program Financing Accounts	20x1 Budgetary	20x1 Non-Budgetary Credit Program Financing Accounts
Status of Budgetary Resources:				
8. Obligations incurred:				
8a. Direct	$ xxx	$ xxx	$ xxx	$ xxx
8b. Reimbursable	xxx	xxx	xxx	xxx
8c. Subtotal	xxx	xxx	xxx	xxx
9. Unobligated balance:				
9a. Apportioned	xxx	xxx	xxx	xxx
9b. Exempt from apportionment	xxx	xxx	xxx	xxx
9c. Other available	xxx	xxx	xxx	xxx
10. Unobligated balance not available	xxx	xxx	xxx	xxx
11. Total Status of Budgetary Resources	x,xxx	x,xxx	x,xxx	x,xxx
Relationship of Obligations to Outlays:				
12. Obligated balance, net, beginning of period	xxx	xxx	xxx	xxx
13. Obligated balance transferred, net (+/-)	xxx	xxx	xxx	xxx
14. Obligated balance, net, end of period:				
14a. Accounts receivable	xxx	xxx	xxx	xxx
14b. Unfilled customer orders from Federal sources	xxx	xxx	xxx	xxx
14c. Undelivered orders	xxx	xxx	xxx	xxx
14d. Accounts payable	xxx	xxx	xxx	xxx
15. Outlays:				
15a. Disbursements	xxx	xxx	xxx	xxx
15b. Collections	xxx	xxx	xxx	xxx
15c. Subtotal	xxx	xxx	xxx	xxx
16. Less: Offsetting receipts	xxx	xxx	xxx	xxx
17. Net Outlays	$ x,xxx	$ x,xxx	$ x,xxx	$ x,xxx

Appendix E: Statement of Financing *(from OMB Bulleting 01-09, September 25, 2001)*

Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars /millions)

	20x2	20x1
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
1. Obligations incurred	$ xxx	$ xxx
2. Less: Spending authority from offsetting collections and recoveries	xxx	xxx
3. Obligations net of offsetting collections and recoveries	xxx	xxx
4. Less: Offsetting receipts	xxx	xxx
5. Net obligations	xxx	xxx
Other Resources		
6. Donations and forfeitures of property	xxx	xxx
7. Transfers in/out without reimbursement (+/-)	xxx	xxx
8. Imputed financing from costs absorbed by others	xxx	xxx
9. Other (+/-)	xxx	xxx
10. Net other resources used to finance activities	xxx	xxx
11. *Total resources used to finance activities*	x,xxx	x,xxx
Resources Used to Finance Items not Part of the Net Cost of Operations		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	xxx	xxx
13. Resources that fund expenses recognized in prior periods	xxx	xxx
14. Budgetary offsetting collections and receipts that do not affect net cost of operations		
14a. Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	xxx	xxx
14b. Other	xxx	xxx
15. Resources that finance the acquisition of assets	xxx	xxx
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	xxx	xxx
17. *Total resources used to finance items not part of the net cost of operations*	xxx	xxx
18. *Total resources used to finance the net cost of operations*	x,xxx	x,xxx

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Department/Agency/Reporting Entity
CONSOLIDATED STATEMENT OF FINANCING (Page 2 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars /millions)

	20x2	20x1
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
19. Increase in annual leave liability	xxx	xxx
20. Increase in environmental and disposal liability	xxx	xxx
21. Upward/Downward reestimates of credit subsidy expense (+/-)	xxx	xxx
22. Increase in exchange revenue receivable from the public	xxx	xxx
23. Other (+/-)	xxx	xxx
24. Total components of Net Cost of Operations that will require or generate resources in future periods	xxx	xxx
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	xxx	xxx
26. Revaluation of assets or liabilities (+/-)	xxx	xxx
27. Other (+/-)	xxx	xxx
28. Total components of Net Cost of Operations that will not require or generate resources	xxx	xxx
29. *Total components of net cost of operations that will not require or generate resources in the current period*	x,xxx	x,xxx
30. *Net Cost of Operations*	$ x,xxx	$ x,xxx

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GLOSSARY

The definitions for the entries below are taken from FASAB's Consolidated Glossary *unless otherwise noted*.

Accrual Accounting – Records the effects on a reporting entity of transactions and other events and circumstances in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. Accrual accounting is concerned with an entity's acquiring of goods and services and using them to produce and distribute other goods and services. It recognizes that the buying, producing, selling, distributing, and other operations of an entity during a period, as well as other events that affect entity performance, often do not coincide with the cash receipts and payments of the period. Compare with cash accounting. [See Financial Accounting Standards Board Statement of Financial Accounting Concepts (SFAC) No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, paragraph 50, and SFAC No. 6, *Elements of Financial Statements*, pars. 139-141, 144-5; and Congressional Budget Office, Glossary of Budgetary and Economic Terms, "Accrual Accounting."]

Allotment – A distribution made within an entity of amounts available for obligation. [See OMB Bulletin A-34, *Instructions on Budget Execution*, Section 11, Terms and Concepts, "Allotment."]

Apportionment -- A distribution made by OMB of amounts available for obligation in an appropriation or fund account into amounts available for specified time periods, programs, activities, projects, objects, or combinations thereof. The apportioned amount limits the obligations that may be incurred. The recipient entity normally allots the apportionment among organizational units.

Appropriation -- See Budget Authority

Budget – The Budget of the United States Government setting forth the President's comprehensive financial plan for allocating resources. The Government uses the budget system to allocate resources among its major functions and individual programs. The budget process has three main phases: formulation, congressional action on the budget, and execution. Some presentations in the budget distinguish between "on-budget" and "off-budget" totals. "On-budget" totals reflect the transactions of all Government entities except those excluded from the unified budget totals by law. Likewise, "off-budget" totals reflect the transactions of Government entities that are excluded from the unified budget totals by law. Currently excluded are the social security trust funds and the Postal Service Fund. The on- and off-budget totals are combined to derive unified or consolidated totals for Federal activity. The budget amounts and references in this exposure draft refer to the unified budget. [See *FY 2003 Budget of the United States Government: Analytical Perspectives*, "Budget System and Concepts and Glossary."]

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Budget Authority -- Authority provided by Federal law to incur financial obligations that will result in immediate or future outlays. Specific forms of budget authority include:

Appropriations – In most cases, authority provided by law permitting Federal agencies to incur obligations and make payments for specified purposes.

Borrowing Authority – Authority to incur obligations and to borrow, usually from the Treasury Department to liquidate the obligations. Borrowing is repaid in due course by the Federal entity from other resources.

Contract Authority – Authority to incur obligations in conjunction with a contract for goods or services, with subsequent appropriation or collection to liquidate the obligation.

Spending Authority from Offsetting Collections – Authority to incur obligations against collections credited to a specific expenditure account; and to make payments using the collections.

Budget Obligation – See Obligation below.

Budget Outlay – See Outlay below.

Budget Receipt – See Receipt below.

Budget Surplus or Deficit, Unified – The unified budget surplus is the excess of budget receipts over budget outlays during a fiscal year and a deficit is the excess of budget outlays over budget receipts during a fiscal year. [See *FY 2003 Budget of the United States Government: Analytical Perspectives*, "Budget System and Concepts and Glossary."]

Budget, Unified – The budget presents combined on- and off-budget totals to derive totals for Federal activity, which is sometimes called the unified budget. The off-budget receipts and outlays of the Social Security trust funds and the Postal Service Fund are added to the on-budget receipts and outlays to calculate the unified budget totals.

Budgetary Accounting – The system that measures and controls the use of resources according to the purposes for which budget authority was enacted; and, that records receipts and other collections by source. It tracks the use of each appropriation for specified purposes through the various stages of budget execution from appropriation to apportionment and allotment to obligation and eventual outlay.

Budgetary Resources – The amount of authority given to an agency allowing it to incur obligations.

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Cash Accounting – A system of accounting in which revenues are recorded when received in cash and expenses or expenditures are recorded when cash is disbursed. [See Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, paragraph 50; and Congressional Budget Office, *Glossary of Budgetary and Economic Terms*, "Cash Accounting."]

Component Entities – The term "component entity" is used to distinguish between the U.S. Federal Government and its components. The U.S. Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, *Entity and Display*, pars. 11-12). Use of "component entity" in this standard is only intended to distinguish between the U.S. Federal Government's consolidated financial statements and financial statements of its components. *[See FASAB exposure draft of Technical Bulletin,* Assigning Costs and Liabilities to Agencies that Result from Legal Claims against the Federal Government, *fn. 2.]*

Financing Sources, Other – Inflows of resources other than exchange and nonexchange revenue, including appropriations used, transfers of assets from other Government entities, and **imputed financing**. [See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 70.]

Imputed Financing – Financing provided to the reporting entity by another Government entity covering certain costs incurred by the former. For example, part of Federal employee retirement benefits have been paid by the Government's central personnel office. A reporting entity would recognize the full accruing cost of the benefits as well as the imputed financing so provided. [See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 73.]

Net Cost of Operations – Total costs incurred by the reporting entity less exchange revenue earned during the period. This is the "bottom line" of the statement of net costs. [See SFFAC 2, *Entity and Display*, pars. 86-99 and Appendix 1-B; and OMB Bulletin 01-09, *Form and Content*, Section 4.8, "Net Cost of Operations."]

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Net Operating Revenue (or Cost) – At the CFR level, the difference between the net cost of operations and, essentially, all non-exchange revenue.

Nonexchange Revenue – Inflows of resources to the Government that the Government demands or that it receives by donations. The inflows that it demands include taxes, duties, fines, and penalties.

Obligation – Following the enactment of budget authority and the completion of required apportionment action, Government agencies incur obligations to make payments. Obligations are binding agreements that will result in outlays immediately or in the future. Obligations include, for example: current liabilities for salaries, wages, and interest; contracts for the purchase of supplies and equipment, construction, and the acquisition of office space, buildings, and land; and other arrangements requiring the payment of money. [See *FY 2003 Budget of the United States Government: Analytical Perspectives*, "Budget System and Concepts and Glossary" (Obligations Incurred).]

Outlays – Outlays are payments to liquidate obligations and generally are recorded on a cash basis but also include certain non-cash items such as the estimated subsidy cost of direct loans and loan guarantees, and interest accrued on public issues of Treasury debt.

Principal Financial Statements – See SFFAC 2, paragraph 74, for a listing of the financial statements and other information that a financial report should include. The FASAB considers principal financial statements an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information. [SFFAC 2, *Entity and* Display, paragraph 71, footnote 12.]

Proprietary Accounting – A process employing accrual accounting (see definition above) and financial reporting to show actual financial position and results of operations by accounting for assets, liabilities, net position, revenues, and expenses.

Receipts – Collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment, and gifts of money to the Government.

Revenue, Nonexchange – See Nonexchange Revenue above.

Unified Budget – See Budget, Unified

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Wendy M. Comes, Executive Director

Project Staff:
Richard Fontenrose

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment

Statement of Federal Financial Accounting Standards No. 25

July 17, 2003

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB or its website:

- *Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.*

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Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
http://www.fasab.gov/

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Summary

This Statement of Federal Financial Accounting Standards (SFFAS) changes the classification of information about stewardship responsibilities required by federal accounting standards. It also eliminates the requirement to present certain information about stewardship responsibilities, known as the "Current Services Assessment," previously required by SFFAS 8.

Scope of this Statement

This Statement deals with

- **Risk Assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*
- The **Current Services Assessment** (CSA) required by SFFAS 8, *Supplementary Stewardship Reporting*, and
- **Social Insurance** information required by SFFAS 17, *Accounting for Social Insurance*.

Information about stewardship responsibilities is currently designated Required Supplementary Stewardship Information (RSSI), a category unique to federal financial reporting. Pursuant to this SFFAS, information about Risk Assumed will become required supplementary information (RSI). The Statement of Social Insurance (SOSI) will become a basic financial statement, while the remaining information about Social Insurance required by SFFAS 17 will be reported as RSI.

Reasons for Issuing this Statement

For reasons explained in Appendix A, the Board decided to review the classification of all RSSI required by federal accounting standards. The Board eliminated use of RSSI to report information about weapons systems when it issued SFFAS 23*, Eliminating the Category "National Defense Property, Plant, and Equipment*." Classification of other items of information currently designated RSSI (stewardship land, stewardship investments, and heritage assets) may be dealt with in one or more future exposure drafts. The Board also decided to eliminate the requirement to present the CSA now, because timely issuance of federal financial reports, a practice that was not possible when SFFAS 8 was published, will make it infeasible to present the CSA in the Government's annual financial report. The same information will, however, continue to be publicly available in the *Budget of the United States Government*.

How the Changes in this Statement Improve Federal Financial Reporting

These changes will improve the clarity and significance of federal financial reporting in two ways: (1) by defining the SOSI as essential to fair presentation and (2) by using reporting categories that are well defined in existing professional literature and familiar to report users.

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The Effective Date

The requirement to report the CSA will be eliminated effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as RSSI for periods beginning after September 30, 2004, with earlier implementation encouraged. Other information required by SFFAS 17 shall be presented as RSI rather than as RSSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements, for periods beginning after September 30, 2004.

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Reclassification of Stewardship Responsibilities And Eliminating the Current Services Assessment

INTRODUCTION 1
STANDARDS OF FEDERAL FINANCIAL ACCOUNTING 2
Risk Assumed ***2***
Current Services Assessment ***2***
Social Insurance ***2***
Effective Date ***2***
APPENDIX A: BASIS FOR CONCLUSIONS 3
Background ***3***
Conclusions Regarding Each Type of Stewardship Responsibility Information ***7***
Risk Assumed 7
Current Services Assessment (CSA) 8
Social Insurance 9
Conclusions Regarding Effective Date ***10***
Distinguishing RSI from the Basic Financial Statements and Associated Notes ***11***
Operational Differences Between the Basic Financial Statements and RSI 11
Footnote vs. RSI Section 13
Audit Aspects of Basic vs. RSI 13
Factors to Consider 14
Board Approval and Dissent ***17***

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_25.pdf.

Abbreviations

AGA	Association of Government Accountants
AICPA	American Institute of Certified Public Accountants
AT	Attestation Standards codified and published by AICPA
AU	Audit Standards codified and published by AICPA
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government (formerly the “CFS”)
CMS	Centers for Medicare and Medicaid Services (formerly HCFA)
CSA	Current Services Assessment
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	General Accounting Office
GASB	Governmental Accounting Standards Board
OAI	Other Accompanying Information (also known as “other supplementary information” – i.e., supplementary information not required by GAAP)
OMB	Office of Management and Budget
PCIE	President’s Council on Integrity and Efficiency (Inspectors General)
RSI	Required Supplementary Information (as used in SFAS 25 and other accounting standards and in AU Section 558)
RSSI	Required Supplementary Stewardship Information (as used in SFFAS 5, 8 and 17)
SFAC	Statement of Financial Accounting Concepts
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
SSA	Social Security Administration

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Statement of Federal Financial Accounting Standards
Reclassification of Stewardship Responsibilities
And Eliminating the Current Services Assessment

Introduction

1. Federal accounting standards require the following information to be reported regarding stewardship responsibilities:

   - **Risk Assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*,
   - The **Current Services Assessment** (CSA) required by SFFAS 8, *Supplementary Stewardship Reporting*, and
   - **Social Insurance** information required by SFFAS 17, *Accounting for Social Insurance.*

2. This information is currently designated Required Supplementary Stewardship Information (RSSI). RSSI is a reporting category unique to federal accounting. Pursuant to this Statement, Risk Assumed information will become required supplementary information (RSI), [1] and the CSA will not be required after FY 2002. For FY 2005 the Statement of Social insurance (SOSI) will become a basic financial statement, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Other Social Insurance information required by SFFAS 17 shall be presented as RSI rather than as RSSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements. Appendix A presents background information and the reasons for these changes.

3. This Statement amends SFFAS 5 and SFFAS 17 by reclassifying Risk Assumed information and Social Insurance information. Those standards would remain unchanged in all other respects. The requirement in SFFAS 8 to report the CSA is rescinded.

[1] RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, the Governmental Accounting Standards Board (GASB), and the FASAB. The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by AICPA.

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Standards of Federal Financial Accounting

Risk Assumed

4. Information about Risk Assumed, required by SFFAS 5 and previously designated required supplementary stewardship information (RSSI), shall be designated required supplementary information (RSI).

Current Services Assessment

5. Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8.

Social Insurance

6. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as required supplementary stewardship information (RSSI). Other information required by SFFAS 17 shall be presented as RSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements,

Effective Date

7. Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8, effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement for periods beginning after September 30, 2004, with earlier implementation encouraged. Other information required by SFFAS 17 shall be presented as RSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements, for periods beginning after September 30, 2004.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix summarizes the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background

8. In SFFAS 8, FASAB stated:

> A key aspect of the stewardship objective requires that Federal reporting provide information that helps users determine (1) whether the Government's financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
>
> Information on 'stewardship responsibilities' will aid in these determinations. It will provide an essential perspective on the Government's commitment to discretionary and mandatory programs.[2]

These objectives have not changed. However, for reasons discussed below, the Board believes that information about stewardship responsibilities should be reported in the context of the basic financial statements, the associated notes,[3] and required supplementary information, rather than as RSSI. The Board eliminated use of RSSI to report information about weapons systems when it issued SFFAS 23*, Eliminating the Category "National Defense Property, Plant, and Equipment*." The Board will consider in other projects the proper classification of other items that are now classified as RSSI.

9. The Board originally contemplated that GAO and OMB would provide special guidance regarding the audit procedures or "fieldwork" to be performed on RSSI. At the same time, the Board expected that the auditor would report on this information in much the same way as on the basic financial statements, in the sense that the auditor would qualify or disclaim an opinion when the RSSI was omitted or materially misstated. The category was seen as a response to the unique aspects of the federal accounting and reporting environment, and to the broad objectives of federal financial reporting. It was intended to permit flexibility

[2] SFFAS 8, paragraphs 14 and 15.

[3] The notes are regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP.

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on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information. [4]

10. Some members became concerned that users: (1) may pay insufficient attention to some important information because it is called "supplementary," and (2) may be confused by complicated reports in which information is reported in various places. They believed this might impede users' understanding and reduce the credibility of federal financial reports. Some members believed that FASAB's use of the RSSI category invites suspicion of accounting in which items that are as important as the basic financial statements are labeled "supplementary." Accordingly, in *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information"* (December 2000), the Board proposed to eliminate the RSSI category by reviewing and reconsidering the appropriate classification of each item classified as RSSI.

11. In deciding to review the classification of components of RSSI, some members were influenced by the fact that existing audit standards do not discuss RSSI. Therefore, auditors do not know what to do with respect to information in this category without consulting federal publications that provide additional guidance on how to conduct or contract for audits of federal financial statements. Furthermore, as practice evolved, it was not clear that auditors would qualify or disclaim their opinion on the basic financial statements when RSSI was missing or misstated, because it was not clear to everyone that the information was essential to fair presentation in conformity with GAAP. Some FASAB members were concerned that, under these circumstances, even sophisticated users might not understand fully the significance of certain information classified as RSSI. Some members believed that it would be desirable for FASAB to use categories that are widely understood by the broader accounting and auditing professions, particularly now that FASAB has been recognized by AICPA as the body that promulgates generally accepted accounting principles for the federal government.

12. The Board received 29 written comments on its December 2000 *Preliminary Views* from the following sources:

    - 16 preparers (all federal),
    - 8 auditors (three nonfederal, including AICPA),

[4] See the *Implementation Guide to Statement of Federal Financial Accounting Standards No. 7*: *Accounting for Revenue and Other Financing Sources*, June 1996, paragraphs 22-24, the diagram on page 15, and minutes of associated Board discussions. See also SFFAS 8, *Supplementary Stewardship Reporting*, June 1996, paragraphs 21, 34, 111-115, and minutes of associated Board discussions.

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- 5 others. (This category includes academics, retired federal employees, and the Association of Government Accountants (AGA), a professional association of federal and nonfederal accountants and auditors.)

13. The comments reflected the views of more than 29 people. Comments from the President's Council on Integrity and Efficiency (PCIE), AGA, federal agencies, and AICPA were the work of numerous individuals. Twenty of the respondents would have retained the RSSI category, at least for some period. Some typical concerns expressed include the following:

    - Elimination of the category would provide less stewardship information to users, lead to a qualified opinion that would send a less-clear signal to users than is available with current and potential alternatives, and raise audit costs. The category provides a clear and unique method to prominently display stewardship information essential to meeting taxpayer accountability. The category has been successful in communicating our financial condition.

    - The separate category and section of the report is an effective and practical means of reporting. It is appropriate for the unique environment and objectives of federal financial reporting. Approaches to providing audit assurance over RSSI are evolving. FASAB should work with specialists in the relevant disciplines to define common units of reporting for items not expressed in monetary terms.

    - Unique aspects of the federal financial reporting environment and objectives led the Board to create the new category. If used properly, the category should be a mechanism to provide much-needed information to decision makers, including citizens, when they consider the consequences of decisions relating to public lands, heritage assets, and similar items.

14. In April 2001 the Board held a public hearing to discuss the *Preliminary Views* proposal with interested parties. Fourteen individuals, representing seven organizations, made presentations and discussed issues with the Board. Comments were similar to those expressed in the 29 comment letters.

15. After considering these comments, the Board continued to believe that federal accounting standards may be able to address the objectives of federal financial reporting, including accountability and reporting on stewardship, without a unique category. The Board noted that eliminating the RSSI category need not result in a reduction of information required by existing standards. (The Board subsequently decided to rescind the requirement to present the CSA in the annual consolidated financial report of the U.S. Government (CFR) for other reasons, which are explained on page 8, but the information will continue to be available to the public). Furthermore, the Board noted, preparers will continue to have the option of voluntarily presenting supplementary information beyond what

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is required. This "other accompanying information" would be unaudited, unless special arrangements were made to extend the auditor's work in the context of a particular audit.

16. The Board continued to believe that avoiding use of the RSSI category where it is not essential would eliminate some potential confusion and ambiguity. In particular, it should clarify the Board's expectation that when material information that is essential to fair presentation is missing or materially misstated, the auditor should consider whether a qualified or adverse opinion is appropriate regarding whether the basic financial statements are prepared in conformity with GAAP. After consultation with AICPA staff, the Board concluded that this result could best be assured by designating such information as an integral part of the basic financial statements.

17. Accordingly, in February 2002, the Board published an exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*. The exposure draft proposed to eliminate the Current Services Assessment, reclassify information about Risk Assumed as RSI, and reclassify all Social Insurance information as an integral part of the basic financial statements. The Board received 22 comment letters from the following sources:

    - 11 preparers (all federal),
    - 7 auditors (6 federal and AICPA),
    - 4 others. (This category includes an academic, two former Board members, and the AGA.)

18. Some letters reflected the views of an organization, while others were from individuals. Comments generally supported or did not oppose eliminating the CSA and reclassifying Risk Assumed information as RSI. Some letters did express concern about the feasibility of auditing Social Insurance information as an integral part of the basic financial statements and/or questioned whether the benefit of doing so would outweigh the cost. In response to these concerns, the Board consulted with representatives of AICPA, and decided (1) to designate only the SOSI as a basic financial statement, while classifying other Social Insurance information as RSI, and (2) to extend the time allowed to implement this change. More detailed explanation of the basis for the Board's conclusions follows.

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Conclusions Regarding Each Type of Stewardship Responsibility Information

19. Figure 2 on page 14 presents a list of general factors that one or more Board members considered relevant for the classification choices. Specific decisions on each of the three types of stewardship responsibility information are discussed in the remainder of this Appendix.

Risk Assumed

20. The Board agreed that information about Risk Assumed should be RSI rather than an integral part of the basic financial statements, because the amounts are not sufficiently reliable and measurement methods are still experimental. This information is potentially valuable, but it is not yet a suitable basis for recognition or disclosure.[5] The Office of Management and Budget (OMB), the General Accounting Office (GAO), and the Congressional Budget Office (CBO) have considered the use of Risk Assumed information as a basis for budgeting for insurance programs. These agencies have concluded that more experience is needed before the measurements can be regarded as sufficiently reliable for budgeting. Similar considerations lead the FASAB to conclude that information about Risk Assumed should be included in financial reports as RSI, at least until agencies and auditors have more experience with this information.

21. The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables. The Board believes that additional guidance from FASAB on definition and measurement of “Risk Assumed” would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements. Developing and promulgating such guidance would require a separate project. Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies’ data systems and modeling capabilities to support reporting Risk Assumed. The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner. The Board notes that the “state of the art” for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop more specific criteria for reporting Risk Assumed, the Board will be able to learn from this ongoing experience.

[5] FASAB uses the term “disclosure” to refer to information that is not recognized on the face of the basic financial statements but is regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Normally such disclosures are presented in footnotes, but federal accounting standards published by FASAB do not currently prescribe the format for presentation of such disclosures. GAAP does not prohibit formatting or combining pieces of information in appropriate ways to direct the reader’s attention, provided that the results are not misleading.

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Current Services Assessment (CSA)

22. The CSA provides receipt and outlay data on the basis of the President's projections of future activities pursuant to current law. It is relevant for assessing the sustainability of programs established by current law; that is, relevant for assessing the sufficiency of future resources to sustain public services and to meet obligations as they come due. The CSA focuses on the totality of government operations rather than on individual programs. It provides an analytical perspective on the Government because it shows the short- and long-term direction of current programs.

23. SFFAS 8 defines the CSA by reference to what is published in the President's Budget. The Board did not then foresee the possibility that the CFR would be published before the Budget. Because the Board now expects that within a few years the CFR will be published before the President's Budget is available, the requirement to include the CSA in the CFR will expire in FY 2002 (i.e., the CSA will not be required in the CFR after FY 2002). In order to continue to require something comparable to the CSA as part of the CFR when the CFR is published before the Budget, federal accounting standards would need to define the CSA in some way other than by reference to the Budget. Developing the criteria for such a projection is beyond the scope of this project.

24. The Board considered the alternative of including OMB's current services estimates prepared for the "midsession review." The Board concluded that certain technical problems would make this alternative problematic. Furthermore, supplementary reporting on this basis would not add value, because the estimates are publicly available in any event, and because the base year actual data published in the budget would not be subject to review by the auditor.

25. The Board notes that OMB, CBO, and others regularly publish similar projections; therefore, similar information will continue to be available, regardless of whether it is required to be part of the CFR. The Board also notes that the "state of the art" for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop criteria for such a projection as a part of federal financial reporting, the Board will be able to learn from this ongoing experience.

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Social Insurance

26. The Board believes that the SOSI should be treated as a basic financial statement because it is essential to fair presentation and is important to achieve the objectives of federal financial reporting. The related stewardship objectives include helping users to assess the impact on the country of the Government's activities, determine whether the Government's financial position improved or deteriorated over the period, and predict whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due. In that regard, the multi-trillion dollar obligations associated with Social Insurance over the next 75 years could significantly exceed the largest liabilities currently recognized in the U.S. Government Balance Sheet.

27. The Board acknowledges that there is great uncertainty inherent in long term projections, but believes that if the uncertainty is suitably disclosed--as is required by SFFAS 17--it need not preclude designating the information as a basic financial statement, essential for fair presentation in conformity with GAAP. The Board rejects the idea that information based on projections cannot be an integral part of the basic financial statements. FASAB has not limited the content of federal financial statements to historical information.

28. Even within the context of historical financial reporting, the Board notes that accrual-basis “historical” financial statements include many measurements that involve assumptions about the future. The distinction between reporting on the financial effects of events that have occurred and the effects of future events depends, obviously, upon the definition of the event. The information required by SFFAS 17 reports on the financial effects of existing law and demographic conditions and assumptions, just as the pension obligation at a point in time is based on existing conditions. In that sense, Social Insurance information can be viewed as reflecting events that have occurred and, therefore, as “historical.”

29. Measuring the future effects of existing law and conditions for Social Insurance involves projections of economic and demographic trends, just as measuring the pension benefit obligation at a point in time involves assumptions about future salary progression. It is true that SFFAS 5 specifies a different measurement method for pensions and retiree healthcare than the method SFFAS 17 specifies for Social Insurance. It is also true that Social Insurance measurements are more sensitive to assumptions about the most distant years of the projection period. Nevertheless, the Board believes that it is appropriate to report the SOSI as a basic financial statement, essential for fair presentation in conformity with GAAP.

30. Classifying the SOSI as a basic financial statement will mean that auditors will consider a modification of their opinion if this information is materially misstated. A modification would send a clear and appropriate signal to users in such a

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circumstance. The Board understands that some added audit expense will be incurred as a result of this change in status for Social Insurance information, and added demands may be made on the accounting and actuarial staff of agencies that report Social Insurance information. The Board believes that the benefits in this case outweigh the expense. The SOSI is important to those who would understand the Government's financial condition and its impact on the financial condition of individual citizens, interesting to the public, and essential to fair presentation.

31. The exposure draft proposed to reclassify all Social Insurance information as an integral part of the basic financial statements. In response to concerns expressed about the cost and feasibility of auditing this information, the Board decided to define only the SOSI as a basic financial statement, and provided additional time for implementation. The impact of the change in audit status for the SOSI should be mitigated by the fact that preparers and users have experience with similar information. Also, much of the actuarial and audit work can be done before the end of the fiscal year, if the preparer and auditor prefer. SFFAS 17 provides for considerable flexibility in selecting the measurement date. Paragraph 26 of SFFAS 17 states:

> All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

Conclusions Regarding Effective Date

32. The standard eliminates the requirement to present the CSA, and does not change the definition, presentation guidelines, or audit status for Risk Assumed information. (RSSI is currently treated as RSI for audit purposes, pursuant to instructions in OMB's *Audit Bulletin*.) No delay is needed as a result of the changes regarding these two items. Accordingly, these changes are effective immediately.

33. Audit status for the SOSI would change; however, as noted above, the information is not new. Most of the relevant agencies have produced similar information for several years, and analysts and public officials have routinely used this information. Also, the impact of the audit requirement on the auditor and preparer should be reduced by the flexibility SFFAS 17 provides in selecting a measurement date for Social Insurance. The Board consulted with AICPA regarding the time needed to develop appropriate audit guidance. The Board also noted that federal agencies will be confronted with a challenging requirement for accelerated financial reporting in FY 2004. As a result, the Board

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concluded that the SOSI should be presented as a basic financial statement for reporting periods that begin after September 30, 2004, with earlier implementation encouraged.

Distinguishing RSI from the Basic Financial Statements and Associated Notes

34. To help readers understand the Board's deliberations, this section provides more details about some practical and conceptual factors that affected the Board's decision whether to designate an item as RSI or as an integral part of the basic financial statements. The basic financial statements include the principal financial statements and associated notes on which the auditor expresses an opinion as to whether the information is presented in conformity with GAAP. The terms "basic financial statements" and "principal financial statements" have been used synonymously in federal accounting.

35. FASB tends to use the term "basic financial statements" or simply "financial statements" consistent with the definition in FASB Concepts Statement 5, *Recognition and Measurement in Financial Statements of Business Enterprises*:

> . . . a financial statement is a formal tabulation of names and amounts of money derived from accounting records that displays either financial position of an entity at a moment in time or one or more kinds of changes in financial position of the entity during a period of time. Items that are recognized in financial statements are financial representations of certain resources (assets) of an entity, claims to those resources (liabilities and owners' equity), and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data. (SFAC 5, paragraph 5, footnote omitted.)

AICPA tends to use the term "basic financial statements" or simply "financial statements" also to encompass footnotes that are regarded as an integral part of the basic financial statements as defined in SFAC 5. Depending on the context, FASAB may use the term either way. The following discussion focuses on the distinction between information on which the auditor expresses an opinion (whether reported on the face of the basic statements or in the notes to the statements) and supplementary information that is also required by GAAP.

Operational Differences Between the Basic Financial Statements and RSI

36. Figure 1 (on page 12) identifies some operational differences under current auditing standards. Given these operational differences between basic financial statements and RSI, the Board must determine whether it would be more appropriate for a given item of required information to be deemed an integral part of the basic financial statements or RSI. The appropriateness depends on the

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particular benefits (based on various federal financial reporting objectives) and the costs (preparing, auditing, user processing, other) of making it subject to audit (vs. more limited procedures) and varying the potential audit opinion treatment (qualification vs. mere mention in the auditor's report).

Figure 1

Comparison Dimension	Basic Financial Statements	RSI
Is the information required to be in the financial **report**? (That is, it is either an integral part of the basic financial statements or it must accompany them.)	Yes	Usually[6]
Is the information deemed essential if the financial **statements** are to "present fairly" in conformity with GAAP?	Yes	No
What audit fieldwork is required?	Audit	Limited procedures pursuant to AU 558
Auditor's report	Positive assurance regarding "fair presentation"	Silent, no explicit assurance unless engaged to audit the RSI. However, if the RSI is financial information that has been subjected to audit procedures in connection with auditing the basic financial statements, the auditor may express assurance "in relation to the financial statements taken as a whole."
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Qualified or adverse opinion	Mention in report; no qualification of opinion on the basic financial statements.

37. It should be noted that the value of information to users and the value added by auditing it are separate, though certainly related, considerations. For example, some information may be valuable to some users, yet auditing it might add little value. On the other hand, some information (e.g., aggregated financial information for a federal agency as a whole) may not be used directly by decision makers as input to a particular "decision model," but auditing it might provide some degree of valuable assurance about other information (e.g., detailed program cost or budgetary expenditure information) or objectives of interest (e.g., internal accounting control and finance-related legal compliance). Auditing

[6] In some cases, RSI need not physically accompany the basic financial statements in the same document; certain GASB standards permit reference to another publicly-available report as an option for specified RSI.

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financial statements may also deter fraud and unintentional errors of various sorts in other, more timely reports.

Footnote vs. RSI Section

38. Although not required by auditing standards, RSI has customarily been located in a separate section of the financial report, to aid in distinguishing it from audited information.[7] This practice has continued with RSSI, evidently in part because federal preparers thought it was necessary, or at least desirable, to report "stewardship" items together. It is possible that placement of information in different sections of the financial report leads some types of readers to pay more (or less) attention to the information. Although the magnitude of these differences is an open question, research has shown that formatting can matter to individual users.

Audit Aspects of Basic vs. RSI

39. Both footnote disclosures and required supplementary information are viewed as being sufficiently relevant to be required to accompany the basic financial statements in financial reports,[8] though only the notes are regarded as required for fair presentation in conformity with GAAP. As discussed previously, one major difference between the two types of information is the extent and nature of the auditor's scrutiny and responsibility for the information; another is the nature of the auditor's report and the kind of "signal" it sends. Thus, the cost and value

[7] AU 558.10 states: "Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB, GASB, or FASAB. However, management may choose not to place the required supplementary information outside the basic financial statements. In such circumstances, the information should be clearly marked as unaudited. If the information is not clearly marked as unaudited, the auditor's report on the audited financial statements should be expanded to include a disclaimer on the supplementary information."

In practice, notes and RSI generally have not been commingled. Indeed, in discussing the location of RSI it requires, FASB said, "Reporting specialized information on oil and gas producing activities in a single location within a financial report is a desired objective of this Statement so as to make the relationship among the different types of information easier to analyze." (FAS 69, par. 117)

In theory, RSI might be integrated with related audited information, provided the unaudited information was suitably labeled. Whether this would be feasible and desirable in practice may be debatable. Concern on the part of independent CPAs about litigation risk has been among the factors that encouraged physical separation of audited information from unaudited information.

Another practical consideration may be introduced by recent guidance from AICPA intended to clarify the auditor's ability to offer some limited assurance "in relation to the financial statements" on certain RSI. This could imply a need to distinguish the RSI for which such assurance is offered from other types of supplementary information, both required and voluntary.

Some comments regarding FASAB's *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information"* suggested that some people believe there are conceptual as well as practical reasons to report different kinds of information separately.

[8] As noted, certain GASB standards permit reference to another publicly-available report as an option for specified RSI.

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added by audit are factors to consider. The main question is: for what types of information, users, and objectives would the benefits of making an item an integral part of the basic financial statements instead of RSI exceed the incremental costs of audit, compared with reviewing pursuant to AU 558's limited procedures?

Factors to Consider

40. In deciding whether a given item should be classified as RSI or as an integral part of the basic financial statements, one might consider a variety of factors, such as those listed in figure 2. They are not listed in any particular order, and some "overlap" or convey similar ideas. Different people assign different weight to each factor. Some people may not consider some of the factors at all, and some people may consider factors that are not listed. Likewise, different people may evaluate each item to be reported differently on each dimension. Therefore, figure 2 is not a decision tree, hierarchy, or precise algorithm for classifying items, but a general framework for each individual's judgment.

Figure 2

-Low (implies RSI) < <

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classification of Social Insurance information that three related factors are particularly important for that decision: (1) The Board agreed that the SOSI is "essential to fair presentation." A set of financial statements could not be said to "present fairly" when the SOSI is missing or materially misstated. For this reason, it is important (2) that this signal clearly be communicated to the reader of the financial report and (3) to the reader of the auditor's report. Other factors listed also were deemed relevant, and were deemed consistent with "basic" status; for example, a wide audience is interested in this information.

42. The Board ultimately decided to rescind the requirement to present the CSA for reasons discussed on page 8, but not before it considered the proper classification of the CSA. The amount of discretion available to the preparer was deemed especially important to the decision about how to classify the CSA. If there is very little discretion in preparing the information, the value of auditing may be modest. An example is SFFAS 8's requirement to reprint information as it was presented in the *President's Budget*, without independent criteria for evaluating it. On the other hand, if there is great discretion, questions may arise about whether the resulting information would be sufficiently reliable, comparable, and consistent without auditing. Another factor, relevant both to the decision initially to classify the information as RSI and to the decision eventually to terminate the requirement, is that there are other, credible sources of similar information. As noted, OMB and CBO routinely publish intermediate and long-term projections that are scrutinized by Congress and by analysts in the private sector.

43. Because SFFAS 5 does not include detailed criteria for defining and measuring Risk Assumed, preparers have considerable discretion in calculating it. This might seem to imply that audit would be desirable. However, auditors may have concerns about expressing positive assurance on information for which specific definitions and measurement criteria have not been defined. In other words, there may not be sufficient agreement on criteria that permit comparable and consistent reporting to permit classifying Risk Assumed as an integral part of the basic financial statements. Another example where this concern has affected classification is information about the condition of stewardship assets and deferred maintenance of property, plant and equipment. Even when auditors do provide assurance, in some cases they may wish to express special qualifications, explanations, or caveats in their report. An example might be an auditor's report on an examination of prospective financial information where there is great inherent uncertainty, or an examination of other assertions by management about matters where management has great discretion.

44. Concerning the "significance" factor: The basic financial statements (including notes that are regarded as an integral part of the financial statements) and RSI are both important enough to be required items in financial reports. With respect to the audit status of the information, it would seem that, by itself, the importance

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of an item need not automatically imply that the information should be audited. Rather, one would also consider the extent of the information-preparer's discretion as well as the cost of auditing the information item. However, it does seem that the more important the item, the more likely it should be audited, if the information preparer had a significant degree of discretion. One would be willing to incur more audit costs to avoid misstatement of very important information items that could affect users' decisions. Furthermore, the more important the item, the more likely it would be deemed essential to fair presentation, thus implying a need to qualify the auditor's opinion if the information were missing or misstated.

45. Concerning the "reliability and/or precision" factors: These factors are intertwined, and all affect the extent to which one would prefer audited information to RSI. "Reliability and/or precision *needed*" asks one to evaluate the users' tolerance for imprecise measures of a relevant item. Since auditing is likely to increase precision (either through inducing more precise measures by the preparer or by reducing the variance in the measures by audit procedures), the less tolerance for imprecision that users have concerning an information item, the more likely that the Board would want to make the item a required note disclosure instead of RSI.

46. "Reliability and/or precision *possible*" deals with the very nature of the information item being reported. Precision about measures of past events seems inherently more possible than precision about estimates of future events. To the extent that there is a fundamental minimum amount of imprecision in certain information items, the cost of increasing audit effort might not be justified. For some Board members, this consideration was among the factors (along with others such as cost/benefit) that imply "Risk Assumed" information should properly be classified as RSI at this time. At the same time, however, uncertainty need not preclude classifying information as an integral part of the basic financial statements when other factors indicate this is appropriate, as is the case with the SOSI. Uncertainty should be disclosed and described to the extent feasible.

47. Some other listed factors also relate to the nature of the information. For example, some people may define the domain of accounting and/or financial reporting (or categories within that domain) in terms of the nature of information involved (e.g., as limited to "historical" financial information or to certain defined "elements" of financial reporting, or to certain concepts such as "financial position"). FASB has emphasized the role of "elements of financial reporting" in defining the financial statements and notes. FASB and GASB also emphasize the concept of net assets or financial position in defining financial statements and notes.

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48. Other people may define financial reporting, and its component categories, in terms of the comparative advantage unique to reporting based on the information system for processing financial transactions. SFAC 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* says that the "financial statements . . . articulate with each other and derive from the same underlying data (par. 5). Some believe this idea is rooted in the basic "bookkeeping" paradigm of accounting (see SFFAC 1, *Objectives of Federal Financial Reporting,* paragraphs 166-168). Such a definition might be expected to lead to accounting standards that would define the basic financial statements in a narrow or traditional way, with other kinds of information (e.g., performance indicators or management's assertions about internal control) being reported as RSI.

49. Others may define the domain of financial reporting, and categories within that domain, more broadly. A broader definition might, for example, be expressed in terms of the objectives of federal financial reporting, or the comparative advantage of the annual reporting and audit cycle, which assures the production and examination of information that GAAP say is essential to fair presentation, where GAAP reporting is mandated by law, contract, or market forces. This kind of broader definition might be expected to lead to standards that would define more types of information (e.g., performance indicators or management's assertions about internal controls) as a part of the basic financial statements.

50. More generally, the "benefit/cost ratio of using resources to assure accuracy" asks one to assess the costs of producing auditable information and auditing it versus the benefits that could be achieved by merely preparing the information as RSI and applying the procedures specified at AU 558. Other things being equal, one would avoid auditing where the cost of auditing is quite high. Similarly, to the extent that alternative, credible sources of information exist, the cost of auditing the information may exceed its benefits.

Board Approval and Dissent

51. This Statement was adopted by the affirmative votes of seven members of the Board. Mr. Anania dissented. Mr. Kull abstained.

52. Mr. Anania dissents from this Statement because he believes the Board's decision to have the information required by Par. 27(3) and 32(3) of SFFAS l7 presented as a basic financial statement is premature and is not supported by a change in circumstances or appropriate technical considerations by the Board.

53. The Board issued SFFAS 17 in August 1999 after more than four years of debate and consideration of many major issues including: (1) definition of a federal liability with weight given to the unique circumstances of the Federal Government, including its sovereign powers, (2) nature of Social Insurance laws

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and practices, (3) significance of Social Insurance programs to individual taxpayers, and (4) long-term sustainability of the programs as currently constructed.

54. In SFFAS 17, Appendix A - Basis for Conclusions - Section 2, the arguments are presented for (Par. 73-79) and against (Par. 65-72) recognition, disclosure or supplementary reporting of Social Insurance programs. The Board's conclusion (Par. 80-83) acknowledges there were two polarized views. These sentences from SFFAS 17 summarize those views and the Board's decisions related to disclosure and measurement of Social Insurance obligations:

> . . . On the one side are those who believe that social insurance programs - especially Social Security and Medicare - constitute a liability of the Federal Government that should be recognized on the consolidated balance sheet and that the closed group is the best measure of it.... At the opposite pole are those who firmly believe that the closed group measure is meaningless or even potentially misleading and should not be disclosed at all in the financial report (Par. 80).
>
> . . . Although both sides make strong arguments, no empirical evidence has been offered that would prove one side right and the other wrong. The Board believes the best approach to resolve this issue is for the closed group data to be reported off the balance sheet as a part of a balanced RSSI package of disclosures about the Social Security and other social insurance programs (Par. 81).
>
> The Board believes that a more complete picture of the financial condition of the government can be provided by a forward-looking assessment of whether it can 'sustain public service and meet obligations as they come due' (Par. 85). . . .

55. Mr. Anania believes the key issues debated by the Board prior to the issuance of SFFAS 17 remain significant and unresolved. He believes the Board should reconsider the technical aspects of the Social Insurance programs from an accounting and reporting perspective before making the change that is called for by this Statement. He cites the following issues as some, but not all, of the issues the Board should deliberate while keeping the original SFFAS 17 requirements in place: (1) whether the distinction between exchange and non-exchange transactions in the Board's concepts is relevant to a liability recognition, (2) whether the closed group (current participants) population is the most meaningful focus for either recording a liability or for disclosure, and (3) whether the notions of a constructive liability or an "in substance" plan concept require consideration.

56. Further, he is concerned that not enough consideration and debate in connection with the issuance of this Statement was focused on the uncertainty inherent in

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the open group population (current and future participants) actuarial present values required by Par. 27 (3) (c), (f) and (g). While he acknowledges that the use of assumptions and estimates is accepted in the recording and/or disclosure of financial information, he has serious reservations as to whether the open group actuarial projections that include estimates for future participants in the plans can meet the reliability test. Those projections include receipts and outlays for people expected to be born or immigrate to the U.S. during the projection period (currently 75 years), as well as individuals under 15 years of age at the time of the projection. He believes it is imperative that this issue be fully considered before the Statement of Social Insurance (SOSI) is reclassified as a basic financial statement.

57. Mr. Anania also points out that audit coverage of the SOSI and other information required by SFFAS 17 has been discussed with members of the American Institute of Certified Public Accountants (AICPA) FASAB Liaison Taskforce and Social Insurance Taskforce. To date, there is no clear indication from the AICPA as to the nature of the audit coverage and audit report that would be forthcoming from the independent accountants engaged to audit the Social Security Administration (SSA) financial statements, including the SOSI information. He believes there is a direct correlation and linkage between the reliability of measurement for recognition purposes and the independent auditor's ability to render a meaningful report on those elements in financial statements. The links include the use of relevant empirical data, reasonability of and support for assumptions used, and the extent to which the information used can be objectively verified. The reliability of the projection methodology should be further explored before the results of those calculations are made an integral part of the basic financial statements.

58. The open group projection that is used to estimate the future financing shortfall in Social Insurance programs is inherently more sensitive to assumptions about the distant future than is true for the closed group calculations that are used to account for employee pensions and retiree healthcare costs. This is inevitably true, despite the best efforts of actuaries, economists, and other professionals involved in making these projections. This is mainly caused by the fact that a closed group dwindles over time, so that uncertainty about what will happen in the distant future has less impact than is the case for an open group that grows larger during the projection period. Currently, the SOSI is presented in the SSA financial report and in the Consolidated Financial Report of the United States Government (CFR) based on 75-year projections under the intermediate assumptions (sometimes referred to as the “best estimate”) of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (generally referred to as Social Security) and corresponding assumptions of the other Social Insurance programs for which the SOSI is required.

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59. Mr. Anania observes that FASB Statement of Financial Accounting Concepts No. 7 provides a distinction between estimated cash flows and expected cash flows. The latter refers to the sum of probability-weighted amounts in a range of possible estimated amounts; the estimated mean or average. It is believed by some, including Mr. Anania, that a probability-based approach is a more effective measurement tool in many situations. SSA is currently experimenting with methods that might better incorporate and communicate probabilities and uncertainties, as has been recommended by its technical review panels.[9] Mr. Anania believes that FASAB should study this further in consultation with others, including actuaries from SSA and the Centers for Medicare and Medicaid Services, before elevating the SOSI as currently defined to the status of a basic financial statement. Mr. Anania believes that the open-group projections that are the basis of the SOSI are more sensitive to assumptions about uncertain future events than is true for most, if not all, long-term liabilities and basic financial statement disclosures in both private and governmental financial reporting today.

60. Mr. Anania believes there is a further, significant issue that requires consideration before the SOSI is reclassified as a basic statement. The concept is articulation of the elements of the required financial statements. Articulation refers to the linkage of an item in one financial statement to an item reported on a different financial statement. Articulation demonstrates the interrelationships of the various financial statements. That linkage is demonstrated in Appendix 1- A thru 1- F of SFFAC 2*, Entity and Display*. The concept of linkage (described therein as "the order and flow of Data in the financial statements") is also very clearly depicted in a chart on page 43 of the 2001 *Consolidated Financial Report of the United States Government* (CFR). Since the other statements outlined in SFFAC 2 are prepared on an accrual basis, there is no linkage (articulation), as

[9] For example, the report of the 1999 Technical Panel includes the following observations (available at http://www.ssab.gov/Rpt99_III.html#pgfId-1005309) under the heading, "Illustrating Uncertainty":

"The current system of presenting low- and high-cost alternatives to the intermediate assumptions is inadequate. The alternatives are useful in demonstrating the sensitivity of the forecast to the underlying parameters (section II.G of the Trustees Report). However, without any model of the probabilities of the underlying parameters taking on the alternative values, there is no way to use the alternatives to form a distribution of possible outcomes. It is inadequate to show any forecast without an indication of the uncertainty that surrounds it. We follow previous panels in strongly recommending efforts toward stochastic modeling or similar techniques that are better able to capture the interrelationship among assumptions. We are not dogmatic in the recommendation, as we recognize that even stochastic modeling requires some set of assumptions about the variance in future outcomes--for example in fertility rates--that are hard to estimate. However, the assumptions are in some way embedded in current methods of projection in any case.

"Some modeling techniques allow for graphical presentations that are better at displaying the range of uncertainty. What we seek is a method of displaying to policy makers and the public just how uncertain is some average cost outcome or date of exhaustion of the Trust Funds, and what are the probabilities that events will be close to or far from that result. That the system might have a very high probability of being out of balance by 2 or more percent of taxable payroll, for instance, may be worth knowing regardless of whether it has attained actuarial balance under some set of intermediate assumptions."

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traditionally understood, between the basic financial statements described in SFFAC 2 and the SOSI. While that condition may be tolerable in a compromise standard that requires disclosure as Required Supplementary Stewardship Information (RSSI), Mr. Anania does not believe that condition is technically sound or tolerable in basic financial statements.

61. Finally, Mr. Anania does not believe the users of the SSA and CFR financial reports, particularly citizens and citizen intermediaries, will be better served by the change required by this Statement. He is concerned that the lack of linkage to the other basic statements will not be easily understood by users willing to study the information with reasonable diligence. Elevating the SOSI information to become a basic financial statement without accruing a liability or recognizing an expense based on that information might increase confusion of users of Government reports.

62. Mr. Anania does not dissent to Par. 4 of this statement in which the information about Risk Assumed is reclassified from RSSI to required supplementary information (RSI) or to Par. 5, which rescinds the current requirements for the Current Services Assessment.

63. Mr. Kull will abstain from voting on this statement. He will not dissent, as he believes that social insurance information should be included in the basic financial statements and notes and should be subject to audit. However, he shares Mr. Anania's concerns, and further believes these and other concerns need to be resolved before full implementation takes effect, including the development of appropriate audit standards, and the need for items in the financial statements to be grounded in appropriate definitions of the elements of financial reporting. His abstention from voting is intended as an expression of his assessment that the Board has not completed work on this matter.

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Joseph L. Kull
James M. Patton
Robert N. Reid
Alan H. Schumacher

FASAB Staff
Wendy M. Comes, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25

Statement of Federal Financial Accounting Standards 26

November 1, 2004

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in additional to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statement of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

- "Mission Statement: Federal Accounting Standards Advisory Board"

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Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Table of Contents

Summary 1
Introduction 2
Standards 3
Appendix A: Basis for Conclusions 4
Appendix B: Abbreviations 7

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_26.pdf.

Summary

This standard amends Statement of Federal Financial Accounting Standards 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, to require disclosure of significant assumptions underlying the Statement of Social Insurance (SOSI). “Disclosure” means “reporting information in notes or narrative regarded as an integral part of the basic financial statements.” Thus, this amendment reclassifies significant assumptions as basic information rather than as required supplementary information (RSI).

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Introduction

1. In July of 2003, the Board issued SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, and included changes addressing many of the issues identified in responses to the exposure draft (ED) preceding it. One change to the proposal in the exposure draft preceding SFFAS 25 shifted information other than the SOSI from disclosure to RSI status "Disclosure" means "reporting information in notes or narrative regarded as an integral part of the basic financial statements." [1] RSI is not part of the basic financial statements and is customarily presented as a separate section accompanying the financial statements. Another change to the proposal in the exposure draft preceding SFFAS 25 delayed the effective date to permit the development of audit guidance.

2. The task force of the American Institute of CPAs (AICPA) charged with developing that audit guidance takes exception to the fact that SFFAS 25 permits the preparer to present the significant assumptions underlying SOSI, a basic financial statement, as RSI.[2] The task force concluded that disclosure related to SOSI would be inadequate if management elects not to disclose significant assumptions in the notes to the financial statements. The task force believes that inadequate disclosure should result in a qualification of the audit opinion. The task force has proposed audit guidance that would require a qualification in the event significant assumptions are not disclosed.

3. The Board believes that generally accepted accounting principles (GAAP) should be clear with respect to adequate disclosure. In this instance, the Board agrees that disclosure of the significant assumptions underlying the SOSI is necessary to an understanding of the SOSI and through this statement amends SFFAS 25.

[1] In accounting literature "disclosures" also may be referred to as "notes" or "footnotes." This statement presents excerpts from other documents with these terms. There is no difference in meaning – rather different authors used different terms with the same meaning.

[2] SFFAS 25 affords management the option of disclosing the significant assumptions. Par. 6 of SFFAS 25 provides that "Other information required by SFFAS 17 shall be presented as RSI, **except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.** " (Emphasis added.)

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Standards

Amendment of SFFAS 25

4. Paragraph 6 of SFFAS 25 is rescinded.

5. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as required supplementary stewardship information (RSSI). The underlying significant assumptions shall be included in notes that are presented as an integral part of the basic financial statement. Other information required by SFFAS 17– including the sensitivity analysis required in par. 27(4) and 32(4)-- shall be presented as required supplementary information, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.

Effective Date

6. Consistent with the effective date of SFFAS 25, this standard is effective for periods beginning after September 30, 2004.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this proposed statement---not the material in this appendix---would govern the accounting for specific transactions, events or conditions.

7. The Board issued this standard to ensure that significant assumptions are presented as note disclosures to the Statement of Social Insurance so that well established expectations regarding adequate disclosure would be met. Concepts statements from many standard setters explain the requirement for adequate disclosure as follows:

    a. Financial reporting should include explanations and interpretations to help users understand financial information provided. … Moreover, financial reporting often provides information that depends on, or is affected by, management's estimates and judgment. Investors, creditors, and others are aided in evaluating estimates and judgmental information by explanations of underlying assumptions or methods used, including disclosure of significant uncertainties about principal underlying assumptions or estimates. Financial reporting may, of course, provide information in addition to that specified by financial accounting standards, regulatory rules, or custom. (Financial Accounting Standards Board, CON 1, *Objectives of Financial Reporting by Business Enterprises,* par. 54)

    b. Information disclosed in notes or parenthetically on the face of financial statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements.[4] That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles. [[4]For example, notes provide essential descriptive information for long-term obligations, including what amounts are due, what interest they bear, and whether important restrictions are imposed by related covenants. For inventory, notes provide information on the measurement method used—FIFO cost, LIFO cost, current market value, etc. For an estimated litigation liability, an extended discussion of the circumstances, counsel's opinions, and the basis for management's judgments may all be provided in the notes. For sales, useful information about revenue

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recognition policies may appear only in the notes. (FASB Statement No. 47, *Disclosure of Long-term Obligations;* ARB No. 43, Chapter 4 - Inventory Pricing, Statement 8; FASB Statement No. 5, *Accounting for Contingencies*, par. 10; and APB Statement 4, par.199)] (CON 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, par. 7a)

c. Financial information is also conveyed with accompanying footnotes, which are an integral part of the financial statements. Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading. (FASAB, SFFAC 2, *Entity and Display*, par. 68)

d. Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading. Reliability does not imply precision or certainty. Reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured; financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances some financial information is based on reasonable estimates. A properly explained estimate provides more meaningful information than no estimate at all. (Governmental Accounting Standards Board, Concept Statement 1, par. 64)

8. The Board believes that the underlying significant assumptions are essential to fair presentation. The Board believes that generally accepted accounting principles should result in disclosure of the significant assumptions upon which SOSI is based. Disclosures are an integral part of the basic financial statements while RSI is not an integral part of the basic financial statements. RSI accompanies the basic financial statements. Placing the significant assumptions in the disclosures associated with the SOSI serves two purposes. First, the significant assumptions inform the reader about the basis for the projections presented in the SOSI. Second, the reader has ready access to the significant assumptions through association with a principal financial statement.

9. The Board received 8 responses to its March 12, 2004 exposure draft on this subject. Of the responses, 5 were from federal respondents and 3 were from non-federal respondents. Seven of the eight respondents supported the proposal. However, two supported the proposal contingent on suggested changes.

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10. One recommended that the Board also include in the note disclosure an explanation of the uncertainty inherent in the process. The recommendation is not without merit but cannot be adopted absent an exposure draft proposing the change. The Board is not actively pursuing this additional amendment to SFFAS 25. The Board believes the nature of the information is adequately explained by the:

    a. required summary of significant accounting policies,

    b. disclosure of the significant assumptions,

    c. language in the auditor's report on SOSI explaining that there will be differences between the forecasts and actual results, and

    d. presentation of the sensitivity analysis as required supplementary information.

11. Another respondent requested that the Board defer the effective date of this amendment and SFFAS 25. Occasionally, the Board has deviated from the proposed effective date when finalizing standards proposed in an exposure draft and this is not considered a deviation significant enough to warrant re-exposure of the proposal. However, to alter the effective date of a previously issued standard – in this case SFFAS 25 – due process requires that the Board seek input on that change through an exposure draft proposing such a change. One example of this is the deferral of SFFAS 4, *Managerial Cost Accounting Standards for the Federal Government*.

12. Since the Board is unable to alter the effective date of SFFAS 25 through this amendment, the Board is proceeding with the earlier effective date for this amendment to ensure consistency with SFFAS 25. The Board is considering the request for deferral of SFFAS 25. An exposure draft was issued on July 20, 2004 proposing a one-year deferral of both SFFAS 25 and this standard. The Board will consider comments on the exposure draft and may issue a statement amending the effective dates.

Board Approval

13. This statement was approved for issuance by all members of the Board.

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Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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FASAB Board Members

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Joseph V. Anania, Sr.

Philip T. Calder

Claire Gorham Cohen

John A. Farrell

James M. Patton

Robert N. Reid

Elizabeth Robinson

Alan H. Schumacher

David Zavada

FASAB Staff

Wendy M. Comes, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7359
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Identifying and Reporting Earmarked Funds

Statement of Federal Financial Accounting Standards 27

28 December 2004

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Summary

This statement defines and addresses “earmarked funds.” Note that this statement uses the term “earmarked” only as it is defined below. This statement does not use the term “earmarked” as it is sometimes used to refer to set-asides of appropriations for specific purposes.

Scope of this Statement

The Board's proposed standard for "Fiduciary Activities" and this standard on "Earmarked Funds" together address all activities or funds considered "dedicated collections" by Statement of Federal Financial Accounting Standards (SFFAS) 7. When finalized, the fiduciary activities standard will rescind the "dedicated collections" provisions in SFFAS 7. This standard supersedes the “dedicated collections” provisions in SFFAS 7 (paragraphs 83-87) for earmarked funds.

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government’s general revenues. The three required criteria for an earmarked fund are:

1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government’s general revenues.

An earmarked fund may be classified in the unified budget as a trust, special, or public enterprise fund. Application of this standard, however, should not be based on whether a statute or the unified budget labels an earmarked fund as a certain type of fund. Rather, the Board intends that the term earmarked fund be applied based on the substance of the statute and consistent with the three criteria set forth in the standard.

Reporting Requirements

The component entity will show earmarked nonexchange revenue and other financing sources, including appropriations, and net cost of operations separately on the Statement of Changes in Net Position. The component entity also will show the portion of cumulative results of operations attributable to earmarked funds on the Statement of Changes in Net Position and on the Balance Sheet.

At the Government-wide level, earmarked revenue, other financing sources and net cost of operations will be shown separately on the U.S. Government Statement of Operations

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and Changes in Net Position. The U.S. Government Balance Sheet will show separately the portion of net position attributable to earmarked funds.

This standard requires that every component entity disclose the earmarked fund(s) for which it has program management responsibility. It also requires condensed information on assets, liabilities and cost for all earmarked funds, although it permits information on funds not presented individually to be aggregated. In addition, it requires disclosure of any legislation that changed the purpose of or redirected a significant portion of an earmarked fund.

Required note disclosures at the component entity level will clarify the fact that investments in Treasury securities held by the component entity are not assets for the Government as a whole. That is, the investments in Treasury securities are available for authorized expenditures and are thus assets of the managing component entity. However, financing will be needed by the Government as a whole when those investments in Treasury securities are redeemed to make expenditures.

In addition, this standard addresses those situations where several component entities each have program management responsibility for separate, identifiable portions of the earmarked fund. By requiring each component entity to report on only its portion of the earmarked fund, the standard assists report users in evaluating the service efforts, costs and accomplishments of the component entity.

Effective Date

The provisions of this standard are effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

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Table of Contents

Summary i
Scope of this Statement i
Reporting Requirements i
Effective Date ii
Table of Contents iii
Introduction 1
Scope 3
Effective Date 3
Accounting Standards 4
Definition of Earmarked Funds 4
Reporting for Earmarked Funds 6
Basis of Accounting 9
Effective Date and Implementation 10
Effect on Existing Standards 10
Appendix A: Basis for Conclusions 12
Response to Comments Received 12
Existing Accounting Standard Needs Clarification 13
Special Accountability 14
Identifying Earmarked Funds 14
Reporting Treatment 15
Board Approval 18
Appendix B: Glossary 19
Appendix C: Pro Forma Illustrations 21
Appendix D: Example of Note Disclosure Summary Financial Information for Component Entity 26
Appendix E: List of Abbreviations 27

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_27.pdf.

Introduction

1. This statement defines and addresses "**earmarked funds**[1]." Note that this statement uses the term "earmarked" only as it is defined below. This statement does not use the term "earmarked" as it is sometimes used to refer to set-asides of appropriations for specific purposes.

2. This statement amends Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources.* This statement defines and addresses earmarked funds and differentiates between earmarked funds and **fiduciary activity**. This statement requires that earmarked funds be identified and shown separately on the Statement of Changes in Net Position (for U.S. Government-wide, the Statement of Operations and Changes in Net Position) and the Balance Sheet. It also requires the component entity to identify all earmarked funds for which it has management responsibility, by either a list by official title or a statement indicating where the information can be obtained and to provide specific information on earmarked funds including revenue sources, assets and liabilities, and changes in net position.

3. Earmarked revenue and other financing sources are accounted for in earmarked funds with widely disparate characteristics. In a 2001 report, the Government Accountability Office (GAO) identified three hundred and ninety-two possible earmarked funds.[2] Annual revenues and other financing sources for those earmarked funds range from negligible amounts to over half a trillion dollars. Accumulated balances range from zero to over a trillion dollars.

4. Earmarked funds are financed by specifically identified revenues and other financing sources (such as appropriations) and serve a variety of purposes. Revenue sources may be exchange or nonexchange and include but are not limited to payroll taxes, excise taxes, customs duties, fees, user charges, sales of goods and services and interest earned. In addition, although earmarked funds are usually the responsibility of a single entity, management responsibility for some earmarked funds is shared by two or more entities.

5. The purpose of earmarked funds ranges from the long-term commitments financed by social insurance taxes, such as Social Security, to business-type activities financed mainly by exchange transactions, such as the Employees Life Insurance Fund. Every department and many independent agencies have at least one earmarked fund. Therefore, earmarked funds affect a wide array of programs, including commerce, income security, natural resources, administration of justice, agriculture, education, science and technology, the environment, healthcare, housing credit and insurance.

6. Despite the differences among earmarked funds they do share certain characteristics. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain

[1] Words first appearing in **boldface** are defined in Appendix B: Glossary.
[2] GAO, *Federal Trust and Other Earmarked Funds*, January 2001, GAO-01-199SP, p. 12. The term "earmarked funds" used by GAO in its survey differs from that established by this standard and was not intended to reflect standards for financial reporting. The term "earmarked funds" as used in either the GAO report or other governmental issuances shall not govern the application of this standard.

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available over time, are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the government's general revenues.

7. The following chart shows fund types used in reporting to the Treasury Financial Management Service (FMS) and the Office of Management and Budget (OMB). It is intended only to show the general relationship between fund groups and earmarked funds as classified in this statement. Regardless of classification for reporting to the Treasury FMS or the OMB, funds meeting the definition of earmarked funds promulgated in this standard should be so classified and funds not meeting the definition should not be so classified.

Table 1. Fund Groups Used in Federal Reporting to the Treasury FMS and the OMB

Fund Groups and Major Classes	Generally Are Subject to the Reporting Requirements of this Standard	Generally Are Not Subject to the Reporting Requirements of this Standard
General Funds ……..0000-3999		X
Revolving Funds……...4000-4999		
Intra-governmental Revolving Funds		X
Public Enterprise Funds:		
Credit Reform Financing Funds		X
All Other Public Enterprise Funds	X	
Special Funds …….. 5000-5999	X	
Deposit Funds ……6000-6999		X
Trust Funds ……..8000-8999	X	

8. Funds that receive earmarked revenue and other financing sources include special funds, trust funds -- both revolving and non-revolving -- and public enterprise funds. The **general fund** is used to carry out the general purposes of Government rather than being restricted by law to a specific program. It consists of all collections not earmarked by law to finance other funds, including virtually all income taxes and many excise taxes, and all expenditures financed by these collections and by general U.S. Treasury borrowing.[3] While **intragovernmental funds,** which are revolving funds that conduct business-type operations primarily within and between Government agencies, share the characteristics of an earmarked fund, they are excluded

[3] Analytical Perspectives, Budget of the United States Government, Fiscal Year 2005, p. 339.

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from the reporting requirements of this standard. Credit financing accounts and fiduciary funds are also excluded.

Scope

9. This statement provides accounting and reporting standards for earmarked funds in the general purpose financial statements of reporting entities and the U.S. Government-wide Financial Report. This statement does not affect reporting in the *Budget of the United States Government* or any other special purpose type of report.

Effective Date

10. This statement is effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

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Accounting Standards

Definition of Earmarked Funds

11. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. The three required criteria for an earmarked fund are:

    1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;

    2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and

    3. A requirement to account for and report[4] on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

12. The requirement to account for revenues and other financing sources that are statutorily available only for designated activities, benefits or purposes is usually created by statute. An earmarked fund may be classified in the statute, the unified budget, or both, as a trust, special, or public enterprise fund. Application of this standard, however, shall not be based on how a statute or the unified budget labels the fund. Rather, the Board intends that the term "earmarked fund" be applied based on the substance of the statute and consistent with the three criteria described above.

13. **Fund** in this statement's definition of earmarked funds refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[5]

Distinct from the General Fund

14. Whereas earmarked funds are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not earmarked by law for a specific purpose and the proceeds of general borrowing. Although there are exceptions, funding decisions regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing earmarked funds reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified

[4] A "report" may be something other than stand-alone financial statements for the earmarked fund.
[5] National Council on Governmental Accounting Statement 1, par. 16.

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revenues for a designated activity, benefit or purpose. Earmarked funds may have a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the appropriation is provided by authorizing legislation or annual appropriations acts, the cumulative results of operations arising from earmarked funds is reserved or restricted to the designated activity, benefit or purpose.

Distinct from Fiduciary Activities

15. The activity of earmarked funds differs from fiduciary activities primarily in that earmarked fund assets are Government-owned. A fiduciary activity is the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.[6] Therefore, even though an earmarked fund is designated exclusively for a specific activity, benefit or purpose, the Federal Government does not have a fiduciary relationship with the individuals or groups who potentially will benefit from the fund.

Distinct from Private Sector Trust Funds

16. Although earmarked monies are predominantly in funds that are designated by law as trust funds, the meaning of the term "trust" in the Federal Government differs significantly from its meaning in the private sector. Whereas earmarked funds in the Federal Government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship.

17. An earmarked fund should not be characterized as a "trust" in general purpose external financial reports of Federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Exclusions from Reporting Requirements

18. Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds are excluded because they are revolving funds that conduct business primarily within and between Government agencies. Credit financing accounts are also excluded. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to Federal credit programs. Fiduciary funds, which are not Government-owned, are also excluded.

[6] See the FASAB exposure draft of March 2003, *Accounting for Fiduciary Activities,* for more on fiduciary activity in the Federal Government and the differences between private trust funds and Federal government trust funds.

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Reporting for Earmarked Funds

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

19. Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position. Also, the portion of cumulative results of operations attributable to earmarked funds should be shown separately on both the Statement of Changes in Net Position and the Balance Sheet. This standard does not require earmarked funds to be separately shown on the Statement of Net Cost. (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)

20. Most earmarked revenues and other financing sources are in the basic financial statements of the entity carrying out the program and responsible for administration of the fund. If more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.[7]

Disclosure

21. A component entity should disclose[8] all earmarked funds for which it has program management responsibility by either a list, by official title, or a statement indicating where the information can be obtained. An earmarked fund should not be characterized as a "trust" in general purpose external financial reports of Federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

22. The following information should be disclosed for individual earmarked funds. An exception is provided for component entities having numerous individual earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual earmarked funds and in aggregate for all remaining earmarked funds:

    1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.

    2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

[7] To determine program management/accounting responsibility, agencies should consider the legislation authorizing the program; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display,* as amended by this standard.
[8] Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

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The information required by this paragraph for earmarked funds may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. Information for funds not presented individually may be aggregated, but must be provided even if the aggregate total is immaterial. The total cumulative results of operations shown in the note disclosure should agree with the cumulative results of operations for earmarked funds shown on the face of the component entity's basic financial statements.[9] (See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)

23. The following information should be disclosed for each individually reported earmarked fund, or portion thereof, for which a component entity has program management responsibility (see paragraph 24).

    1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.

    2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.

    3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.

24. Selecting earmarked funds to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's earmarked revenues or cumulative results of operations from earmarked funds; and qualitative factors such as whether an earmarked fund is of immediate concern to constituents of the fund, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the financial statements would be the primary source of financial information for the public.

25. The total cumulative results of operations of all earmarked funds shown in the note disclosure should agree with the cumulative results of operations of earmarked funds shown on the face of the component entity's Balance Sheet and the Statement of Changes in Net Position.

26. In accordance with the provisions of paragraph 20, if a component entity reports a different portion of an earmarked fund than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change in a note. This applies if a component entity does not report an earmarked fund, or portion thereof, that it reported in the previous year. It also applies if a component entity does report an earmarked fund, or portion thereof, that it did not report in the previous year.

[9] For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.

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Note on Investments

27. Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general Government purposes.

- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).

- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.

- When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.

28. Below is one example of a note that addresses the points in paragraph 27 above.

Intra-governmental Investments in Treasury Securities

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (or name/s of fund/s). The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the (component entity) as evidence of its receipts. Treasury securities are an asset to the (component entity) and a liability to the U.S. Treasury. Because the (component entity) and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the (component entity) with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the (component entity) requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

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Financial Statement Presentation and Disclosures for the U.S. Government-wide Financial Statements

Financial Statement Presentation

29. Earmarked funds should be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The portion of Net Position attributable to earmarked funds should be shown separately on the U.S. Government Balance Sheet.[10] (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)

Disclosure

30. Specific information should be disclosed for selected earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual earmarked funds and in aggregate for all remaining earmarked funds with eliminations necessary to produce the Government-wide total of earmarked funds:

    1. Condensed information about assets, liabilities and net position.

    2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

31. The information for earmarked funds should be disclosed in the notes accompanying the basic financial statements. Information for funds not shown individually may be aggregated (see paragraph 24). A total column should be presented that relates the disaggregated data to the data on the face of the principal financial statements. The net position shown in the note disclosure should agree with the portion of net position attributable to earmarked funds shown on the face of the balance sheet.

32. A note disclosure should provide a reference to component reports for additional information about individual earmarked funds.

33. A note disclosure should provide a general description of earmarked funds and an explanation of how the Federal Government as a whole could provide the resources represented by the earmarked funds' balance in Treasury securities.

34. An earmarked fund should not be characterized as a "trust" in general purpose external financial reports of Federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Basis of Accounting

35. All amounts reported and disclosed in the reporting entity's basic financial statements or the notes thereto, as required in paragraphs 19 through 34, should be recognized and measured using the standards provided in

[10] Net Position is composed of unexpended appropriations and cumulative results of operations for component entities. Since unexpended appropriations are not applicable at the U. S. Government-wide level, net position equals cumulative results of operations.

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generally accepted accounting principles applicable to the Federal Government.

Effective Date and Implementation

36. This standard is effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

Effect on Existing Standards

37. This standard affects existing standards dealing with "dedicated collections" in Statement of Federal Financial Accounting Standards 7*, Revenue and Other Financing Sources*, as follows: for funds meeting the definition of earmarked funds promulgated in this standard, paragraphs 83 through 87 are replaced by this standard.

38. This standard amends Statement of Federal Financial Accounting Concepts (SFFAC) 2, Entity and Display" footnote 3, as follows:

For some trust funds, the collection of the revenues is performed by an organizational entity acting in a custodial capacity that differs from the organizational entity that administers the trust fund. In those instances, the organizational entity that collects the revenue would be responsible for reporting only the collection and subsequent disposition of the funds. The organizational entity responsible for carrying out the program(s) financed by a trust fund, ~~or in the case of multiple responsible entities, the entity with the preponderance of fund activity,~~ will report all assets, liabilities, revenues and expenses of the fund, notwithstanding the fact that another entity has custodial responsibility for the assets. In the case of multiple responsible entities, if the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of SFFAS 27, *Identifying and Reporting Earmarked Funds*. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.

39. This standard amends SFFAC 3, Management's Discussion and Analysis-Concepts, paragraph 26 as follows:

Financial Results, Position and Condition-MD&A should help those who read it to understand the entity's financial results and financial position and the entity's effect on the financial position and condition of the Government. It should give readers the benefit of management's understanding of the significance and potential effect from both a short- and a long-term perspective of:

- the variations discussed in paragraph 14 in terms of major changes in types or amounts of assets, liabilities, costs, revenues, obligations and outlays;

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- particular balances and amounts shown in the basic financial statements, including the notes, such as those dealing with ~~dedicated collections or trust funds~~ earmarked funds, if relevant to important financial management issues and concerns; and

- the entity's required supplementary stewardship information (because RSSI describes economic conditions that cannot be expressed in the basic financial statements).

The provisions of this statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement – not the material in this or other appendices– should govern the accounting for specific transactions, events or conditions.

40. FASAB published the exposure draft *Identifying and Reporting Earmarked Funds* on October 16, 2003. Upon release of the exposure draft, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter, Government Accounting and Auditing Update,* and *JFMIP News;* the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past. A public hearing was held on March 4, 2004. Sixteen letters were received from the following sources; three respondents supplemented their written responses with oral testimony at the public hearing.

Comment letters and/or oral testimony provided by:	Federal (Internal)	Non-Federal (External)
Users, academics, others		3
Auditors	1	2
Preparers and financial managers	10	

Response to Comments Received

41. The majority of the respondents concurred with most of the provisions of the proposed standard. Several sources expressed the opinion that all of the disclosures should be placed in the notes to the financial statements. The Board's reasons for requiring some reporting on the face of the financial statements is provided in the section, "Reporting Treatment," which begins at paragraph 59 of this Appendix.

42. Several respondents requested guidance regarding criteria to consider in selecting earmarked funds for disaggregated disclosure; additional guidance has been included in this standard.

43. Several respondents questioned the term, "accounting mechanism," and asked why this term was used instead of a more specific term, such as Treasury account fund symbol. This standard eliminates references to accounting mechanisms and states that the Board's intent is to establish a principle-based standard that is not dependent upon funding terminology that is subject to change.

44. Two respondents requested that the examples in Appendix C differentiate between the Treasury General Fund and the Treasury Bureau of Public Debt. The examples in Appendix C now include that distinction.

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45. Two respondents asked for more detail regarding mixed-activity funds and the word “primarily.” However, the Board considers the definition criteria and the term “primarily” to be sufficiently clear regarding the classification of mixed-activity funds

46. One respondent identified credit financing accounts as a category of funds that would be covered by the standard, based upon definition criteria, that should not be included. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to Federal credit programs. The standard includes an “Exclusions” paragraph (paragraph 18) which excludes credit financing accounts from the reporting requirements of this standard

47. Three respondents had questions about earmarked funds that have exchange revenue. Appendix C has been expanded to include both exchange and nonexchange revenue.

48. Two respondents had questions about the reporting requirements for earmarked funds managed by multiple agencies. Footnote 7, which provides factors to consider in determining program management, has been added. Paragraph 38, which amends SFFAC 2, “Entity and Display,” has also been added.

Existing Accounting Standard Needs Clarification

49. The objective of this standard is to define earmarked funds and provide accounting and reporting guidance for them. In the existing standard, SFFAS 7, *Revenue and Other Financing Sources*, paragraphs 83 through 87, the term “dedicated collections” includes revenue earmarked or dedicated to finance or help finance specific Federal programs as well as revenue being held for the exclusive benefit of specific, identifiable non-Federal parties.[11]

50. SFFAS 7 did not differentiate between (a) Government-owned revenue and other financing sources earmarked to finance or help finance specific Federal programs (earmarked funds) and (b) cash and other assets being held for the exclusive benefit of specific, identifiable non-Federal parties who have ownership interest in the assets (fiduciary activities). The Board believes separate standards based on the unique characteristics of these two types of “dedicated collections” are needed. In April 2003 the Board issued an exposure draft of a proposed standard, *Accounting for Fiduciary Activities*, to address those activities relating to the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

51. The Board's proposed standard for "Fiduciary Activities" and this standard on "Earmarked Funds" together address all activities or funds considered "dedicated collections" by SFFAS 7. When finalized, the fiduciary activities standard will rescind the "dedicated collections" provisions in SFFAS 7. This standard supersedes the “dedicated collections” provisions in SFFAS 7 (paragraphs 83-87) for earmarked funds.

[11] SFFAS 7, par. 83.

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52. SFFAS 7 classifies funds as "dedicated collections" based on the term ''trust" as used in the U.S. Government Budget. It states that the standard covered "all funds within the budget classified as trust funds, " and "those funds within the budget that are classified as "special funds" but that are similar in nature to trust funds."[12] The Board found this definition was insufficiently precise to ensure that all earmarked funds were reported as intended. The definition in this standard provides a substantive basis for classifying funds instead of relying on terms used in the budget.[13]

Special Accountability

53. Although the Federal Government does not have a fiduciary relationship (as defined by the proposed standard, *Accounting for Fiduciary Activities*[14]*)* with the potential beneficiaries of earmarked funds, the unique nature of earmarked funds necessitates additional explanation and disclosure in the basic financial statements. In SFFAS 7, *Accounting for Revenue and Other Financing Sources,* special accountability reporting provisions were applied to all "dedicated collections" regardless of whether or not they involved Government-owned funds or private funds. The concept of special accountability applies to earmarked funds.

54. All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose. There is often a direct link between the source of fund revenues and designated activities, benefits or purposes in an effort to charge beneficiaries or users for benefits received. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined. Many earmarked funds receive permanent appropriations in an amount equal to these inflows that become available without recurrent action by Congress through annual appropriations.

55. Earmarked funds are of interest to a universe of contributors, taxpayers and recipients, who have an expectation that earmarked revenues will be used for the purposes specified in the law authorizing the collection of the revenues. For example, current contributors to Social Security programs may assume that their earmarked taxes in excess of payments to current recipients will be available to fund future social security benefits. The likelihood of the public making this assumption may reasonably be expected when the Federal Government issues projections of the availability of accumulated balances for future payments.

Identifying Earmarked Funds

56. The Board considered whether any substantive difference exists between earmarked funds that are designated as "trusts" and those that are not. It

[12] Ibid.
[13] The exposure draft, *Accounting for Fiduciary Activities*, discusses the differences between private trust funds, Federal government trust funds designated as trusts by Congress, and fiduciary funds.
[14] The exposure draft, *Accounting for Fiduciary Activities,* was issued in March 2003.

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also considered whether any substantive difference exists between earmarked funds that conduct business-type operations and those that do not. The Board did not find a substantive difference in either case. Therefore, all earmarked funds that meet the special accountability criteria in paragraph 11 of the standard are subject to the provisions of the standard, regardless of whether they are labeled as "trusts" or not and regardless of whether they conduct business-type operations or not.

57. The Board also considered whether intragovernmental funds should be included in the reporting requirements for earmarked funds. Although intragovernmental funds may meet the criteria of the definition of an earmarked fund, the Board does not believe Intragovernmental funds warrant special accountability to the public because these funds conduct business-type operations primarily within and between Government agencies. Intragovernmental balances are eliminated in the consolidation process in the preparation of the U.S. Government-wide financial statements.

58. The Board also decided to exclude credit financing accounts from the reporting requirements for earmarked funds. Although credit financing accounts may meet the criteria of the definition for earmarked funds, they primarily serve as clearing accounts for cash activity relating to Federal credit programs and do not accumulate results of operations. Fiduciary funds, which are not Government-owned, are also excluded.

Reporting Treatment

Effect on Net Position

59. Special accountability for earmarked funds is of increasing importance because the amount of revenue directed to earmarked funds has increased dramatically over the past two decades. It now constitutes a much greater proportion of the Federal budget. Just those earmarked funds designated as "Federal trust funds" by Congress alone accounted for over fifty percent of receipts from the public in 2003.

60. In addition, the invested balances of earmarked funds have grown significantly over the past two decades. Debt held by Government accounts was approximately $2.85 trillion in 2003, a twelve-fold increase from 1983[15].

61. Most of these balances are invested in Treasury securities. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general government purposes. Treasury securities are issued to the earmarked fund as evidence of its receipts. Treasury securities are an asset to the component entity and a liability to the U.S. Treasury. Because the component entity and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

[15] Fiscal Year 2005 Historical Tables, Budget of the U.S. Government, pp. 118-119.

62. Treasury securities provide the component entity with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the component entity requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures. The investments in Treasury securities (an asset) held by the various earmarked funds and the liability of the U.S. Treasury to redeem the securities are treated as intragovernmental eliminations when the consolidated U.S. Government-wide financial statements are prepared. Therefore, the consolidated net position of the Federal Government reported on the U.S. Government-wide financial statements does not include the effect of the claim on the U.S. Treasury that the various funds hold, just as the consolidated net position does not include the effect of other intragovernmental claims. Instead, the U.S. Government-wide financial statements include the cumulative results of operations of earmarked funds – currently a large positive balance – as an offset against the cumulative results of operations of the general fund – currently a large negative balance. The result is that the financing provided by earmarked fund operations to general fund operations – which would otherwise be financed through the issuance of debt to the public, tax increases or other financing sources – is not shown on the face of the U.S. Government Balance Sheet.

63. This standard requires component entities to show the total amount of cumulative results of operations attributable to earmarked funds on the Statement of Changes in Net Position and on the Balance Sheet. The U.S. Government-wide financial statements are subject to the same requirement, except that the U.S. Government-wide financial statements include the U.S. Government Statement of Operations and Changes in Net Position instead of the Statement of Changes in Net Position. Net position at the component level is composed of unexpended appropriations and cumulative results of operations. Since unexpended appropriations are not applicable at the Government-wide level, net position equals cumulative results of operations. Under this standard the financial statements would thus present – in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.

64. This standard also requires that component level financial statements include an explanation of earmarked fund investments in Treasury securities similar to the one given in paragraphs 27 and 28. The U.S. Government-wide financial statements are required to include an explanation of how the Government as a whole could provide the resources represented by the earmarked funds' balance in Treasury securities.

65. Several respondents to the exposure draft recommended that all reporting requirements relating to earmarked funds should be limited to the financial statement notes. Due to the impact of earmarked funds upon the financial position of the U.S. Government as a whole, as discussed in this section, the Board decided that certain basic disclosures, such as the impact upon net position, should appear on the face of the financial statements.

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Effect on Flows

66. For component entities, earmarked nonexchange revenue and other financing sources and net cost of operations are required to be shown separately in the Statement of Changes in Net Position. For the U.S. Government-wide financial statements, the components of earmarked funds activity should be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The Board believes that it is equally as important to show the earmarked funds activity during the period as it is to show the cumulative results of operations. Each gives a different and complementary perspective on the proportion of activity financed by general versus earmarked resources: the cumulative results of operations show the effect of all reporting periods up to a single point in time, whereas reporting of the earmarked funds activity shows the inflows and outflows during the reporting period. The relative importance indicated by each measure may differ because of trends in financing or special timing needs.

Disclosure

67. The Board determined that a number of earmarked funds were not being reported as intended under the existing standard. Therefore, in addition to clarifying the definition of earmarked funds, the standard requires that each component provide either a list of all earmarked funds for which it has program management responsibility or a statement as to where the information can be obtained. This requirement would ensure that no earmarked fund is omitted from the financial statements and that users could more easily locate information on a specific earmarked fund and determine its status. This information would not be required at the Government-wide level since program management responsibility does not reside at that level.

68. This standard requires condensed information on selected earmarked funds to be disclosed individually, with aggregate condensed information required for all others. In response to several requests from respondents to the exposure draft, the Board included, in paragraph 24 of this Statement, examples of quantitative and qualitative factors to be considered in selecting earmarked funds to be presented individually.

69. A component entity is required to disclose any change in legislation that significantly changes the purpose of the fund or that redirects a significant portion of the accumulated balance. In the opinion of the Board, the characteristic of special accountability requires that any significant change in the legislation governing the earmarked fund be disclosed in order to provide greater accountability for the earmarked revenues.

Other Changes

70. If more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the separate portions of the program can be clearly identified with the responsible component entity, then each component entity should report its portion in accordance with this standard. In the existing standard, SFFAS 7, paragraph 87, requires that “If more than one component entity is responsible for carrying out the program financed with the dedicated collections, then the

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entity with the largest share of the activity should be responsible for reporting all revenues, other financing sources, assets, liabilities, and costs of the fund."[16] The Board believes that this revision will assist users to evaluate the service efforts, costs and accomplishments of the component entity with actual program management responsibility, by relating relevant costs directly to the associated mission and performance.

71. For funds meeting the definition criteria of earmarked funds, paragraph 86 of SFFAS 7 is replaced by this standard. In the opinion of the Board, the necessary guidance is provided in this standard in paragraph 35.

Implementation

72. Early implementation of this standard is not permitted because of the difficulties that might arise when component financial statements are consolidated into the Government-wide financial statements. For example, a problem might arise if a component entity, which had previously reported all of the activity of an earmarked fund based on the requirements of the existing standard, decided upon early implementation of the standard, which allows it to report only that portion of the earmarked fund for which it has program management responsibility. This choice would cause portions of the earmarked fund not to be reported in the consolidated financial statements unless the component entities with management responsibility for the other portions of the earmarked fund also chose early implementation of the standard. For the same reason, restatement of the prior period columns in the initial year of implementation is not permitted.

Board Approval

73. This statement was approved for issuance by all members of the Board.

[16] SFFAS 7, Accounting for Revenue and Other Financing Sources.

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Appendix B: Glossary

Component Entity – A "component entity" that prepares financial statements is a unit of the Government. The Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into sub-organizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. "Component entity" is used in this standard to distinguish between the Financial Report of the United States Government's consolidated financial statements and financial statements of its components. Also see "Entity."

Earmarked – Statutory dedication of specifically identified revenues and other financing sources to designated activities, benefits or purposes.

Earmarked Fund – Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the Government's general revenues. The three required criteria for an earmarked fund are:

- A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
- Explicit authority for the earmarked funds to retain revenues and other financing sources not used in the current period for the future benefit of the designated activities, benefits, or purposes; and
- A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

Entity – An entity may be the Government as a whole or a unit of the Federal Government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, "trust funds," and/or other accounts for which financial statements will be prepared in accordance with OMB guidance. Also see "Component Entity."

Fiduciary Activity – An activity that relates to the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

Fiduciary Relationship – A fiduciary relationship exists when an authorized agent or entity of the Government accepts, recognizes, agrees to or consents to undertake fiduciary activity.

Fund – "Fund" has more than one meaning. Depending on the context it may mean merely a resource as in "funds" available to pay an obligation. Or, for budgetary accounting, it may mean "Federal funds" or "trust funds," the two major groups of funds in the budget. The Federal funds include all transactions not classified by law as being in trust funds. The main financing component of the Federal funds group is referred to as the "General Fund," which is used to

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carry out the general purposes of Government rather than being restricted by law to a specific program and consists of all collections not earmarked by law to finance other funds.

A fund can also mean a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.[17] Fund financial statements can be used to report additional and detailed information. The term "fund" is used in this standard to refer to a fiscal and accounting entity.

General Fund – The general fund accounts for receipts not earmarked by law for specific purposes, the proceeds of general borrowing, and the expenditure of these monies. General fund receipts constitutes the greater part of the budget, e.g., almost all income tax receipts are general fund receipts. General fund appropriations draw from general fund receipts and borrowing collectively and, therefore, are not specifically linked to earmarked receipts. [See *The Budget of the United States FY 2004, The Budget System and Concepts and Glossary*.]

Intragovernmental Fund – Revolving funds that conduct business-type operations primarily within and between Government agencies.

Non-Federal Individuals or Entities – Individuals and entities acting in their private capacities outside of the authority and control of the Federal Government. Federal employees are "non-Federal individuals" when acting in their private capacities, e.g., with respect to their private retirement assets managed by a Federal plan.

[17] National Council on Governmental Accounting Statement 1, par. 16.

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Appendix C: Pro Forma Illustrations

Table of Illustrations

Transactions – Component Entity Receives Revenue and Purchases Securities
1.A. Entries recording receipt of earmarked revenue by Component Entity
1.B. Entries recording the Component Entity's purchase of Treasury Securities
1.C. Entries recording interest on Treasury Securities
Pro Forma Statements showing effect on Component Entity's basic financial statement reporting
1.D. (1) Component Entity Statement of Changes in Net Position
1.D. (2) Component Entity Balance Sheet
Pro Forma Statements showing effect on the U.S. Government-wide Financial Statements
1.E. (1) U.S. Government-wide Consolidation Worksheet:
1.E. (2) U.S. Government Statement of Operations and Changes In Net Position
1.E. (3) U.S. Government Balance Sheet

Transactions– Component Entity Receives Revenue and Purchases Securities

1. A. Entries recording receipt of earmarked revenue collected by the Component Entity:

	DR	CR
Component Entity		
Fund Balance with Treasury (FBWT)	1,000	
Nonexchange revenue		600
Exchange revenue[18]		400
To record receipts credited to earmarked fund.		
Treasury General Fund Entity		
Treasury General Fund Cash	1,000	
General Fund's Liability for FBWT		1,000
To record earmarked revenue collected by Component Entity.		

1.B. Entries recording the Component Entity purchase of Treasury securities:

	DR	CR
Component Entity		
Investments in Treasury Securities	1,000	
Fund Balance with Treasury		1,000
To record Treasury securities purchased.		

[18] This standard does **not** require exchange revenue for earmarked funds to be separately shown on the Statement of Net Cost

Treasury General Fund Entity

General Fund's Liability for FBWT (Component Entity)	1,000	
General Fund's Liability for FBWT (Treasury BPD)		1,000

To record payment to Treasury Bureau of Public Debt for securities purchased.

Treasury Bureau of Public Debt Entity

Fund Balance with Treasury	1,000	
Liability for Intragovernmental Debt- Treasury Securities		1,000

To record sale of securities to Component Entity earmarked fund.

1.C. Entries recording interest earned on Treasury securities

Component Entity

Fund Balance with Treasury (FBWT)	10	
Interest Revenue- Exchange		4
Interest Revenue- Nonexchange[19]		6

To record interest income on Treasury securities.

Treasury Bureau of Public Debt Entity

Interest Expense	10	
Fund Balance with Treasury (FBWT)		10

To record interest expense.

Treasury General Fund Entity

General Fund's Liability for FBWT (Treasury BPD)	10	
General Fund's Liability for FBWT (Component Entity)		10

To record payment of interest to Component Entity by Treasury BPD.

[19] For classification of exchange and nonexchange interest revenue, see SFFAS 7, Appendix B, paragraphs 306-308.

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Pro Forma Statements showing effect of illustrative transactions on Component Entity's basic financial statement reporting[20]

(This is only one example of how the required information could be displayed**.)**

1.D. (1) **Component Entity**
Statement of Changes in Net Position

	Cumulative Results Of Operations	
	Social Security and Other Earmarked Funds	All Other
Beginning balance of net position	$ -	$ -
Budgetary financing sources:		
Non-exchange revenue	606	
Net cost of operations [from statement of net cost]	(404)	
Change in net position	1,010	
Ending balance of net position	$ 1,010	$ -

1.D. (2) **Component Entity**
Balance Sheet

	Social Security and Other Earmarked Funds	All Other
ASSETS		
Fund balance with Treasury	$ 10	$ -
Investments in Treasury securities	1,000	
Total assets	$ 1,010	
LIABILITIES	$ -	$ -
NET POSITION		
Unexpended Appropriations	$ -	$ -
Cumulative Results of Operations	1,010	
Total Net Position	1,010	
Total liabilities and net position	$ 1,010	$ -

[20] This standard does **not** require earmarked funds to be separately shown on the Statement of Net Cost.

1.E. (1) Consolidation Worksheet for U.S. Government-wide Financial Statements

	Component Entity	Treasury General Fund	Treasury BPD	Eliminations	Gov't-wide
ASSETS					
Treasury General Fund Cash Account	$ -	$ 1,000	$ -	$ -	$ 1,000
Fund balance with Treasury	10	-	990	-1,000	-
Investments in Treasury Securities	1,000			-1,000	-
Total assets	$ 1,010	$ 1,000	$ 990	$ -	$ 1,000
LIABILITIES					
Treasury General Fund Liability for FBWT	$ -	$ 1,000	$ -	$-1,000	
Treasury BPD Liability for Intragovernmental Debt			1,000	-1,000	-
Total Liabilities	$ -	$ 1,000	$ 1,000	$ -	$ -
NET POSITION					
Net Position of Other Funds	-	-	-	-	-
Net Position of Federal Old-Age Survivors Insurance and Other Earmarked Funds	$ 1,010	$ -	$ -10	$ -	$ 1,000

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Pro Forma Statements showing effect of illustrative transactions on U.S. Government-wide financial reporting

1.E. (2) U.S. Government Statement of Operations and Changes in Net Position

Operating Results:

Earmarked Funds Activity

Revenue:	
Social Security Tax Revenue	$ 600
Other Revenue and Other Financing Sources	400
Total revenue	1,000
Less net cost of operations	--
Net operating revenue	1,000

General Activities

Revenue	--
Less net cost of operations	--
Net operating cost	--
Total net operating revenue (cost), all government activities	$ 1,000

Net Position:

Net Position, Beginning of Period	
Social Security and Other Earmarked Funds	$ --
All Other	--
Net Position, End of Period	
Social Security and Other Earmarked Funds	1,000
All Other	--
Total Net Position	$ 1,000

1.E. (3) U.S. Government Balance Sheet

ASSETS	
Treasury Government-wide Cash Account	$ 1,000
Total assets	$ 1,000
LIABILITIES	$ --
NET POSITION	1,000
Social Security and Other Earmarked Funds	1,000
All Other	--
Total liabilities and net position	$ 1,000

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Appendix D: Example of Note Disclosure Summary Financial Information for Component Entity

The following illustrates the component entity summary financial information required in paragraph 22. The illustration has been simplified by not showing prior year comparative statements.

	ABC Fund	CDE Fund	Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30				
(In thousands)				
ASSETS				
Fund balance with Treasury	$ 20,635	$ 15,000	$ 5,000	$ 40,635
Investments	1,364,823	9,000,000	350,000	10,714,823
Taxes and Interest Receivable			10,000	10,000
Total Assets	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
LIABILITIES and NET POSITION				
Cumulative Results of Operations	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
Total Liabilities and Net Position	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
Statement of Net Cost For the Period Ended September 30				
Program Costs	$ 383,547	$ 450,000	$ 247,000	$ 1,080,547
Less Earned Revenues			5,000	5,000
Net Program Costs	383,547	450,000	242,000	1,075,547
Less Earned Revenues Not Attributable to Programs				
Net Cost of Operations	$ 383,547	$ 450,000	$ 242,000	$ 1,075,547
Statement of Changes in Net Position For the Period Ended September 30				
Net Position Beginning of Period	$ 1,317,760	$ 8,715,000	$ 287,000	$ 10,319,760
Net Cost of Operations	383,547	450,000	242,000	1,075,547
Taxes and Other Nonexchange Revenue	451,245	750,000	320,000	1,521,245
Change in Net Position	67,698	300,000	78,000	445,698
Net Position End of Period	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458

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Appendix E: List of Abbreviations

FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
MD&A	Management Discussion and Analysis
OMB	Office of Management and Budget
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
Treasury FMS	Treasury Financial Management Service
U.S.	United States

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David M. Zavada

FASAB Staff
Wendy M. Comes, Executive Director

Project Staff:
Eileen W. Parlow

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26

Statement of Federal Financial Accounting Standards 28

January 6, 2005

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in additional to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statement of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

- "Mission Statement: Federal Accounting Standards Advisory Board"

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441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
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Table of Contents

Summary i
Introduction 1
Standards 2
Appendix A: Basis for Conclusions 3
Appendix B: SFFAS 26 5
Appendix C: Abbreviations 6

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_28.pdf.

Summary

This standard defers for one year the effective dates of Statement of Federal Financial Accounting Standards (SFFAS) 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, as well as SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25.* The provisions of these standards will be effective for periods beginning after September 30, 2005.

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Introduction

1. In July of 2003, the Board issued SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*. SFFAS 25 requires that the Statement of Social Insurance (SOSI) be presented as a basic financial statement. SFFAS 26[1], *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, requires disclosure of significant assumptions underlying the SOSI. Both statements were to be effective for periods beginning after September 30, 2004.

2. Three federal agencies – the Office of Management and Budget (OMB), the Social Security Administration (SSA) and the Department of Health and Human Services (HHS) -- requested that the implementation of SFFAS 25 and 26 be deferred for one year. Each agency cites the fact that audit guidance was not finalized in time to support the original implementation date.

3. While noting the importance of reclassifying SOSI and related disclosures, the Board agrees that the current effective date is not feasible in light of the delayed audit guidance. Therefore, the effective date is deferred for one year. For ease of reference, Appendix B presents the text of SFFAS 26 as amended by this standard.

[1] The relevant text of SFFAS 26 marked with amendments is presented as Appendix B.

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Standards

Amendment of SFFAS 25

4. Par. 7 of Statement of Federal Financial Accounting Standards (SFFAS) 25 is amended as follows:

> Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8, effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002. ~~The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement for periods beginning after September 30, 2004, with earlier implementation encouraged. Other information required by SFFAS 17 shall be presented as RSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements, for periods beginning after September 30, 2004.~~

Amendment of SFFAS 26

5. Par. 6 of SFFAS 26 is amended as follows:

> ~~Consistent with the effective date of SFFAS 25, this~~ This standard is effective for periods beginning after September 30, ~~2004~~ 2005.

Effective Date

6. This standard is effective upon issuance.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---govern the accounting for specific transactions, events or conditions.

7. The Board conferred with the AICPA regarding the need for audit guidance prior to issuing SFFAS 25. In late 2003, a task force of the AICPA was formed to develop audit guidance. An exposure draft of the guidance was issued by the AICPA in March 2004. The final guidance was not issued in sufficient time to prepare for the initial implementation date despite the extensive efforts of the AICPA.

8. The Board issued an exposure draft proposing this deferral on July 21, 2004. Comments were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	2	1
Preparers and financial managers	5	

9. All ten respondents supported the proposed deferral.

Structure of the Amendment

10. SFFAS 25, par. 7 contained provisions concerning the SOSI as well as an effective date for the provisions. SFFAS 26 replaces the reclassification provisions of SFFAS 25 related to the SOSI and provides an effective date for the revised provisions. The amendments in this standard replace the prior effective dates concerning the SOSI reclassification and information in the prior statements with a new effective date of "periods beginning after September 30, 2005." Appendix B presents SFFAS 26 as amended by this standard.

Reasons for the Deferral

11. Agencies requesting the deferred implementation identified the following consequences of the delayed audit guidance:

    a. Agency staff was not able to prepare for the audit process due to the uncertainty absent final audit guidance on the process.

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b. Agency staff was engaged in deliberations with the AICPA task force and unable to begin tentative preparations for the audit.

c. Contracts for audit engagements have not been expanded to encompass the audit process to be required relative to the SOSI.

d. Funding for the expanded audit engagements could not be included in fiscal year 2005 budget submissions.

12. The Board believes that a one-year delay is reasonable, necessary and appropriate in light of the delayed audit guidance.

Board Approval

13. This statement was approved for issuance by all members of the Board.

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Appendix B: SFFAS 26

Paragraphs 4 through 6 of SFFAS 26 are presented with the revisions included for ease of reference.

Amendment of SFFAS 25

4. Paragraph 6 of SFFAS 25 is rescinded.

5. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as required supplementary stewardship information (RSSI). The underlying significant assumptions shall be included in notes that are presented as an integral part of the basic financial statement. Other information required by SFFAS 17– including the sensitivity analysis required in par. 27(4) and 32(4)-- shall be presented as required supplementary information, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.

Effective Date

6. ~~Consistent with the effective date of SFFAS 25, this~~This standard is effective for periods beginning after September 30, ~~2004~~ 2005.

The provisions of this Statement need not be applied to immaterial items.

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Appendix C: Abbreviations

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
HHS	Department of Health and Human Services
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SSA	Social Security Administration
SOSI	Statement of Social Insurance

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Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
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Federal Accounting Standards Advisory Board

Heritage Assets and Stewardship Land

Statement of Federal Financial Accounting Standards 29

July 7, 2005

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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Summary

This standard changes the classification of information reported for heritage assets and stewardship land provided by Statement of Federal Financial Accounting Standards 8. This standard reclassifies all heritage assets and stewardship land information as basic except for condition information, which is reclassified as required supplementary information (RSI). This standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be shown. Instead, the note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land. These requirements include a description of major categories, physical unit information for the end of the reporting period, physical units added and withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

This standard also requires two new disclosures for heritage assets and stewardship land. Specifically, this standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

This standard also includes the requirements for the U.S. Government-wide Financial Statement. It provides for a general discussion and directs users to the applicable entities' financial statements for more detailed information on heritage assets and stewardship land.

This standard amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_29.pdf.

Heritage Assets and Stewardship Land

Table of Contents

Introduction 1

Standards of Federal Financial Accounting 3

Heritage Assets (including Multi-use Heritage Assets) 3

Amendments to Existing Standards 3

Definitions 3

Recognition and Measurement 4

Disclosures and Required Supplementary Information 5

U.S. Government-wide Financial Statement Disclosures 7

Stewardship Land 8

Amendments to Existing Standards 8

Definitions 8

Recognition and Measurement 9

Disclosures and Required Supplementary Information 9

U.S. Government-wide Financial Statement Disclosures 11

Effective Date 12

Appendix A: Basis for Conclusions 13

Introduction 13

Amendments to Standards 14

Basic vs. RSI 15

U.S. Government-wide Financial Statement 16

Exposure Draft 16

Responses to the ED 17

Board Consideration of Comments 18

Importance to Mission 18

Limiting Information Presented 19

Categorization and Unitization 19

Supporting Documentation 21

Additional Guidance 21

Effective Date/Phased-In Implementation 22

Materiality 23

Board Approval 24

Appendix B: List of Abbreviations 25

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Statement of Federal Financial Accounting Standards
Heritage Assets and Stewardship Land

Introduction

1. The required supplementary stewardship information (RSSI) category, as described in Statement of Federal Financial Accounting Standards (SFFAS) 8, was a response to the unique aspects of the Federal accounting and reporting environment, and to the broad objectives of Federal financial reporting. It was intended to permit flexibility on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information.[1]

2. Although some stewardship information may not link directly with the basic financial statements because the data to be reported may be other than in dollar terms, the Federal Accounting Standards Advisory Board (the Board or FASAB) intended that RSSI information would augment the basic financial statements and would receive commensurate audit scrutiny.

3. The Board found, however, that in many cases the word "supplementary" in the RSSI title caused certain readers to assume that the information was of secondary importance. Since this was contrary to its intentions, the Board decided to eliminate the RSSI category and re-categorize the stewardship elements within the reporting categories that are well defined in existing professional literature and familiar to report users. Additionally, this standard clarifies the Board's expectation that information essential to fair presentation will be subject to audit.

4. The main focus of this standard is the reclassification of heritage assets and stewardship land information. This standard reclassifies heritage assets and stewardship land information as basic information with the exception of condition reporting, which is considered RSI[2]. Specifically, this standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be

[1] See the *Implementation Guide to Statement of Federal Financial Accounting Standards 7*: *Accounting for Revenue and Other Financing Sources*, par. 22-24, the diagram on page 15, and minutes of associated Board discussions. See also SFFAS 8, *Supplementary Stewardship Reporting*, par. 21, 34, 111-115, and minutes of associated Board discussions.

[2] RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, Governmental Accounting Standards Board (GASB), and FASAB. The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by the American Institute of Certified Public Accountants (AICPA).

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shown. The note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land, which includes a description of major categories, physical unit information for the end of the reporting period, physical units added and withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

5. Although the most significant change within this standard is this reclassification, it also introduces certain changes to the disclosure requirements for heritage assets and stewardship land. Specifically, the standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

6. This standard also includes disclosure requirements applicable to the U.S. Government-wide Financial Statement. This financial statement must provide a general discussion of heritage assets and stewardship land and direct users to the applicable entities' financial statements for more detailed information on these assets.

7. This standard also amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.

8. The Board believes by fully incorporating into this standard all requirements for heritage assets (including multi-use heritage assets) and stewardship land, readers will better understand all reporting requirements. However, the main issues deliberated by the Board were the reclassification and presentation of heritage assets and stewardship land information. The Board has not reconsidered the definition, recognition and measurement provisions of the existing standards. These provisions have been brought forward from those standards that were based on prior Boards' conclusions.

9. The Board developed this standard for heritage assets and stewardship land based on the importance of the data in meeting the stewardship reporting objective as described in Statement of Federal Financial Accounting Concepts (SFFAC) 1*, Objectives of Federal Financial Reporting*. Further information on the Board's considerations regarding this reclassification is included in the Basis for Conclusions.

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Standards of Federal Financial Accounting

Heritage Assets (including Multi-use Heritage Assets)

Amendments to Existing Standards

10. SFFAS 6 par. 21 is amended as follows:

The following paragraphs provide recognition and measurement principles, and disclosure requirements for general PP&E. For standards relating to heritage assets, multi-use heritage-assets and stewardship land, see SFFAS 29, *Heritage Assets and Stewardship Land*. ~~each category of PP&E. The categories identified are:~~

- ~~general PP&E (including land acquired for or in connection with other general PP&E),~~
- ~~National Defense PP&E,~~
- ~~heritage assets, and~~
- ~~stewardship land (i.e., land not included in general PP&E).~~

11. SFFAS 6 par. 57 through 65 are rescinded.

12. SFFAS 8 Chapter 2 (Heritage Assets) is rescinded in its entirety.

13. SFFAS 14 par. 10 and 11 are rescinded.

14. SFFAS 16 is rescinded in its entirety.

Definitions

15. Heritage assets are property, plant and equipment (PP&E) that are unique for one or more of the following reasons:
    - historical or natural significance,
    - cultural, educational, or artistic (e.g., aesthetic) importance; or
    - significant architectural characteristics.

    Heritage assets consist of (1) collection type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections; and (2) non-collection-type heritage assets, such as parks, memorials, monuments, and buildings.

16. Heritage assets are generally expected to be preserved indefinitely. One example of evidence that a particular asset is heritage in nature is that it is listed on the National Register of Historic Places.

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17. Some investments in heritage assets (e.g., national parks) will meet the definitions and be considered and reported as both heritage assets and stewardship land (see Stewardship Land below). Such reporting would not be considered duplication, as the type of information reported for the physical unit would be different for each category of stewardship asset.

18. Heritage assets may in some cases be used to serve two purposes—a heritage function and general government operations. In cases where a heritage asset serves two purposes, the heritage asset should be considered a **multi-use heritage** asset if the predominant use of the asset is in general government operations (e.g., the main Treasury building used as an office building). Heritage assets having an incidental use in government operations are not multi-use heritage assets; they are simply heritage assets.

Recognition and Measurement

Heritage Assets

19. With the exception of multi-use heritage assets (addressed in par. 22) the cost of acquisition, improvement, reconstruction, or renovation of heritage assets should be recognized on the statement of net cost for the period in which the cost is incurred. The cost[3] should include all costs incurred during the period to bring the item to its current condition (See par. 26 of SFFAS 6 for examples of the costs to be considered).

20. With the exception of multi-use heritage assets (addressed in par.23) no amounts for heritage assets acquired through donation or devise[4] should be recognized in the cost of heritage assets.[5]

21. With the exception of multi-use heritage assets (addressed in par.24) transfers of heritage assets from one Federal entity to another do not affect the net cost of operations or net position of either entity. However, in some cases, assets included in general PP&E may be transferred to an entity for use as heritage assets. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.[6]

[3] For a full discussion of cost, including full cost, direct cost and indirect cost, see SFFAS 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government.* Also, see par. 94-95, SFFAC 2, *Entity and Display.*
[4] A will or clause of a will disposing of property.
[5] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258-259 explains that stewardship PP&E is "expensed if purchased, but no amount is recognized if it is received as a donation."
[6] SFFAS 7, *Accounting for Revenue and Other Financing Sources,* par. 74 and par. 345-346.

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Multi-use Heritage Assets

22. The cost of acquisition, improvement, reconstruction, or renovation of multi-use heritage assets should be capitalized as general PP&E and depreciated over its estimated useful life.

23. Multi-use heritage assets acquired through donation or devise should be recognized as general PP&E at the assets' fair value at the time received, and the amount should also be recognized as "nonexchange revenues" as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources*.

24. Transfers of multi-use heritage assets from one Federal entity to another are transfers of capitalized assets. The receiving entity should recognize a transfer-in as an additional financing source and the transferring entity should recognize a transfer-out. The value recorded should be the transferring entity's book value of the multi-use heritage asset. If the receiving entity is not provided the book value, the multi-use heritage asset should be recorded at its estimated fair value.[7]

Disclosures and Required Supplementary Information

25. Entities with heritage assets should reference a note[8] on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown.[9] The note disclosure related to heritage assets should provide the following:

    a. A concise statement explaining how they relate to the mission of the entity.

    b. A brief description of the entity's stewardship policies for heritage assets. Stewardship policies for heritage assets are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of heritage assets consistent with statutory requirements, prohibitions, and limitations governing the entity and the heritage assets.

    c. A concise description of each major category of heritage asset. The appropriate level of categorization of heritage assets should be meaningful and

[7] See SFFAS 7, *Accounting for Revenue and Other Financing Sources,* par. 74 for a discussion of transfers of assets.
[8] This standard does not prescribe a specific reference or line item entitled "Heritage Assets" as it may be included with other items for which no dollar amounts are recognized (such as stewardship land and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.
[9] No asset dollar amount is shown, except for multi-use heritage assets, which are capitalized and reported as part of general PP&E. See par. 22 through 24 and par. 27 for additional explanation.

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determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets.

d. Heritage assets should be quantified in terms of physical units. The appropriate level of aggregation and physical units[10] of measure for each major category should be meaningful and determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets. For each major category of heritage asset (identified in c. above) the following should be reported:

1. The number of physical units by major category; major categories should be classified by collection or non-collection type heritage assets for which the entity is the steward as of the end of the reporting period;

2. The number of physical units by major category that were acquired and the number of physical units by major category that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of heritage assets during the reporting period. This should include disclosure of the number of physical units (by major category) of transfers of heritage assets between Federal entities and the number of physical units (by major category) of heritage assets acquired through donation or devise, if material. In addition, the fair value of heritage assets acquired through donation or devise during the reporting period should be disclosed, if known and material.

26. Entities should report the condition[11] of the heritage assets (which may be reported with the deferred maintenance information[12]) as required supplementary information. Entities should include a reference to the condition and deferred

[10] Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities.
[11] Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.
[12] See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

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maintenance information[13] if reported elsewhere in the report containing the basic financial statements.

27. Entities should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.

U.S. Government-wide Financial Statement Disclosures[14]

28. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown. The note disclosure related to heritage assets should provide the following:

    a. A concise statement explaining how they relate to the mission of the Federal Government.

    b. A description of the broad categories of heritage assets of the Federal Government.

    c. A general reference to agency reports for additional information about heritage assets, such as agency stewardship policies for heritage assets, physical units by major categories of heritage assets, and the condition of the heritage assets.

29. The U.S. Government-wide financial statement should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.

[13] SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting,* defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

[14] SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government,* clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

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Stewardship Land

Amendments to Existing Standards

30. SFFAS 6 par. 66 through 76 are rescinded.

31. SFFAS 8 Chapter 4 (Stewardship Land) is rescinded in its entirety.

32. SFFAS 14 par. 10 and 11 are rescinded.

Definitions

33. Stewardship Land is land and land rights[15] owned by the Federal Government but not acquired for or in connection with[16] items of general PP&E. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.

34. "Land" is defined as the solid part of the surface of the earth. Excluded from the definition are the natural resources (that is, depletable resources, such as mineral deposits and petroleum; renewable resources, such as timber; and the outer-continental shelf resources) related to land. [17]

35. Land and land rights owned by the Federal Government and acquired for or in connection with items of general PP&E should be accounted for and reported as general PP&E.

36. Land and land rights owned by the Federal Government and not acquired for or in connection with items of general PP&E should be reported as stewardship land.

[15] Land rights are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land.
[16] "Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.
[17] The Board presently has an active project to address standards for natural resources, for which the Board is considering developing individual standards for each type of natural resource separately. To begin the project, the Board will be addressing oil and gas resources. The framework for the oil and gas resource phase of the project will be used as a model when addressing the other types or logical sets of natural resources (e.g., timber, grazing land, solid leasable minerals) in subsequent phases of the project.

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Recognition and Measurement

37. The cost of acquisition of stewardship land should be recognized on the statement of net cost for the period in which the cost is incurred. The cost should include all costs to prepare stewardship land for its intended use (e.g., razing a building). In some cases, land may be acquired along with existing structures. The following treatments should apply:

    a. if the structure would be deemed a heritage asset and is significant in and of itself, the entity should use its judgment as to whether the acquisition cost should be treated as the cost of stewardship land, heritage asset, or both;

    b. if the structure is to be used in operations (for example, as general PP&E) but 1) the value of the structure is insignificant, or 2) its acquisition is merely a byproduct of the acquisition of the land, the cost in its entirety should be treated as an acquisition of stewardship land; or

    c. significant structures that have an operating use (e.g., a constructed hotel or employee housing block) should be treated as general PP&E by identifying the cost attributable to general PP&E and segregating it from the cost of the stewardship land acquired.

38. No amounts for stewardship land acquired through donation or devise[18] should be recognized in the cost of stewardship land.[19]

39. Transfers of stewardship land from one Federal entity to another, does not affect the net cost of operations or net position of either entity. However, in some cases, land included in general PP&E may be transferred to an entity for use as stewardship land. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.[20]

Disclosures and Required Supplementary Information

40. Entities with stewardship land should reference a note[21] on the balance sheet that discloses information about stewardship land, but no asset dollar amount

[18] A will or clause of a will disposing of property.
[19] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258-259 explains that stewardship PP&E is "expensed if purchased, but no amount is recognized if it is received as a donation."
[20] SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.
[21] This standard does not prescribe a specific reference or line item entitled "Stewardship Land" as it may be included with other items for which no dollar amounts are recognized (such as heritage assets and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

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should be shown. The note disclosure related to stewardship land should provide the following:

a. A concise statement explaining how it relates to the mission of the entity.

b. A brief description of the entity's stewardship policies for stewardship land. Stewardship policies for stewardship land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of stewardship land consistent with statutory requirements, prohibitions, and limitations governing the entity and the stewardship land.

c. A concise description of each major category of stewardship land use. Where parcels of land have more than one use, the predominant use of the land should be considered the major use. In cases where land has multiple uses, none of which is predominant, a description of the multiple uses should be presented. The appropriate level of categorization of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets.

d. Stewardship land should be quantified in terms of physical units. The appropriate level of aggregation and physical units of measure for each major category of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets. For each major category of stewardship land use the following should be reported:

1. The number of physical units by major category of stewardship land use for which the entity is the steward as of the end of the reporting period;

2. The number of physical units by major category of stewardship land use that were acquired and the number of physical units by major category of stewardship land use that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of stewardship land during the reporting period. This should include disclosure of physical units (by major category of stewardship land use) of transfers of stewardship land between Federal entities and the number of physical units (by major category of stewardship land use) of stewardship land acquired through donation or devise, if material. In addition, the fair value of stewardship land acquired through donation or devise during the reporting period should be disclosed, if known and material.

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41. Entities should report the condition[22] of the stewardship land (which may be reported with the deferred maintenance information[23]) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information[24] if reported elsewhere in the report containing the basic financial statements.

U.S. Government-wide Financial Statement Disclosures[25]

42. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:

    a. A concise statement explaining how it relates to the mission of the Federal Government.

    b. A description of the predominant uses of the stewardship land of the Federal Government.

    c. A general reference to agency reports for additional information about stewardship land, such as agency stewardship policies for stewardship land, physical units by major categories of stewardship land use, and the condition of the stewardship land.

[22] Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.

[23] See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

[24] SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting,* defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

[25] SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government,* clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

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Effective Date

43. These standards are effective for reporting periods beginning after September 30, 2005 with the exception of the specific paragraphs listed below. These exceptions provide for a phase-in of disclosure requirements being reported as basic information such that these standards will be fully implemented for reporting periods beginning after September 30, 2008.

    a. Section c and section d1 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2007;

    b. Section d2 and section d3 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2008; and

    c. Information that is provided an exception (described in par. a. and b. above) to being reported as basic information during the phase-in period is still required, but should be reported as RSI until the exceptions expire.

44. Full implementation of the standards is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

Introduction

45. In SFFAS 8, *Supplementary Stewardship Reporting*, the Board described stewardship information and required the reporting of that information. When the Board established the RSSI category, it believed that the new category was needed to highlight the unique nature of the reported items, to accommodate non-financial data, and to allow for reporting experimental information, such as condition. The Board believed that as agencies gained experience in reporting stewardship information that the reporting would evolve to a level where there was consistency within categories and at the government-wide consolidated reporting level. The Board has found that this evolution is, in fact, happening.

46. Consequently, the Board also has considered entities' improved accounting and reporting methods in deciding how to categorize the stewardship elements. The Board has found that, in many cases, entities have adopted the stewardship standards with a sense of responsible creativity. There are many instances where entities have developed imaginative, informative, and meaningful displays of stewardship information. The Board commends the efforts of these entities and supports their continued efforts to report on the Nation's stewardship resources and responsibilities in a responsible and informative manner.

47. The Board believes that avoiding the use of the RSSI category will eliminate some potential confusion and ambiguity. In particular, it should clarify the Board's expectation that significant information essential to fair presentation will be subject to audit.

48. The Board eliminated the use of RSSI to report information about weapons systems when it issued SFFAS 23*, Eliminating the Category "National Defense Property, Plant, and Equipment*." Additionally, SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment,* eliminated the use of RSSI for reporting stewardship responsibilities. Classification of other items of information currently designated RSSI (stewardship investments) may be dealt with in one or more future standards.

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49. This standard eliminates the use of RSSI for reporting Stewardship PP&E. Stewardship PP&E consists of items whose physical properties resemble those of general PP&E traditionally capitalized in basic financial statements. However, the nature of Federal physical assets classified as stewardship PP&E (e.g., museum collections, monuments, assets acquired in the formation of the nation, etc.) differ from general PP&E. Stewardship PP&E includes heritage assets (e.g., Federal monuments and memorials and historically or culturally significant property) and stewardship land (i.e., land not acquired for or in connection with general property, plant, and equipment).[26]

Amendments to Standards

50. This standard amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serves as a means to incorporate all standards specific to heritage assets and stewardship land into one standard.

51. This standard amends SFFAS 8 by rescinding chapters 2 and 4 of that standard. This change eliminates the use of the RSSI category to report information about heritage assets and stewardship land. This standard also incorporates the revised multi-use heritage asset standards of SFFAS 16, *Amendments to Accounting for Property, Plant, and Equipment: Measurement and Reporting for Multi-use Heritage Assets.*[27] Accordingly, SFFAS 16 is rescinded in its entirety. Additionally, par. 57 through 76 of SFFAS 6, *Accounting for Property, Plant and Equipment* also is rescinded because they relate to heritage assets and stewardship land.

52. SFFAS 14, *Amendments to Deferred Maintenance Reporting,* also amended certain paragraphs within Chapters 2 and 4 of SFFAS 8 that related to deferred maintenance and condition reporting. This standard also incorporates those revisions. Accordingly, the portion of SFFAS 14 entitled 'Amendments to SFFAS 8' (SFFAS 14 par. 10 and 11) is rescinded.[28]

53. As a result, this standard incorporates all standards for heritage assets and stewardship land into one document. The Board believes by fully incorporating all requirements for heritage assets (including multi-use heritage assets) and stewardship land, readers will better understand all existing reporting

[26] SFFAS 8, par. 11
[27] SFFAS 16 has been incorporated into the current standard for ease in understanding because SFFAS 16 amended Chapter 2 Heritage Assets of SFFAS 8 and portions of SFFAS 6.
[28] SFFAS 14 did amend the status of deferred maintenance by classifying it as RSI, however, SFFAS 6, *Accounting for Property, Plant and Equipment*, provides for the information to be reported. See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

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requirements. However, the main issues deliberated by the Board were the reclassification and presentation of heritage assets and stewardship land information. The Board has not reconsidered the definition, recognition and measurement provisions of the current standards at this time. These provisions have been brought forward from previous standards that were based on prior Boards' conclusions. In the future, the Board may reconsider the recognition and measurement issues for heritage assets and stewardship land.

Basic vs. RSI

54. The Board believes that information on heritage assets and stewardship land (except for condition) should be basic information for the following reasons:

    a. Information on these assets is essential to fair presentation and may be crucial to understanding the entirety of an entity's financial condition.

    b. Accountability for heritage assets and stewardship land requires more audit scrutiny than would be afforded if they were considered RSI.[29]

    c. This classification is consistent with existing standards issued by the Governmental Accounting Standards Board (GASB) that is specific to reporting on art and historical treasures; and the Financial Accounting Standards Board (FASB) that is specific to collections, and other works of art and historical treasures. There is also existing audit guidance available in this area.[30]

55. It should be noted that during Board discussions and deliberations related to SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment,* and the reclassification of the stewardship responsibilities, the Board developed a detailed list of practical and conceptual factors for consideration in determining RSI versus basic information classification. This structure was also considered in the decisions relating to the appropriate classification of heritage assets and stewardship land information and will be invoked in any future classification decisions by the Board.[31]

[29] See SFFAS 8, par. 114 which details the fact the Board believed "that certain stewardship information, should receive more audit scrutiny than it would if it were RSI…"
[30] For additional information on these existing standards and guidance see Statement of Financial Accounting Standards 116, *Accounting for Contributions Received and Contributions Made*, GASB 34 par. 27-29 (*Reporting Works of Art and Historical Treasures*), and AICPA Audit and Accounting Guide, *Not-for-Profit Organizations*.
[31] See SFFAS 25, Appendix A paragraphs 34-50 for detail on the factors. To help readers understand the Board's deliberations, those paragraphs provide more details about some practical and conceptual factors that affected the Board's decision whether to designate an item as RSI or as an integral part of the basic financial statements.

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56. Specifically, the Board agreed that heritage assets and stewardship land information was essential and relevant to fair presentation. Additionally, the Board believed that it was important that this be clearly communicated to the readers of the financial statements and auditor reports. The Board also noted the importance and relevance of the information in light of the *Objectives of Federal Financial Reporting*.[32]

57. Condition reporting for heritage assets and stewardship land should be reported as required supplementary information because this information is experimental in nature and there is inconsistency in the manner of assessing and reporting this information.

U.S. Government-wide Financial Statement

58. In determining the required disclosures for the U.S. Government-wide Financial Statement, the Board considered SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, which designated the intended or primary audience of the U.S. Government-wide Financial Statement and qualitative characteristics for the U.S. Government-wide Financial Statement that would be most useful for that audience.[33]

59. Par. 6 of SFFAC 4 explains that the U.S. Government-wide Financial Statement "is a general purpose report that is aggregated from agency reports and tells users where to find information in other formats, both aggregated and disaggregated, such as individual agency reports, agency websites, and the President's Budget."

60. The Board considered the nature and the variety of the data that would be aggregated from the various entities in preparing the heritage assets and stewardship land disclosures for the U.S. Government-wide Financial Statement. The Board determined that the standards for the U.S. Government-wide Financial Statement should provide for a general discussion and direct users to the applicable entities' financial statements for more detailed information on heritage assets and stewardship land.

Exposure Draft

61. FASAB published the exposure draft (ED) *Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information* on

[32] See Stewardship (Objective 3) as described in SFFAC 1*, Objectives of Federal Financial Reporting.*
[33] See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government* par. 5

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August 20, 2003. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter, Government Accounting and Auditing Update,* and *JFMIP News;* the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past.

62. Twelve letters were received from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others	1	3
Auditors	1	1
Preparers and financial managers	6	

63. A public hearing was held on March 4, 2004. Individuals from the Library of Congress, U.S. Department of Agriculture, Department of Interior (including representatives from the CFO, OIG and IPA currently performing the DOI audit), and a representative from the Institute for Truth in Accounting testified at the public hearing. The participants reiterated issues included in the comment letters to the ED.

Responses to the ED

64. A majority of the respondents did not agree with heritage assets and stewardship land information being reported as basic. Key issues raised by respondents included the following:

    a. A need for more specific guidance on categorization and unitization for reporting heritage assets and stewardship land information;

    b. The audit implications of the standard, including the additional audit costs by classifying the information as basic; and

    c. Less useful information being presented by agencies with the reclassification.

65. Most respondents that did not agree with heritage assets and stewardship land information being reported as basic, recommended that it be classified as RSI (or remain as RSSI).

66. Most respondents agreed with the Board's new disclosure requirements and did not foresee any problems with the new disclosure requirements

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67. Most respondents did not agree with the proposed effective date for periods beginning after September 30, 2004 in the ED. Key reasons cited for the delay of the effective date included the need for additional time to address implementation issues and time for including funding in their budgets to cover the additional costs for implementation and audit.

Board Consideration of Comments

68. Considering that the majority of respondents did not agree with the ED, the Board directed staff to research various issues that would assist the Board in addressing the comments raised by respondents. For example, the Board considered the current FASB and GASB standards in this area. The Board also considered results of a review of private museum reporting practices.

69. The Board also considered several recent government-wide initiatives that promote accountability and stewardship over real property assets and heritage assets such as the Federal Real Property Asset Management Initiative, Executive Order 13327 Federal Real Property Asset Management, and Executive Order 13287 Preserve America. The Board believes these initiatives provide further support for the decision to classify the heritage assets and stewardship land as basic information and the importance of accountability for these types of assets.

70. The Board also considered the issue of unitization and categorization further by reviewing draft guidance prepared by the Heritage Assets Categorization Project Team and the Accounting and Auditing Policy Committee (AAPC) Stewardship Guidance Workgroup. The Board believes that the draft products from these workgroups are excellent starting points for developing comprehensive guidance on many of the issues raised by respondents.

71. In response to the audit concerns, FASAB held a roundtable meeting with representatives from the Office of Inspector General (OIG) and CPA firms responsible for financial statement audits to solicit their views on specific issues raised by respondents as well as potential audit costs involved with implementing the standard.

72. As a result of the comments received and testimony provided at the public hearing, as well as the above actions, the Board did make certain revisions, which are detailed in the following paragraphs. Additionally, reasons for not making revisions on specific issues are detailed below.

Importance to Mission

73. The ED contained the new disclosure that required a statement explaining how heritage assets and stewardship land are “important to the overall mission of the

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entity." A respondent explained that agencies may have significant stewardship assets as a result of their compliance with cultural resource protection laws and regulations or because Congress has determined that certain classes of assets to be nationally significant, regardless of the agency mission. The respondent believed that showing the link between the agency mission and the assets may result in less disclosure by agencies that lack a direct link to their mission.

74. The Board understands that some agencies may have heritage assets because of the facts described by the respondent and it is possible that the assets may not be important to the overall mission of the agency. However, the Board considered the new requirement to be explanatory in nature by offering more information about the assets. The Board did not envision the importance to the mission to be considered in determining which heritage assets and stewardship land should be included.

75. The Board revised the language of the new requirement to read "A concise statement explaining how they relate to the mission of the entity." The Board believes with this language, the requirement is flexible enough that if the assets are not related to the mission of the entity, the entity may state that and provide additional explanation, if they so choose.

Limiting Information Presented

76. Several respondents commented that agencies would present less information in their annual reports because the heritage assets information and stewardship land information would be subject to audit since it is classified as basic information. The classification of heritage assets and stewardship land information as basic should not limit the information entities choose to present or prevent the continuation of informative and meaningful displays of information.

77. This standard does not eliminate any information that was previously required for heritage assets and stewardship land. In drafting the standard, the Board envisioned the required disclosures to be presented in a concise format similar to the format that most entities present for general property, plant and equipment.

78. The Board notes that preparers continue to have the option of voluntarily presenting information beyond the minimum reporting requirements as other accompanying information.

Categorization and Unitization

79. The standard does not define asset categories or physical units for reporting. The Board recognizes that there may be difficulties for agencies in determining the appropriate level of aggregation for reporting categories of heritage assets. However, the Board believes that the agencies are in the best position to

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determine the most meaningful level of presentation. The Board believes that ultimately the presentation depends upon the specifics of the entity—its mission, the types of heritage assets, how it manages, and materiality considerations. It would be difficult for the standard to define such specific reporting requirements, as they may be unique to each entity.

80. The Board also has avoided detailed illustrations and limited specific examples in the standard because preparers and auditors may attempt to strictly adhere to the illustrations.

81. The standard emphasizes reporting on asset categories, rather than individual assets. Based on comments to the ED, it appeared that this may not have been clear to the readers. Therefore, additional language was added to the final standard to clarify that the appropriate level of categorization of stewardship assets and the associated physical units should be determined by the preparer based on the entity's mission, types of use, and how it manages the assets.

82. Entities should designate asset reporting categories that allow inclusion and aggregation of their heritage assets and stewardship land. Entities should determine the appropriate level of detail for their categorization. It is helpful if entities designate asset categories that are meaningful and reflect how the entity views the assets for management purposes. It would also be helpful for entities to document the reasoning for the categorization.

83. The Board recognizes that the information that is appropriate for reporting heritage assets and stewardship land can vary from one entity to another. The amount and level of detail of the information presented depends, in part, on the mission of the entity and the materiality of the assets in question. For example, categories reported by an agency that has a stewardship mission, might be more disaggregated than is appropriate for one that does not.

84. Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities. The level of detail may differ by entity.

85. It is the intent of the Board to provide entities with considerable latitude and flexibility in designating categories, determining a meaningful level of aggregation for reporting, and selecting physical units aligned with those categories. For example, should a library report that it has a collection of papers or that it has 10,000 pieces of paper in that collection? Further, should a museum report that is has 10 dinosaur skeletons or 10,000 dinosaur bones, or a single collection of skeletons in one facility? Ultimately, the answer is influenced by how the entity manages as well as materiality considerations. Agencies may be required to count the number of individual items for control purposes. But due to materiality considerations, entities may choose to report a higher level of aggregation such as the number of collections or facilities in which individual items are located.

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Although individual item counts may not be necessary to support the reporting requirements in the standard, this does not mean that item counts for management control and safeguarding purposes are not necessary to fulfill mandates required by other public laws and regulations.

Supporting Documentation

86. The Board has recognized in previous standards that historical records for items acquired long ago may not have been retained.[34] Based on responses to the ED, testimony provided at the public hearing, and discussions with the auditors at the roundtable meeting, the Board believes this may be an issue in implementing this standard.

87. The Board understands that with the heritage assets and stewardship land information being classified as basic, auditors may require certain supporting documentation to fulfill audit assertions. There may be instances where the historical documents are not available for items acquired many years ago, prior to the effective date of this standard, in an environment in which the historical records were not required to be retained and may therefore be inadequate.

88. Therefore, the Board encourages preparers, program offices, and auditors to develop other reasonable approaches and methods for satisfying the specific audit assertions that would rely on historical documents as evidence and support. In addition, the Board plans to suggest that this issue be addressed further in the forthcoming AAPC Guidance (discussed below).

Additional Guidance

89. The Board notes that there has been work by certain government-wide task forces (such as the AAPC Stewardship Guidance Work Group and the Heritage Assets Categorization Team) to address issues identified such as standardized categories, definitions of units of measurements, and other areas where prescriptive guidance has been requested. The task forces contained representatives from pertinent agencies and experts in the field, which most likely provided for a comprehensive assessment.

90. Considering the extensive research performed by the task forces, their draft proposals or guides which address areas such as categories and subcategories and related physical units should be a good starting point for additional guidance that could be included in a Technical Release from the AAPC.

[34] SFFAS 23 *Eliminating the Category National Defense PP&E,* par. 11 provided implementation guidance as follows: "This standard recognizes that determining initial historical cost may not be practical for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate."

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91. The Board will request that the AAPC revitalize the efforts of the Stewardship Guidance Work Group and work towards finalization of their draft guidance, which may ultimately be published as a Technical Release. The guidance will be expanded where necessary to cover the issues identified by respondents in the comment letters. For example, the Board will suggest that the AAPC review case studies where supporting documentation may not be available and determine other reasonable approaches, methods, and best practices for satisfying specific assertions that would rely on historical documents as evidence and support.

92. The Board will suggest that the AAPC also consider the work done by the Heritage Assets Categorization Team. FASAB staff will work closely with the task force with the goal of finalizing the guide within one year of the issuance of this standard.

Effective Date/Phased-In Implementation

93. Most respondents to the ED and participants at the public hearing did not agree with the proposed effective date in the ED for periods beginning after September 30, 2004. Key reasons cited for the delay of the effective date were the need for additional time to address issues noted in their arguments against classifying the information as basic and time for including funding in their budgets for the additional work and audit costs to be incurred.

94. The Board believed the reasons provided for the delay of the effective date were valid and justified some delay. Therefore, the Board believed a phased implementation would provide time for entities to address some of the issues identified and for consideration of the strained resources facing most agencies.

95. The Board also believed that the effective date for certain disclosures to be classified as basic should be delayed to allow time for the issuance of the additional guidance by the AAPC. Therefore, the standard was revised to allow for a phase-in of required reporting disclosures as basic.

96. The standards are effective for reporting periods beginning after September 30, 2005, with the exception of the section c (category descriptions) and section d1 (physical units by major category for the end of the reporting period) in par. 25 and 40 that are effective for reporting periods beginning after September 30, 2007; and section d2 (physical units by major category that were acquired and withdrawn during the reporting period) and section d3 (major methods of acquisition and withdrawal during the reporting period) in par. 25 and 40 that are effective for reporting periods beginning after September 30, 2008.

97. These exceptions provide for a phase-in of disclosure requirements being reported as basic information such that the standard will be fully implemented for

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reporting periods beginning after September 30, 2008. Information that is provided an exception (see par. above) to being reported as basic information during the phase-in period is still required, but should be reported as RSI until the exceptions expire. It may be appropriate for entities to include a reference to the information reported as RSI during the phase-in period.

98. The phased-in implementation offers additional time for agencies to determine the proper level of aggregation for major categories, as well as determining the appropriate physical unit of measure and documenting their reasoning for such. This additional time will also allow for the AAPC to issue its guidance in time for consideration before implementation. It is anticipated that the AAPC will finalize the guide prior to the implementation of the required reporting by major categories.

Materiality

99. In the ED, the disclosure requirements language read "Entities with significant heritage assets/stewardship land should reference a note…" The Board used the term "significant" to emphasize that some entities may not be subject to the disclosure requirements due to certain entities having only immaterial amounts of heritage assets and stewardship land covered by this standard.

100. Although most respondents to the ED agreed that the preparer should have flexibility in determining appropriate categories for aggregation and that the preparer should be allowed to exercise professional judgment in determining which assets are significant, there was some concern raised by respondents that these judgments may be difficult to make. Certain respondents noted that "significant" is difficult to apply in the case of heritage assets and stewardship land because there are no financial dollar amounts required to be reported.

101. The term "significant" was removed from the language establishing disclosure requirements in the final standard because the Board has stated within this standard "The provisions of this Statement need not be applied to immaterial items." Therefore, entities may omit heritage asset and stewardship land information if they are immaterial.

102. In SFFAS 3, *Accounting for Inventory and Related Property,* the introduction included a discussion on "materiality".[35] It explained that materiality has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. It further explained that the determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

[35] See SFFAS 3, *Accounting for Inventory and Related Property, par. 7-15.*

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103. In its discussion in SFFAS 3, the Board relied on the FASB's concept as modified by certain concepts expressed in governmental auditing standards[36]. Par. 9 of SFFAS 3 discussed FASB's Statement of Financial Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," that provides for materiality as the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

104. Par. 9 of SFFAS 3 also explains that this concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user. The Board believes that preparers should consider both quantitative and qualitative characteristics when applying materiality to this standard.

Board Approval

105. This statement was approved for issuance by all members of the Board.

[36] Par. 12 of SFFAS 3 explains that the Government Auditing Standards provide "In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private-sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions."

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Appendix B: List of Abbreviations

AAPC	Accounting and Auditing Policy Committee
AICPA	American Institute of Certified Public Accountants
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
OMB	Office of Management and Budget
PP&E	Property, Plant and Equipment
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

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James M. Patton
Robert N. Reid
Elizabeth Robinson
Alan H. Schumacher
David M. Zavada (from December 1, 2003)

FASAB Staff
Wendy M. Comes, Executive Director
Melissa Loughan

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Inter-Entity Cost Implementation
Amending SFFAS 4, *Managerial Cost Accounting Standards and Concepts*

Statement of Federal Financial Accounting Standards 30

August 15, 2005

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Summary

This standard requires full implementation of the inter-entity cost provision in Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*. By fully implementing the provisions in SFFAS 4 (issued in July 1995) this standard will require the following for inter-entity cost:

> Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.
>
> Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity. (Text preceding paragraph 105 of SFFAS 4)

This standard requires full implementation for reporting periods beginning after September 30, 2008.

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Table of Contents

Inter-Entity Cost Implementation
Table of Contents

Summary i

Introduction 1

Standards of Federal Financial Accounting 3

Amendments to SFFAS 4 3
Effective Date 3

Appendix A: Basis for Conclusions 4

Introduction 4
Amendments to Standards 6
Exposure Draft 7
Responses to the ED 7
Board Consideration of Comments 8
Additional Guidance 9
Effective Date 9
Board Approval and Dissent 10

Appendix B: List of Abbreviations 12

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_30.pdf.

Statement of Federal Financial Accounting Standards
Inter-Entity Cost Implementation

Introduction

1. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. SFFAS 4 provided for gradual implementation because recognition of the full cost of goods and services provided by one federal entity (the providing entity) to another federal entity (the receiving entity) (1) required adequate cost accounting systems and (2) engaged all federal agencies in identifying the costs of under-reimbursed goods and services.

2. Thus, an orderly means for consistently implementing the standard was viewed as necessary. The Board's implementation guidance provided "the Office of Management and Budget [OMB], with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs."[1] The inter-entity costs were to be specified in accordance with SFFAS 4, including the recognition criteria.[2] It was anticipated that the largest and most important inter-entity costs would be identified first.

3. OMB requested that the Accounting and Auditing Policy Committee (AAPC) provide assistance in developing the guidance anticipated by SFFAS 4. The AAPC Inter-entity Cost Task Force (task force) was formed and initial research was conducted beginning in July 2000. The task force reported its research findings and recommendations to the AAPC at its May 2003 meeting. The task force noted that the current limitation[3] on recognizing inter-entity costs was an impediment to progress towards full costing. However, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.

4. This standard follows the extensive research and recommendations by the AAPC task force addressing inter-entity cost guidance. Although the task force report acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing, it recommended continued deferral of SFFAS 4's inter-entity cost requirements while encouraging reimbursable agreements for inter-entity provision of goods and services.

---

[1] SFFAS 4, par. 110
[2] See SFFAS 4 par. 111-113 for recognition criteria
[3] To date, OMB has issued guidance for recognizing the following specific inter-entity costs: (1) employees' pension, post-retirement health and life insurance benefits, (2) other post-employment benefits for retired, terminated, and inactive employees, which includes unemployment and workers compensation under the Federal Employees' Compensation Act, and (3) losses in litigation proceedings. The guidance further states that to ensure consistency, agencies should not recognize costs other than those listed until further guidance is provided. See Section 4.3 of OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.*

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5. This standard is intended to balance the concerns expressed by the task force and the ultimate goals of SFFAS 4 related to full cost. SFFAS 4 clarified that full cost was intended to relate resources to outputs regardless of the funding source:

> The full cost of a responsibility segment's output is the total amount of resources used to produce the output. This includes direct and indirect costs that contribute to the output, regardless of funding sources. It also includes costs of supporting services provided by other responsibility segments or entities. (SFFAS 4, par. 89)

6. Ultimately, attaining full cost is critical to improving performance measurement. SFFAS 4 states:

> Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to ". . .improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results." (SFFAS 4, par. 34)
>
> **Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness.** Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show "cost-effectiveness." Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:
>
> > (1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;
> >
> > (2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and
> >
> > (3) Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness. (SFFAS 4, par. 35, emphasis added)
>
> Thus, …, performance measurement requires both financial and non-financial measures. **Cost is a necessary element for performance measurement, but is not the only element.** (SFFAS 4, par. 36, emphasis added)

7. This standard establishes a date certain—reporting periods beginning after September 30, 2008—for full cost accounting by federal reporting entities. This standard affords time to provide needed guidance before the effective date. The Board anticipates the release of one or more Technical Releases that will address implementation issues during this time. Entities may also use the time period between the issuance of this standard and the actual effective date to establish reimbursable agreements, seek implementation guidance on specific issues if necessary, and develop internal guidance on recognizing inter-entity costs.

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Standards of Federal Financial Accounting

Amendments to SFFAS 4

Amendments to Existing Standards

8. Statement of Federal Financial Accounting Standard (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts,* Inter-Entity Costing, par. 110 is rescinded.

9. The sentence “Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above” is rescinded from par. 111 of SFFAS 4.

Effective Date

10. This standard is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

Introduction

11. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. However, SFFAS 4 provided for gradual implementation of the inter-entity cost provision.

12. In 1995, the Board provided implementation guidance stating:

> Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget [OMB], with assistance from the FASAB staff, should **identify the specific inter-entity costs** for entities to begin recognizing. OMB should then issue guidance identifying these costs. **These particular inter-entity costs should be specified in accordance with this standard including the recognition criteria presented below.** The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards. (SFFAS 4, par. 110, emphasis added)

13. OMB requested that the AAPC provide assistance in developing the guidance anticipated by SFFAS 4, par. 110. The AAPC inter-entity cost task force was formed and initial research was conducted beginning in July 2000. The task force, chaired by James Taylor, Deputy Chief Financial Officer of the Department of Commerce, reported the task force research findings and recommendations to the AAPC at its May 2003 meeting. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.

14. The task force recommended no changes to the current limitations on application of SFFAS 4 inter-entity costs provisions. The task force found:

    a) The current implementation guidance (limitation on recognizing inter-entity costs) is an impediment to progress towards full costing.
    b) While there likely is under-recognition of costs, government-wide guidance for any individual cases is not warranted.
    c) Full costing should be accomplished by encouraging reimbursable agreements.

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15. Before implementation of any revision or removal of the limitation on recognition of inter-entity costs, the task force believed that:

    a) There should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. For example, guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued.
    b) There should be established policies and procedures for the providing agency to submit necessary data to the receiving agency (for the receiving agency's evaluation and/or calculation of inter-entity costs). A particular concern is the "providing" agencies' ability and/or willingness to provide the "receiving" agency with needed data, and the availability to the receiving agency of alternate data when the providing agency cannot or will not provide data to the receiving entity.
    c) There should be adequate consultation among Federal agencies and the Federal audit community about the revision or removal of the OMB restriction prior to implementation.

16. The Board appreciates the considerable talents and time volunteered by the AAPC task force. The findings and recommendations of the task force suggest that the gradual implementation planned for SFFAS 4's inter-entity cost provisions is or will be unnecessary with time due to reimbursable agreements. The task force found that inter-entity costs are increasingly being reimbursed at full cost. Further, the task force believes that entities should continue to increase the use of full-cost reimbursable agreements. With these actions, the task force believes the need for implementation guidance would be minimized because costs would be captured based on transactions.

17. While federal entities may continue to pursue reimbursable agreements, the Board does not wish to rely solely on that mechanism. The Board does not believe the existence of reimbursable agreements for all material[4] inter-entity costs at a point in time would be a permanent resolution of the issue. In addition, because there is no guarantee that reimbursable agreements would be universally obtainable and consistently pursued over time, the barrier to full implementation currently provided in SFFAS 4 must be removed. The Board believes that establishing a date for the removal of the barrier is appropriate.

18. The Board believes the task force's proposal would (1) defer action to an unspecified time and (2) still require future action by FASAB to remove the barrier to full implementation of the inter-entity cost to ensure full costing is implemented over time.

19. Since SFFAS 4 – excluding the inter-entity cost provisions -- was effective in fiscal year 1998 and the implementation guidance has not progressed, the Board believes establishing a date certain for full implementation is appropriate. The task force expressed concerns regarding competing priorities for scarce resources and inter-entity cost implementation should not begin at this time. Therefore, the implementation date of this standard is sufficiently distant to alleviate the concerns expressed by the task force.

[4] SFFAS 4 addresses materiality at length in par. 112 and 113. Nothing in this standard or the AAPC task force report alters that guidance. Therefore, terms such as "materiality" and "significance" should be evaluated in the context established by SFFAS 4, par. 112 and 113.

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20. The Board believes that establishing a date certain for implementation of the inter-entity cost provisions of SFFAS 4 would be a more effective and permanent resolution of the issue. Acting soon after the task force's surveys would ensure that deferral of action does not result in a need for further surveys or for future action by the Board to remove the barrier. In addition, this standard affords time to provide needed guidance (See Additional Guidance below).

21. This standard balances the concerns raised by the task force regarding current priorities and resource constraints, and the goals of SFFAS 4. This standard establishes a date certain for full cost accounting by federal reporting entities. Further, by permitting early implementation entities would be afforded the opportunity to improve full cost recognition sooner. For those entities receiving material amounts of non-reimbursed or under-reimbursed inter-entity goods and services, full implementation would enhance the completeness and comparability of cost information.

22. In addition, this standard is consistent with the initial steps taken by the Board in Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* and resolves concerns expressed by respondents to the exposure draft leading to Interpretation 6. Interpretation 6, issued in April 2003 and effective for periods beginning after September 30, 2004, requires recognition of intra-departmental inter-entity costs. Some respondents to the exposure draft leading to Interpretation 6 expressed concern regarding the inconsistent treatment of inter- and intra-departmental inter-entity costs. The Board then concluded that a gradual reduction of the un-recognized inter-entity costs would be preferable to no action. In addition, the Board opined that the experience gained with respect to intra-departmental inter-entity costs would be useful in addressing inter-departmental inter-entity costs. (See par. 42 of Interpretation 6.)

23. The Board believes that this standard is essential to attaining the full cost accounting envisioned in SFFAS 4. Further, full cost information is essential to effective performance measurement.

Amendments to Standards

24. To require full implementation of the inter-entity cost provision, this standard amends SFFAS 4, *Managerial Cost Accounting Standards and Concepts* by

    - Rescinding Inter-Entity Costing, par. 110; and

    - Rescinding the sentence "Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above" from par. 111.

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Exposure Draft

25. FASAB published the exposure draft (ED) *Inter-Entity Cost Implementation Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts* on April 26, 2004. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter,* and the *Government Accounting and Auditing Update;* the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past.

26. 21 letters were received from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others		3
Auditors	2	2
Preparers and financial managers	14	

27. A public hearing was held on December 16, 2004. Individuals from the Library of Congress, Department of Interior, and a representative from the Association of Government Accountants Financial Management Standards Board testified at the public hearing.

Responses to the ED

28. Approximately one-half of the respondents agreed with the Board's proposal that the inter-entity cost provisions of SFFAS 4 should be fully implemented. In other words, approximately one-half of the respondents disagreed with the Board's proposal and agreed with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis.

29. Approximately one-half of the respondents believed that there were non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS 4. Additionally, a majority of respondents believed that federal entities would seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.

30. Approximately one-half of the respondents believed that additional guidance was needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity and that additional guidance was needed to apply the broad and general support exception.

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Board Consideration of Comments

31. The Board determined the main concerns identified by respondents included (1) the lack of implementation guidance and (2) costs would not be recognized consistently across agencies.

32. The Board noted that the task force acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing. In addition, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. However, the task force did note that some costs could be material for selected agencies. This finding would be consistent with the comment letters to the ED, as approximately one-half of the respondents did believe that material non-reimbursed or under-reimbursed inter-entity costs that meet the recognition criteria do exist.

33. The task force reported that there should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. The task force reported that guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued. It also reported that there should be established policies and procedures for the providing agency to submit necessary data to the receiving agency (for the receiving agency's evaluation and/or calculation of inter-entity costs). The comment letters to the ED supported the task force recommendations regarding the need for guidance.

34. Therefore, the Board determined that there was a need for additional guidance. The Board believes that with the issuance of additional detailed, practical guidance, agencies will have the tools necessary to implement inter-entity full costing and capture the costs that potentially exist. (See Additional Guidance below.)

35. Several respondents indicated that costs would not be recognized consistently across agencies as reliance on entity's judgment in identifying costs will result in differing interpretations. The Board expects differences will occur as agencies analyze their particular potential inter-entity cost against the recognition criteria because it is likely that certain costs may be material to one agency and not to another agency. This would appropriately occur considering materiality and the recognition criteria. The Board believes such expected differences are likely to occur but should not prevent agencies from informing financial statement users of material costs incurred.

36. Additionally, the Board reiterates that the recognition criteria in par. 112-113 of SFFAS 4 (which provides general criteria to determine which costs should be recognized) apply. The accounting and reporting for inter-entity costs that are recognized should be consistent and in accordance with par. 108-109 and 114-115 of SFFAS 4, which provide specific accounting examples.

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Additional Guidance

37. As discussed above, the Board determined that there was a need for additional guidance. Therefore, the task force has been requested to continue its work in this area by developing one or more Technical Releases (TR) that will address implementation issues raised by respondents. The Board has also suggested certain operational guidance be issued by the Office of Management and Budget (OMB). It should be noted that the guidance does offer a venue for agencies to direct agency-specific questions.

38. The Board believes that the task force could build upon their already extensive survey results and research, as well as the comment letters and staff analysis in developing the guidance. Specifically, the task force work may include an extensive evaluation of costs to determine which ones may be considered "Broad and General" for all entities and if possible, a list of the costs that should be considered Broad and General for all entities would be included in the TR. The TR may also include additional guidance or discussion on the factors *Directness of relationship to the entity's operations* and *Identifiability* as used in determining if a transaction should be considered material to the receiving entity.[5]

39. It is also anticipated that the task force will collect individual inter-entity requests for guidance on specific cases and determine if general guidance in the area can be provided on the issue, and if so, the TR will provide such clarifying guidance. The actual cases will be forwarded to OMB with the task force's recommendation, which will reference the general guidance in the TR. However, final disposition of the individual entity-specific cases will be determined by OMB.

40. The task force could utilize existing guidance related to cost accounting in developing the guidance. Specifically, the CFO Council's Cost Accounting Implementation Guide and the Joint Financial Management Improvement Program's System Requirements for Managerial Cost Accounting, among others, are good sources of information.

41. Additionally, the task force may wish to solicit volunteers from the agencies that provided comments to the ED for assistance. Also, volunteers could be requested from agencies that successfully implement Interpretation Number 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* considering the effective date for this was for periods beginning after September 30, 2004.

Effective Date

42. The proposed effective date in the ED was for periods beginning after September 30, 2007. The Board determined that the effective date of this standard should be delayed to periods beginning after September 30, 2008. The Board delayed the implementation date to allow the AAPC and OMB to develop the additional guidance detailed above.

[5] See SFFAS 4 par. 111-113 for recognition criteria

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Board Approval and Dissent

43. This Statement was approved for issuance by eight members of the Board. Mr. Reid dissented. Mr. Anania abstained.

44. Mr. Reid dissents from this Statement because he opposes rescinding paragraph 110. He believes that the inter-entity cost provisions should be implemented on a step-by-step basis. Mr. Reid notes that the basis for conclusions of SFFAS 4 states that the Board has expressed the need to take a measured, step-by-step, practical approach to implementing the inter-departmental costing standard. He notes that it further explains that the Board recommended that 1) OMB, with assistance from the FASAB staff, should identify those specific inter-departmental, un-reimbursed or under-reimbursed costs that entities should recognize, and 2) OMB should then issue guidance describing those costs. The Board anticipated that the largest and most important inter-departmental costs would be identified first; then other costs would be identified as entities gained experience in the application of the standard. Mr. Reid believes this approach was seen as a practical way to ensure uniformity in the application and implementation of the standard and to allow time and experience for overcoming any other practical problems which arose.

45. Mr. Reid believes that a better way to proceed is found in the procedure set forth in SFFAS 4 for identifying costs to be recognized. He believes that SFFAS 4 never contemplated the discontinuance of the procedure but rather held that specific costs would continue to be identified. Mr. Reid believes it is a far different approach to open the door to all costs. He believes rescinding paragraph 110 of SFFAS 4 defeats the idea set forth in SFFAS 4 that the standard be consistently applied and implemented.

46. Mr. Reid believes that the notion of consistent application is still a valid concern. He noted that when charged with identifying other costs to be imputed the Accounting and Auditing Policy Committee task force could not suggest additional costs to be recognized that were government-wide in nature and met the criteria of SFFAS 4. He believes that opening the door to recognition of inter-departmental costs that are not government-wide in nature is a new approach since such costs, identified on a case-by-case basis, cannot be applied consistently government-wide. Mr. Reid believes that control over the implementation of the standard will be lost and uncertainty will result.

47. Mr. Reid believes that if FASAB is dissatisfied with progress being made to identify additional costs, FASAB itself should identify specific costs to be recognized. SFFAS 4 indicates that FASAB may do this. Such action by FASAB would be compatible with the consistency notion and would not result in loss of control or uncertainty.

48. Mr. Reid believes that losing control over the recognition of inter-departmental costs will result in considerable activity with little or no value as agencies try to comply with a standard open to different interpretations by the preparer and the auditor. This change will expose agencies to possible challenges by auditors over unknown or immaterial costs, that cannot be determined with any certainty. In addition uncontrolled cost imputation will add significantly to the difficulties of eliminating these costs in consolidation.

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49. He also believes that this standard will result in uncontrolled imputation of inter-departmental costs and may instigate an iterative process of charges and charge-backs. These multiple rounds of cost imputation will provide little benefit and make it difficult for agencies to close their books quickly. Mr. Reid believes that as agencies impute costs from others, their costs will increase thereby increasing the costs others would need to impute from them. He believes this will create multiple rounds of cost imputation which will provide little benefit and will not be useful for agency decision making as it relates to costing of programs.

50. Mr. Reid believes this standard is a departure from the ideas of SFFAS 4 as they relate to the standard on inter-departmental cost recognition. He is not opposed to recognizing additional specific costs, but is opposed to doing so in an uncontrolled fashion.

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Appendix B: List of Abbreviations

AAPC	Accounting and Auditing Policy Committee
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

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Elizabeth Robinson
Alan H. Schumacher
David M. Zavada

FASAB Staff

Wendy M. Comes, Executive Director
Melissa L. Loughan
Monica R. Valentine

Federal Accounting Standards Advisory Board
441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Accounting for Fiduciary Activities

Statement of Federal Financial Accounting Standards 31

24 October 2006

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."*

- *"Mission Statement: Federal Accounting Standards Advisory Board."*

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Summary

Scope of this Statement

This statement defines "fiduciary activities" as those Federal Government activities that relate to the collection or receipt, and the subsequent management, protection, accounting, investment and disposition of cash or other assets in which non-Federal individuals or entities ("non-Federal parties") have an ownership interest that the Federal Government must uphold. The fiduciary relationship must be based on statutory or other legal authority and the fiduciary activity must be in furtherance of that relationship.

Reporting Requirements

This statement requires Federal entities to distinguish the information relating to fiduciary activities of the Federal entity from all other activities of that Federal entity. Fiduciary assets will not be recognized on the balance sheet of any Federal entity. The Federal entity is required to include in its own audited financial statements a note disclosure providing the following information about its fiduciary activities:

- An explanation of the nature of the fiduciary relationship,
- A schedule of fiduciary net assets, and
- A schedule of fiduciary activity.

This requirement applies even if the Federal entity issues stand-alone audited financial statements for the fiduciary activity. For entities managing several distinct fiduciary activities, disaggregated information is required by activity.

The Financial Report of the United States Government (FR) will include a note disclosure describing the nature of the fiduciary activities of the Federal Government. The FR note disclosure will provide a list of component entities responsible for fiduciary activities and the total amount of fiduciary net assets for each responsible component entity. The FR note disclosure will refer the reader to the component entity financial statements for additional information about each component's fiduciary activity.

Effective Date

This statement is effective for periods beginning after September 30, 2008. Early adoption is not permitted. In the year this statement becomes effective, entities should not restate the prior period amounts presented in the basic financial statements and notes.

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Table of Contents

Summary 2
Introduction 4
Accounting Standard 6
Definition and Characteristics of Fiduciary Activities 6
Basis of Accounting 8
Accounting and Reporting for Fiduciary Activities for Component Entities 9
Financial Report of the United States Government 11
Effect on Current Standards 11
Effective Date 15
Appendix A: Basis for Conclusions 16
Appendix B: Glossary 25
Appendix C: Examples of Fiduciary Note Disclosure 29
1. Example of Fiduciary Note Disclosure for Federal Component Entity 29
2. Example of Note Disclosure for the Government-wide Financial Report 31
2. Example of Note Disclosure for the Government-wide Financial Report 31
Appendix D: Pro Forma Transactions 32
Appendix E: List of Abbreviations 40

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_31.pdf.

Introduction

1. This statement defines **fiduciary activity**[1] and provides accounting and reporting guidance for fiduciary activities. Fiduciary activities should be distinguished from Federal programs designated as "trust funds" in the budget and in reporting to the Office of Management and Budget (OMB) and to the Treasury Financial Management Service (FMS). "Trust funds" included in the Federal budget are often established to carry out Federal programs, and their activity differs from the common understanding of trust **fund** activity outside of government. Most of the **revenue** received by Federal "trust funds" represents Government-owned collections "earmarked" or dedicated to finance or help to finance specific Federal programs rather than being held for the exclusive benefit of **non-Federal parties**. Non-fiduciary "trust funds" are addressed by Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds.* This standard addresses activities that are fiduciary in nature.

2. Fiduciary activities involve **ownership interests** described in this statement (see paragraph 10). The Federal employees' Thrift Savings Fund and the Indian tribal and individual Indian trust funds are examples of fiduciary activities.

3. In order to clarify financial reporting in general purpose Federal financial reports, this standard defines fiduciary activity and provides financial reporting guidance for fiduciary activity and for fiduciary assets and liabilities.

4. This standard requires that the terms "**fiduciary,"** "**fiduciary assets**," "fiduciary fund," and "fiduciary activity" be used in general purpose Federal financial reports to characterize only fiduciary activity as defined in this standard. Non-fiduciary "trust fund" assets and activity related thereto should not be characterized as "fiduciary" or "trust" activity in general purpose financial reports of Federal **entities**. Such reporting would obscure an essential fact: that the Federal Government uses the non-fiduciary assets in support of its programs.

5. This standard requires that Federal entities disclose fiduciary assets, liabilities and flows in a note **disclosure**. Fiduciary assets and liabilities should not be recognized on the balance sheet of the Federal entity.

6. This standard also clarifies the definition and reporting for fiduciary cash that is on deposit in the U.S. Treasury. Fiduciary cash deposits are referred to as **Fiduciary Fund Balance with Treasury** (Fiduciary FBWT). This deposit activity is not fully addressed in Statement of Federal Financial Accounting Standards 1, *Accounting for Selected Assets and Liabilities.* SFFAS 1 explains that "in some circumstances, the entity deposits cash in its accounts in a fiduciary capacity for the U.S. Treasury or other entities."[2] However, some unique aspects of Fiduciary

[1] Words first appearing in **boldface** are defined in Appendix B: Glossary

[2] SFFAS 1, paragraph 29.

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FBWT are not included in SFFAS 1. For example, SFFAS 1 defines FBWT as "the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities." SFFAS 1 further explains that "Fund Balance with Treasury is an intragovernmental item." However, Fiduciary FBWT is not an intragovernmental item; the owner of Fiduciary FBWT is a non-Federal party. This standard amends SFFAS 1 to distinguish fiduciary FBWT from Federal component entities' FBWT.

7. Numerous "fund groups"[3] are used in reporting to the Treasury FMS and the OMB. For example, "**deposit funds**" may be used for monies that do not belong to the Federal Government. Regardless of how a fund group may be classified in reporting to the Treasury FMS or to the OMB, only those activities that meet the definition of fiduciary activity promulgated in this standard are subject to the reporting requirements of this standard. Activities that do not meet the definition of fiduciary activities promulgated in this standard are not subject to the reporting requirements of this standard. Deposit funds that do not meet the definition of fiduciary activities, and therefore are not disclosed in the fiduciary note disclosure, should be recognized in the principal financial statements.

Scope

8. This statement provides financial reporting standards for fiduciary activities in the general purpose financial statements for Federal entities. The standard does not affect reporting in the *Budget of the United States* or special-purpose reports.

Effective Date

9. This standard is effective for periods beginning after September 30, 2008. In the initial year of implementation, comparative information should not be restated. Earlier adoption is prohibited.

[3] For a description of "fund groups" used in reporting to the Treasury FMS and the OMB, see the Treasury Financial Manual, Part 2, Chapter 1500.

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Accounting Standard

Definition and Characteristics of Fiduciary Activities

Definition

10. In a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which **non-Federal individuals or entities** (or "non-Federal parties") have an ownership interest that the Federal Government must uphold. Non-Federal parties must have an ownership interest in cash or other assets held by the Federal entity under provision of law, regulation, or other fiduciary arrangement. The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation.

Characteristics

11. Fiduciary activities are initiated by **fiduciary collections**. Fiduciary collections are an inflow to a Federal entity or its non-Federal designee (such as a commercial bank) of cash or other assets that are and remain the property of non-Federal parties. Fiduciary collections may be preceded by the recognition of fiduciary accounts receivable.

12. Fiduciary activities may involve a variety of fiduciary assets, liabilities and transactions. Examples include but are not limited to:

    Cash:
    Fiduciary cash may be held in a variety of ways. Cash may be represented by balances on deposit with the U.S. Treasury[4] or commercial banks.

    Investments:
    Fiduciary assets may include investments in Treasury securities or in non-Treasury securities.

    Other Assets:
    Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending disposition, or held long-term in a fiduciary capacity.

    Liabilities:
    A fiduciary activity may include expenses that will be paid with fiduciary

[4] The U.S. Treasury is in the Treasury Department, which is the primary fiscal agent for the Federal Government. The Treasury Department collects money due to the United States, makes payments, manages borrowings, performs central accounting functions, and produces coins and currency sufficient to meet demand. The Treasury Department manages the Government's daily cash position and borrowing as well as the investment of funds in its custody. The Treasury Department provides Central Accounting System (CAS) services to Federal agencies. CAS transactions involve appropriation credits, transfers-in and -out, collections, disbursements and related adjustments. Such transactions increase or decrease Federal entities' **Fund Balance with Treasury** (FBWT) maintained with the Treasury Department.

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assets. This may result in fiduciary liabilities that will be settled with fiduciary assets.

Inflows:

A fiduciary activity may include collections of cash or other assets that represent contributions from or for beneficiaries or revenue derived from fiduciary assets.

Outflows:

A fiduciary activity may include expenses that will be paid with fiduciary assets and distributions of assets to the beneficiaries.

Exclusions

13. The following are excluded from the reporting requirements for fiduciary activities, and should be recognized in the principal financial statements of the Federal component entity and not in the fiduciary note disclosure:

    - Amounts related to unpaid[5] **payroll withholdings** and **garnishments**[6] are excluded from the reporting requirements of this standard. Liabilities for unpaid payroll withholdings and garnishments should be recognized as accounts payable in accordance with existing standards.[7]

    - **Unearned revenue** should not be reported as fiduciary activity and should be recognized as a liability in accordance with existing standards.[8] Assets collected or received by a Federal entity that represent prepayments or advance payments for which the Federal component entity is expected to provide goods or services should not be classified as fiduciary activity. This exclusion applies broadly and applies to amounts a customer advances for orders that may be placed in the future or deposits made as part of a bid or settlement process, even if these amounts are not specifically classified as "unearned revenue" by the entity due to uncertainty about the ultimate realization of the revenue.

14. Amounts related to operating revenues and expenses in ways that are consistent with the above exclusions also may be excluded.

15. **Seized property**, including seized monetary instruments, is not subject to the reporting requirements for fiduciary activities because it does not meet the definition of a fiduciary activity. Seized assets, including seized monetary instruments, should continue to be reported in accordance with existing standards.[9]

[5] " Unpaid" means that amounts withheld or garnished have not been paid to the designated recipient of the amounts withheld or garnished.

[6] Examples of garnishments include amounts withheld from an individual's salary or tax refund for payments of child support or to another third party in compliance with a statute or court order.

[7] See SFFAS 1, *Accounting for Selected Assets and Liabilities*, paragraphs 74-86.

[8] See SFFAS 1, paragraph 85 and SFFAS 7, *Accounting for Revenue and Other Financing Sources,* paragraph 37.

[9] See SFFAS 3, *Inventory and Related Property,* paragraphs 61 and 69.

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Basis of Accounting

16. Fiduciary activities reported in the Federal entity's notes to the financial statements, as required in paragraphs 17-24, should be disclosed in the required schedules and measured using the standards provided in generally accepted accounting principles.[10]

[10] For the definition of generally accepted accounting principles see the American Institute of Certified Pubic Accountants *Professional Standards, U.S. Auditing Standards (AU)* Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles."

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Accounting and Reporting for Fiduciary Activities for Component Entities

Reporting of Fiduciary Activities

17. Reporting on fiduciary activities is required in two notes to the financial statements. The note disclosing significant accounting policies[11] should include, at a minimum, a statement that: "Fiduciary assets are not assets of the *[Federal component entity*] and are not recognized on the balance sheet. See Note xx, Fiduciary Activities."

18. A separate note to the financial statements should include the following information for individual fiduciary activities:
    a. A description of the fiduciary relationship, e.g., the applicable legal authority, the objectives of the fiduciary activity, and a general description of the beneficial owners or class of owners.
    b. A Schedule of Fiduciary Activity displaying, for all periods presented:
        - The beginning balance of net assets,
        - The inflows from the fiduciary activities by category (e.g., contributions, investment earnings) and outflows by category (e.g., benefit payments, refunds, administrative expenses),
        - The change in net assets, and
        - The ending balance of net assets.
    c. A Schedule of Fiduciary Net Assets displaying the current and prior period ending balances of cash and any other assets by category (e.g., receivables, investments), and liabilities by category (e.g., accounts payable, refunds payable), and a variance analysis addressing significant changes from the prior period. The disclosure for non-monetary fiduciary assets should include a description of the composition of the assets, the method(s) of valuation, and changes (if any) from prior period accounting methods.
    d. Component entities also may have **non-valued fiduciary assets.** Non-valued fiduciary assets are fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Component entities holding non-valued fiduciary assets should disclose them in a Schedule of Changes in Non-Valued Fiduciary Assets, which should include a description of non-valued fiduciary assets, beginning quantity, quantity received, quantity disposed of, net increase/decrease in non-valued fiduciary assets, and ending total quantity.
    e. If separate audited financial statements are issued for an individual fiduciary activity, additional disclosures listed in paragraph 22 should be provided. If the separate audited financial statements for an individual fiduciary activity are prepared with a fiscal year-end other than

[11] A note disclosing "Significant Accounting Policies" is a requirement of the Office of Management and Budget (OMB). This disclosure is currently listed as Note 1 in "Form and Content of the Performance and Accountability Report" issued as Part A of OMB Circular A-136.

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September 30, the information required in this paragraph may be provided for the fiduciary activity's most recent fiscal year, provided that the information is clearly labeled.

19. Most fiduciary activities are disclosed by the Federal component entity responsible for administering the fiduciary activity on behalf of the beneficiaries. If more than one Federal component entity is responsible for administering a fiduciary activity, and the separate portions of the activity can be clearly identified with a responsible component entity, then each component entity should disclose its portion in accordance with the requirements of this standard. In such cases, each component entity should identify the other component entities that are involved in managing the activity. If separate portions cannot be identified, the component entity with program management responsibility should disclose the fiduciary activity.[12]

20. For component entities with several distinct fiduciary activities, summary financial information required in paragraph 18 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 21) may be aggregated.

21. Selecting fiduciary activities to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's fiduciary net assets or inflows; and qualitative factors such as whether a fiduciary activity is of immediate concern to **beneficiaries**, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the fiduciary note disclosure would be the primary source of financial information for the public.

22. If separate audited financial statements are issued for an individual fiduciary activity that is presented individually in accordance with the criteria described in the preceding paragraph,
    (a) The fiduciary note should disclose the basis of accounting used and auditor's opinion on the current or most recent financial statements. If the auditor's opinion was not unqualified, the fiduciary note also should disclose the reason(s) stated by the auditors and refer the reader to the audit opinion for further information.
    (b) The note disclosure should provide information on how the reader can obtain a copy of the financial statements and the audit opinion thereon.

23. In the initial year of implementation, prior year information should not be displayed. In the reporting periods following the initial year of implementation, prior period amounts should be displayed.

[12] To determine program management responsibility, Federal component entities should consider the legislation authorizing the activity; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display*.

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24. Notes to the financial statements are an integral part of the basic financial statements, essential for complete and fair presentation in conformity with generally accepted accounting principles for the Federal Government.

Financial Report of the United States Government

25. Reporting on fiduciary activities is required in two notes to the financial statements. The note disclosing significant accounting policies[13] should include, at a minimum, a statement that: "Fiduciary assets are not assets of the Federal Government and are not recognized on the balance sheet of the U.S. Government. See Note *xx*, Fiduciary Activities."

26. In the consolidation process, a distinction must be made between Federal component entities' Fund Balance with Treasury (FBWT) recognized on the balance sheet at the component entity level and the FBWT attributable to fiduciary activities (fiduciary FBWT) reported by Federal component entities in a note disclosure. The liability for fiduciary cash held as FBWT should be recognized as a liability on the Government-wide balance sheet. The liability for fiduciary investments in Treasury securities should be recognized on the Government-wide balance sheet as debt held by the public.

27. The fiduciary note disclosure should include a definition of fiduciary activities, a description of the nature of the Federal Government's fiduciary activities, a list of component entities responsible for fiduciary assets, and the total amount of fiduciary net assets for each responsible component entity. Aggregation of component entities with immaterial amounts of fiduciary net assets is permitted.

28. In the initial year of implementation, prior year information should not be displayed. In the reporting periods following the initial year of implementation, prior period amounts should be displayed.

29. The note disclosure should refer the reader to component entity financial statements for additional information.

30. Notes to the financial statements are an integral part of the basic financial statements, essential for complete and fair presentation in conformity with generally accepted accounting principles for the Federal Government.

Effect on Current Standards

[13] A note disclosing "Significant Accounting Policies" is a requirement of the Office of Management and Budget (OMB). This disclosure is currently listed as Note 1 in "Form and Content of the Performance and Accountability Report issued as Part A of OMB Circular A-136.

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31. This standard affects current standards for reporting non-entity assets. Paragraphs 26 and 29 of SFFAS 1, *Accounting for Selected Assets and Liabilities,* are amended as follows:

> [26] Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements**, except for non-entity assets meeting the definition of fiduciary assets, which should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.*** Non-entity assets ~~reported in~~ **recognized on** an entity's ~~financial statements~~**balance sheet** should be segregated from entity assets. An amount equal to non-entity assets **recognized on the balance sheet** should be recognized as a liability (due to Treasury or other entities) ~~in the entity's financial statements~~.
>
> [29] ***Non-entity cash.*** Non-entity cash is cash that a federal entity collects and holds on behalf of the U.S. Government or other entities. In some circumstances, the entity deposits cash in its accounts in a ~~fiduciary~~ **custodial** capacity for the U.S. Treasury or other **federal component** entities**, or in a fiduciary capacity for non-federal parties.**
>
> **(a)** Non-entity cash **recognized on the balance sheet** should be reported separately from entity cash.
>
> **(b) Non-entity cash meeting the definition of a fiduciary asset should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.***

32. This standard affects current standards that define Fund Balance with Treasury. Paragraph 31 of SFFAS 1 is amended as follows:

> [31] A federal entity's fund balance with the Treasury **(FBWT)** is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. ~~Fund balance with Treasury~~ **FBWT** is an intragovernmental item, **except for fiduciary or other non-federal non-entity FBWT.** From the reporting entity's perspective, **the reporting entity's** ~~a fund balance with Treasury~~ **FBWT** is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. **In contrast, fiduciary and other non-federal non-entity FBWT is not intragovernmental, and it represents a liability of the appropriate Treasury component and of the federal government as a whole to the non-federal beneficiaries.**

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33. Paragraphs 37 and 38 of SFFAS 1 are amended, and a new paragraph is added, as follows:

> [37] Disclosure should be made to distinguish ~~two~~ **three** categories of funds within ~~the entity's fund balance with Treasury~~ **FBWT reported on the entity's balance sheet**: the obligated balance not yet disbursed**,** ~~and~~ the unobligated balance**, and non-budgetary FBWT**. The obligated balance not yet disbursed is the amount of funds against which budgetary obligations have been incurred, but disbursements have not been made.
>
> [38] The unobligated balance is the amount of funds available to an entity against which no claims have been recorded. Unobligated balances are generally available to a federal entity for specific purposes stipulated by law. Unobligated balances may also include balances in expired/canceled accounts that are available only for approved adjustments to prior obligations. Certain unobligated balances may be restricted to future use and are not apportioned for current use. Disclosure should be provided on such restrictions. **Non-budgetary FBWT includes unavailable receipt accounts, clearing accounts and other accounts that do not represent budget authority, as well as non-entity FBWT that is recognized on the balance sheet.**
>
> **[New Paragraph] In addition to entity and non-entity FBWT that is recognized on the balance sheet, a federal entity may also administer fiduciary FBWT on behalf of non-federal entities or individuals. Fiduciary FBWT is not recognized on the balance sheet, but is subject to separate disclosure requirements. For disclosure requirements for fiduciary FBWT, see SFFAS 31, *Accounting for Fiduciary Activities.***

34. This standard affects current standards dealing with fiduciary activity and fiduciary relationships in SFFAS 7, *Accounting for Revenue and Other Financing Sources*. Paragraphs 83-87 and 370 of SFFAS 7 are rescinded. In addition, paragraphs 142 and 276 of SFFAS 7 are amended as follows:

> [142] MMS collects this revenue ~~**acting as an agent for**~~ **and distributes it to** the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. ~~Therefore,~~ MMS should account for ~~the~~ exchange revenue **it collects as an agent for the U.S. Treasury or other federal component entities** as a custodial activity, which is an amount collected **or to be collected** for other~~s~~ **federal entities,** in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. **MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for***

Fiduciary Activities. Because the revenue collected by MMS is exchange revenue, it should be recognized and measured under the exchange revenue standards when the rents, royalties, and bonuses are due pursuant to the contractual agreements.

[276] **~~MMS should instead account for the exchange revenue as a custodial activity.~~** MMS collects rents, royalties, and bonuses~~ acting as an agent on behalf of~~ **and distributes the collections to** the recipients designated by law: the General Fund, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and Allottees. **MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for Fiduciary Activities.*** The amounts of revenue should be recognized and measured under the exchange revenue standards when they are due pursuant to the contractual agreement.

35. This standard also amends paragraphs 84 and 102 of SFFAC 2, *Entity and Display*, as follows:

[84] The elements most likely to be presented in the balance sheet of a Federal suborganization/organization, program, or the entire government would be as follows:

- **Fund Balance with Treasury.** This represents the amount in the entity's accounts with the **U.S.** Treasury that is available only for the purpose for which the funds were appropriated. It ~~would~~ **may** also include balances held by the entity in the capacity of a banker or agent for others. **However, Fund Balance with Treasury (FBWT) meeting the definition of fiduciary FBWT should not be recognized on the balance sheet, but should be disclosed in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities.*** ~~This classification would not be included in the financial statements of the U.S. Government.)~~

[102] Custodial collections do not include deposit funds, i.e., amounts held temporarily by the government (e.g., bidders' earnest money or guarantees for performance) or amounts held by the Government as an agent for others~~,~~ (e.g., state income taxes withheld from Federal employees' salaries that are to be transferred to the states~~.~~)**.** ~~Both of t~~**T**hese types of collections ~~can be considered assets and liabilities until they are returned to the depositor or forwarded to the organization entitled to the funds~~ **should be reported in accordance with the provisions of SFFAS 31, *Accounting for Fiduciary Activities***.

36. Interpretation No. 1, *Reporting on Indian Trust Funds in General Purpose Financial Reports of the Department of the Interior and in the Consolidated Financial Statements of the United States Government: An Interpretation of SFFAS 7*, is rescinded.

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Effective Date

37. This standard is effective for periods beginning after September 30, 2008. In the initial year of implementation, comparative information should not be restated. Earlier adoption is prohibited.

The provisions of this statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by the Board in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors.
The guidance enunciated in the standards - not the material in this or other appendices - should govern the accounting for specific transactions, events or conditions.

Outreach activities

38. FASAB published the revised[14] exposure draft (ED), *Accounting for Fiduciary Activities,* on June 27, 2005. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the FASAB News, the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter, Government Accounting and Auditing Update,* the CFO Council, the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past. Copies of the ED and letters requesting comments were also sent to individuals who spoke at the October 2003 public hearing for the original ED, as well as to the Federal Retirement Thrift Investment Board.

39. During the comment period, FASAB staff also gave informational presentations at the 15th Annual Government Financial Management Conference sponsored by Treasury Agency Services, and at July 2005 meetings of the Financial Statement Audit Network, the OMB Form and Content Work Group, the Greater Washington Society of CPAs, and the U.S. Standard General Ledger Board's Issues Resolution Committee. A public hearing was also held on August 17, 2005.

Comments Received

40. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

41. Fourteen written responses were received from the following sources:

Comment letters and/or oral testimony provided by:	**Federal (Internal)**	**Non-Federal (External)**
Users, academics, others		3
Auditors	3	
Preparers and financial managers	8	

42. Note: The response from one Federal agency's Office of the Inspector General listed above under "auditors," noted that the response represented the

[14] The first exposure draft was issued on April 23, 2003. Issues raised by respondents to that exposure draft caused the Board to revise its proposal.

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consensus expressed by the agency's Office of the Chief Financial Officer as well as the agency's auditors..

43. Also, one Federal agency wrote that it had no comments because the agency's funds are primarily earmarked funds rather than fiduciary.

44. At the public hearing held on August 17, 2005, representatives from two Federal agencies provided oral statements and answered questions from the Board.

Summary of Comments

45. The majority of respondents agreed with the definition of fiduciary activities, the proposed reporting requirements, and the exclusions from the reporting requirements. Other issues raised by respondents included how to report on fiduciary activities that issue separate audited financial statements; the ownership interest(s) for seized assets; the appropriate basis of accounting for fiduciary activities and the effective date of the standard.

Definition

46. The Board believes that the substance of a transaction, rather than its form, should be the determining factor in how it is reported. Accordingly, this standard provides a definition and characteristics for fiduciary activity and does not provide lists of specific funds or fund groups. Some respondents have noted that often fiduciary activities are managed through the establishment of a deposit fund. Therefore, the following section is intended to assist Federal financial managers in understanding the role of deposit funds.

The Role of Deposit Funds

47. Federal component entities report budgetary and proprietary transactions to the OMB and the Treasury FMS using "fund account symbols," which are sub-components of Federal reporting entities. Fund account symbols are assigned by the Treasury FMS in collaboration with the OMB. Based upon certain characteristics, fund account symbols are classified into "fund groups." For example, "deposit funds" are a fund group for monies that do not belong to the Federal Government.[15] The OMB classifies deposit funds as non-budgetary activities and excludes deposit funds from the Federal budget.[16] Within the "deposit fund" group established by the Treasury FMS, there are three distinct types: (a) monies withheld from Government payments for goods and services received, including payroll withholdings and garnishments; (b) monies the Government is holding awaiting distribution based on a legal determination or investigation; and (c) deposits received from outside sources for which the Government is acting solely as a banker, fiscal agent or custodian.[17] Although some fiduciary activities may be recorded and reported in deposit funds, the use of a deposit fund for an activity does not automatically indicate that the activity

[15] Treasury Financial Manual (TFM) Volume 1, Part 2, Section 1535, available on the Internet at http://www.fms.treas.gov/tfm/vol1/index.html
[16] See FY 2006 U.S. Budget, *Analytical Perspectives,* pp. 372, 377 and 378-379.
[17] TFM, Section 1535.

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meets the definition of fiduciary in this standard. The activity in each deposit fund should be reviewed to determine whether it meets the definition and characteristics of a fiduciary activity in this standard. Also, if an activity is not reported in a deposit fund, that fact does not necessarily mean that the activity does not meet the definition of fiduciary in this standard. Each activity must be evaluated based upon whether or not it meets the definition of a fiduciary activity in this standard.

Exclusions

48. Payroll withholdings and garnishments appear to meet the definition of fiduciary activities. When an employer withholds an amount from an employee's wages, the employer has a responsibility to forward those amounts to the required recipient. However, this standard excludes payroll withholdings and garnishments from the reporting requirements for fiduciary activities because payroll withholdings and garnishments are similar to other unpaid costs of operations and do not warrant special reporting. Because of the routine operational nature and short duration of the activity, the Board does not believe that fiduciary reporting of payroll withholdings and garnishments would produce useful information.

49. Similarly, Federal component entities may hold advances received from customers for future sales of goods or services. Such advances represent unearned revenue. One Federal agency, in its written response and oral testimony, noted that certain advances received appear to meet the definition of fiduciary activity. However, this standard excludes unearned revenue from the fiduciary reporting requirements because unearned revenue is a routine operational activity and the Board believes that fiduciary reporting of unearned revenue is not warranted.

50. The standard clarifies the fact that seized property is not subject to the fiduciary reporting requirements because seized assets do not meet the definition of fiduciary activities. In seizure-for-forfeiture the Government is asserting its right to the property, and is taking action to eliminate, rather than to uphold, the ownership interest of the non-Federal party.

Reporting Standards

51. The Board discussed the implications of recognizing fiduciary assets on the balance sheet or on a separate principal statement. The Board considered whether recognizing fiduciary assets on the balance sheet might imply not only managerial control over the assets, but also that the benefit of the assets accrue to the Federal component entity. The Board decided that fiduciary assets should not be recognized on the balance sheet of the Federal component entity because they are not assets of either the Federal component entity or the Federal Government as a whole. The Board considered whether fiduciary activity should be recognized in a separate principal financial statement, but decided that a note disclosure would be preferable, provided that the note disclosure contains adequate information regarding fiduciary assets and activities.

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Basis of Accounting

52. Some members of the Board have dissented to the standard and their reasons are presented at paragraph 63. These members oppose requiring the disclosures to be measured in accordance with generally accepted accounting principles. Two reasons are offered in the written dissent.

53. Some of the members dissenting stated that the Board should not impose requirements on reporting information related to "non-Federal entities." However, a majority of the Board believe that fiduciary activities as defined in this standard are Federal program activities, carried out by Federal employees often with federal funding of administrative expenses. The amount and sources of financing fiduciary activities are determined by Congress. The assenting Board ;members believe that although the assets in fiduciary funds are non-federal assets, the responsibility for managing the assets is a federal responsibility and the funds holding the assets are federal accounting entities established to carry out that responsibility.

54. A major objective of general purpose financial reporting in accordance with generally accepted accounting principles is to meet the needs of users who have limited access to internal documents or statements and lack the ability to demand that desired information be provided. Most citizens and beneficiaries of fiduciary funds lack such ability.

55. Some of the members dissenting stated that the cost-benefit of the requirement to disclose information in conformity with generally accepted accounting principles has not been demonstrated. However, a majority of the Board believes that the need for accountability by public officials is sufficient in its own right to justify the requirement to conform to generally accepted accounting principles. Further, the Board notes that:

    a. Current standards (SFFAS 7, paragraphs 83-87) already require accrual accounting for fiduciary activities; therefore, this standard is merely carrying forward existing requirements and is not introducing new costs.

    b. This standard requires the same basis of accounting that is required for Federal assets, liabilities and flows. Accounting systems on that basis are routinely in operation throughout the government and pose no unusual costs for fiduciary activities.

    c. The Board is permitting generally accepted accounting principles for any domain (FASAB, Governmental Accounting Standards Board, or Financial Accounting Standards Board) to be used. This should mitigate any costs for fiduciary activities currently reporting with a different source of generally accepted accounting principles.

d.The Board is permitting the use of information based on a fiscal year-end other than the fiscal year-end used by the Federal Government. This will mitigate the cost for fiduciary activities currently producing audited financial statements on a different fiscal year.

Custodial Activity Differs from Fiduciary Activity

56. The Statement of Custodial Activity is not amended by this standard. The Statement of Custodial Activity is appropriate for custodial collections, which are amounts collected by one Federal component entity on behalf of another Federal component entity and associated with that other entity in the Federal budget. For example, the Internal Revenue Service (IRS) and the Bureau of Customs and Border Protection (Customs) make collections of income taxes and customs duties, respectively, and they are deposited into designated accounts of the Treasury, which are unavailable to either for use in their operations.[18] The IRS and Customs would report such collections on a Statement of Custodial Activity and the responsible program entity would recognize revenue and the related assets. Thus, the Statement of Custodial Activity is appropriate for those Federal component entities whose primary mission is collecting taxes or other Federal revenues, particularly sovereign revenues that are intended to finance the entire Government's operation, or at least the programs of other Federal component entities, rather than their own activities.[19] Guidance with respect to the Statement of Custodial Activity is provided in Statement of Federal Financial Accounting Concepts (SFFAC) 2 and SFFAS 7.

57. Reporting requirements for fiduciary activities are different from reporting requirements for custodial activities. Although the inflows and assets reported on the Statement of Custodial Activity are not inflows or assets of the Federal component entity, they are inflows and assets of the Federal Government as a whole. In contrast, fiduciary inflows and assets are not inflows of net assets to the Federal Government. Accordingly, fiduciary activities are disclosed in a note and are not recognized on the Statement of Custodial Activity or any other principal financial statement.

58. Because fiduciary assets are not recognized on the balance sheet of the reporting entity, there is no offsetting liability, as there is for custodial assets. The fiduciary note discloses the beneficiaries' equity as "fiduciary net assets."

Effective Date

59. This standard requires that fiduciary assets and liabilities be disclosed in a note, and should not be recognized on the face of the balance sheet. In order to

[18] Implementation Guide to Statement of Financing in Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources*: Detailed Information on the Statement of Financing, par. 25.
[19] SFFAC 2, par. 101.

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facilitate the preparation of the Financial Report of the U.S. Government, a uniform implementation date for all Federal component entities is necessary. Accordingly, early implementation of this standard is prohibited, and Federal component entities should not restate prior periods in the initial year of implementation. The effective date is intended to allow Federal agencies adequate time to comply with the reporting requirements.

Effect on Existing Standards

60. The Board promulgates standards for activities that are defined by specific characteristics, and not by how an activity may be labeled in the budget or reported to the Treasury Financial Management Service. Paragraph 370 of SFFAS 7 addressed the group of funds designated as "deposit funds" as follows:

> *[370] Deposit funds are accounts outside the budget that record amounts that the Government (a) holds temporarily until ownership is determined or (b) holds as an agent for others. The standards and guidance in this Statement do not apply to deposit funds except insofar as a particular deposit fund may be classified as part of a Federal reporting entity or a disclosure may be required due to a fiduciary relationship on the part of a Federal reporting entity toward a deposit fund.*

61. The Board decided that this paragraph was not sufficiently clear that all deposit funds that are not disclosed in the fiduciary note should be recognized in the principal financial statements of the Federal component entity. Accordingly, paragraph 370 of SFFAS 7 is rescinded by this standard and an explanatory sentence was added to paragraph 7 in the introduction section of this standard. All deposit funds that do not meet the definition of fiduciary activities and therefore are not disclosed in the fiduciary note must be recognized on the face of the financial statements.

Board Approval

62. This statement was approved by the Board with a vote of six members in favor of its issuance and four members, Messrs. Dacey, Patton, Reid and Zavada, opposing its issuance.

Dissents

63. Messrs. Dacey, Patton, Reid and Zavada dissented to this standard. Their dissent is presented below. Some members who voted to issue the standard agree with certain of the arguments posed by the dissenters but believe that, on balance, the standard is an improvement in Federal financial reporting.

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Dissent of Messrs. Dacey, Patton, Reid and Zavada

63. Paragraph 16 of the proposed standard requires that information disclosed about fiduciary activities be presented on the basis of generally accepted accounting principles. Board members Robert Dacey, James Patton, Robert Reid, and David Zavada support disclosure of information on fiduciary activities, but disagree with this requirement. These members believe that, at a minimum, the words "and measured using the standards provided in generally accepted accounting principles" should be deleted from paragraph 16 and replaced with words such as "and measured on the basis of accounting used to maintain or report the information." While these members do not disagree that generally accepted accounting principles (GAAP) financial reporting enhances the quality of reported financial information, they nonetheless disagree that the Board should require information related to fiduciary activities to be presented on a GAAP basis. The reasons for these views and the members supporting each of these reasons are as follows:

    The Board Should Not Impose Requirements on Reporting Information Related to Non-Federal Entities

64. Board members James Patton and Robert Reid believe that the Board should not impose requirements on reporting information related to non-Federal entities, including the basis of accounting to be used in disclosures related to such non-Federal entities. Fiduciary activities, as defined in the proposed standard, represent activities of non-Federal entities. All entities are obligated to choose the basis of accounting that will be used to prepare financial information and whether such information will be audited, consistent with any legal and regulatory requirements. In some known instances and likely in others, information related to these non-Federal entities is not maintained or reported on a GAAP basis and/or are not audited.

65. Other organizations are positioned to require the basis of accounting to be used by the non-Federal entities that represent fiduciary activities to the Federal government, as well as require the information to be audited. The beneficiaries/owners that have an interest in the non-Federal entities' activities and oversight bodies that represent them and the respective Federal entities are best positioned to determine the basis of accounting and reporting and audit assurance that best meets their needs. For example, the beneficiaries/owners of the non-Federal entities may have agreements in place covering the basis of accounting used or the audit assurance to be provided. In addition, the basis of reporting and audit assurance can be determined by the courts, by statute or by policy.

66. In summary, the Board should not mandate disclosure of financial information on a basis of accounting that is different from the basis used to maintain or report information related to these non-Federal entities nor require that such information be audited on an individual fiduciary activity basis. However, as part of the current Federal entity project, the Board can reconsider whether certain or all entities representing fiduciary activities should be considered to be Federal entities, and therefore be required to follow Federal GAAP and be audited.

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The Cost-Benefit of the Requirement Has Not Been Demonstrated

67. Board members Robert Dacey, Robert Reid, and David Zavada do not believe that it has been demonstrated that the requirement to disclose information in conformity with GAAP is cost-beneficial (i.e., benefits clearly exceed the additional costs that would be incurred.) As noted above, in some known instances and likely in others, information related to non-Federal entities that represent fiduciary activities to the Federal Government is not maintained or reported on a GAAP basis and/or are not audited.

68. In their response to the exposure draft, the Department of the Interior indicated that they were maintaining the Indian Trust Fund information on a basis of accounting that was consistent with trust activity of commercial banks and institutions and they questioned the benefit of converting the information to a Federal GAAP basis of accounting.

69. Requiring the Federal entities to report financial information on these non-Federal entities in their footnotes on a GAAP basis will incur additional costs, which could be substantial. Furthermore, requiring such disclosure will not require the non-Federal entity to maintain or report financial information on a GAAP basis of accounting. Financial information disclosed in the Federal entity financial statements that is different from information provided to fiduciary owners/beneficiaries and oversight bodies could result in confusion. Such confusion further decreases the benefit of the requirement to report fiduciary activities on a GAAP basis.

70. The disclosure of fiduciary activities in Federal financial statements is not designed to be the primary source of information to owners/beneficiaries of these non-Federal entities. Rather, such beneficiaries should receive information directly from the non-Federal entity or related Federal entity. In the case of the larger fiduciary activities, such information is provided or available, both at an aggregate and individual account holder level.

71. A primary purpose of disclosing fiduciary activities in a Federal entity's financial statements is to demonstrate the nature and extent of the Federal Government's fiduciary responsibilities and whether the Federal entity is adequately carrying out its fiduciary responsibilities. Therefore, disclosure of (1) information prepared on the basis of accounting used to maintain or report the financial information to beneficiaries/oversight bodies, (2) the basis of accounting used (including whether or not it was prepared on a Federal GAAP basis), (3) whether the information was audited, and (4) the type of opinion issued, provides sufficient information that users and oversight bodies (e.g., Congress, OMB) may use to determine the adequacy of Federal actions to discharge their fiduciary responsibilities. It has not been demonstrated that incurring additional costs to develop disclosures beyond these would provide significant benefits relative to the additional costs.

72. The nature and extent of all fiduciary activities have not been identified nor have the related costs to meet the requirements of the proposed standard. In addition to the major fiduciary activities discussed by the Board, there may be many other

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fiduciary activities for which Federal GAAP-based information is not maintained or reported and/or are not audited. Also, the cost of developing accrual-based information, if available, is unknown. In addition, an Interior official indicated that certain accruals, such as for royalties on the thousands of oil and gas leases held and for timber sales on behalf of the Indian trust funds are not readily determinable, and if estimated, would not be reliable. Therefore the relative magnitude of the ultimate cost of adopting this requirement is not known.

73. While a precise estimate of costs and a formal cost benefit analysis is not expected, the Board should consider the relative magnitude of costs before deciding whether a standard is cost beneficial. As part of this consideration, the Board should also consider the expected utility of the requirement (a disclosure in this instance), and alternatives for achieving the related objectives. In this instance, it has not been clearly demonstrated that the increased benefits exceed the related costs.

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Appendix B: Glossary

Beneficiary – An individual or other entity legally entitled to enforce an obligation against the United States such as specified benefits from a fiduciary trust or agent fund.

Component Entity – The term "component entity" is used to distinguish between the U.S. Federal Government and its components. The U.S. Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include departments and independent agencies, which are generally divided into organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. Use of "component entity" in this standard is only intended to distinguish between the Financial Report of the United States Government's consolidated financial statements and financial statements of its components. Also see "Entity."

Deposit Fund – Treasury Financial Management Service establishes deposit fund accounts to record monies that do not belong to the Federal government. A description of deposit fund criteria may be found in the Treasury Financial Manual, Section 1535, "Deposit Fund Accounts."

Disclosure – Displaying information in notes or narrative regarded as an integral part of the basic financial statements.

Entity – The U.S. Federal Government as a whole and/or units within the Federal Government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, "trust funds," and/or other accounts for which financial statements will be prepared in accordance with OMB guidance. Also see "Component Entity."

Exchange Revenue – Inflows of resources to a Government entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return.

Fiduciary – *(noun)* In this standard, a Federal entity that holds assets in trust for non-Federal parties in which the non-Federal parties have an ownership interest that the Federal Government must uphold.

(adjective) In this standard, relating to the process of the collection or receipt, and the management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

Fiduciary Activity – An activity that relates to the collection or receipt, and the management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold. Non-Federal parties must have an ownership interest in assets held by the Federal entity under provision of law, regulation, or other fiduciary arrangement, usually including an ownership interest in any related income generated. For there to be a fiduciary activity under this standard, there must be a fiduciary relationship based on statutory or other legal authority and evidence that the Government activity is in furtherance of that relationship. The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation.

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Fiduciary Asset – In this standard, fiduciary assets are assets in which non-Federal parties have an ownership interest and are held by a Federal entity under provision of law, regulation or other fiduciary arrangement.

Fiduciary Collections - Fiduciary collections are an inflow to a Federal entity of cash or other assets in which non-Federal parties have an ownership interest that the Federal Government must uphold.

Fiduciary Fund Balance with Treasury – Cash that is held in the U.S. Treasury and administered by a Federal entity on behalf of fiduciary beneficiaries.

Fiduciary Relationship – A relationship in which an entity or authorized agent of the Government accepts, recognizes, agrees to or consents to undertake fiduciary activity. A fiduciary relationship is based on statutory or other legal authority and evidence that the Government activity is in furtherance of that relationship. A fiduciary relationship may be implied from the actions of Federal parties acting within the scope of their authority.

Forfeited Property – Forfeited property is property for which title has passed to the Government. Forfeited property includes (1) monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.

Fund – Fund has more than one meaning. Depending on the context it may mean merely a resource as in funds available to pay an obligation. Or, for budgetary accounting, it may mean Federal funds or "trust funds," the two major groups of funds in the budget.[20] The Federal funds include all transactions not classified by law as being in trust funds. The main financing component of the Federal funds group is referred to as the General Fund, which is used to carry out the general purposes of Government rather than being restricted by law to a specific program and consists of all collections not earmarked by law to finance other funds.

A fund can also mean a fiscal and accounting entity with a self-balancing set of accounts recording cash and other assets, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

The term "fund" is used in multiple contexts in this standard. For example, the introductory and background material discusses funds in the context of budget accounting. On the other hand, when the standard refers to a fiduciary fund in the illustrations that follow this Glossary, it is in the context a self-balancing set of accounts.

Fund Balance with Treasury – A Federal entity's fund balance with the Treasury is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund balance with Treasury is an intra-governmental item. From the component entity's perspective, a fund balance with Treasury is an asset because it represents the entity's claim to the Federal Government's resources. However, from the perspective of the Federal Government as a whole, it is not an asset; and while it represents a commitment to make resources available to Federal departments, agencies, programs and other entities, it is not a liability. An entity's fund balance with Treasury

[20] An explanation of the two major categories of Federal Funds and Trust Funds may be found in Chapter 22, "Trust Funds and Federal Funds," of *Analytical Perspectives*, Budget of the U.S. Government, Fiscal Year 2006.

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is increased by, among other things, amounts collected and credited to a fund that the entity is authorized to spend or use to offset its expenditures. Disbursements made to pay liabilities or to purchase assets, goods, and services, investments in Treasury or other securities, transfers and reimbursements to other entities or to the Treasury, and similar transactions reduce an entity's fund balance with Treasury.

Garnishments - Garnishments are a method of debt collection in which a portion of a person's salary or tax refund is paid to a third party in compliance with a statute or court order.

General Fund – The general fund accounts for receipts not earmarked by law for specific purposes, the proceeds of general borrowing, and the expenditure of these monies. General fund receipts constitute the greater part of the budget, e.g., almost all income tax receipts are general fund receipts. General fund appropriations draw from general fund receipts and borrowing collectively and, therefore, are not linked to specific receipts. [See *The Budget of the United States FY 2006, Analytical Perspectives, Chapter 26, The Budget System and Concepts and Glossary*.]

Nonexchange Revenue – Nonexchange revenue is an inflow of resources to the Government that the Government demands or that it receives by donations. The inflows that it demands include taxes, duties, fines, and penalties.

Non-Federal Individuals or Entities – Individuals and entities acting in their private capacities outside of the authority and control of the Federal Government. Federal employees are "non-Federal individuals" when acting in their private capacities, e.g., with respect to their private retirement savings managed by the Federal plan.

Non-Federal Parties – See "Non-Federal Individuals and Entities."

Non-Valued Fiduciary Assets – Fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Fiduciary non-valued assets should be disclosed in accordance with generally accepted accounting principles.[21]

Other Financing Sources – Inflows of resources that increase net position of a reporting entity during the reporting period but that are not revenues or gains. They include appropriations used, transfers of assets from other Government entities, and financing imputed with respect to any cost subsidies. Financing outflows may result from transfers of the reporting entity's assets to other Government entities or from exchange revenues earned by the entity but required to be transferred to the General Fund or another Government entity. Unexpended appropriations are recognized separately in determining net position but are not financing sources until used.

Ownership Interest– The possession of substantially all of the benefits and risks incident to ownership.

Payroll withholdings – Amounts that are withheld from payment of wages to an employee and subsequently remitted to other payees, such as Federal, State or local governments; or health or life insurance providers, on behalf of the employee.

[21] In the future, the Board may require dollar values for certain categories. In the event of such a change in accounting principles, the affected categories would no longer be included in non-valued fiduciary assets.

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Revenue – See "Exchange Revenue" and "Nonexchange Revenue."

Seized Property –Seized property includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.

Unearned Revenue – Unearned revenue is a liability that represents money (income) received in advance of being earned. Unearned revenue is also a liability if a Federal entity requests advances prior to the receipt of cash and records the amount.[22].

[22] See SFFAS 1, paragraph 85, SFFAS 7, paragraph 37, and SFFAS 1, paragraph 41.

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Appendix C: Examples of Fiduciary Note Disclosure

1. Example of Fiduciary Note Disclosure for Federal Component Entity

The following illustrates the summary financial information required in paragraph 18.

Fiduciary Activities
Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

Fiduciary cash and other assets are not assets of the Federal Government and accordingly are not recognized on the balance sheet.

[Fiduciary Fund A] was authorized by the [*legislation]*, which authorized [*the component entity*] to collect *[type of collections*] on behalf of [*beneficiaries*]. Other fiduciary activities by [*the component entity*] include but are not limited to [*examples of fiduciary activities included in "other."*]

Department XYZ

Schedule of Fiduciary Activity

As of September 30, 20010 and 2009

	2010 Fiduciary Fund A	2010 Other Fiduciary Funds	20010 Total Fiduciary Funds	2009 Fiduciary Fund A	2009 Other Fiduciary Funds	2009 Total Fiduciary Funds
Contributions	$ 233,450	$ 116,550	$ 350,000	$ 200,000	$ 125,000	$ 325,000
Investment earnings	116,725	58,275	175,000	100,000	65,000	165,000
Gain (Loss) on disposition of investments, net	6,670	3,330	10,000	4,000	1,000	5,000
Disbursements to beneficiaries	(300,150)	(149,850)	(450,000)	(200,000)	(150,000)	(350,000)
Increases in fiduciary fund balances	56,695	28,305	85,000	104,000	41,000	145,000
Fiduciary net assets, beginning of year	1,810,905	904,095	2,715,000	1,570,000	1,000,000	2,570,000
Fiduciary net assets, end of year	$ 1,867,600	$ 932,400	$2,800,000	$1,674,000	$1,041,000	$2,715,000

Fiduciary Net Assets

As of September 30, 2010 and 2009

	2010 Fiduciary Fund A	2010 Other Fiduciary Funds	2009 Total Fiduciary Funds	2009 Fiduciary Fund A	2009 Other Fiduciary Funds	2009 Total Fiduciary Funds
FIDUCIARY ASSETS						
Cash and cash equivalents	$ 566,800	$ 254,654	$ 821,454	$ 250,000	$ 275,000	$ 525,000
Investments	1,300,000	677,746	1,977,746	1,424,000	766,000	2,190,000
Other assets	1,000		1,000			
Less: Accounts Payable	(200)		(200)			
TOTAL FIDUCIARY NET ASSETS	$ 1,867,600	$ 932,400	$ 2,800,000	$1,674,000	$1,041,000	$2,715,000

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2. Example of Note Disclosure for the Government-wide Financial Report

The following illustrates the summary information required in paragraph 27.

Fiduciary Activities
Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.

Fiduciary cash and other assets are not assets of the Federal Government and accordingly are not recognized on the balance sheet. Examples of the Federal Government's fiduciary activities include the Indian tribal and individual Indian trust funds, which are administered by the Department of the Interior, and the Thrift Savings Fund, which is administered by the Federal Retirement Thrift Investment Board.

The following Federal component entities were responsible for fiduciary net assets at September 30, 2010 and 2009. Detailed information is available in the financial statements of the Federal component entities. The Federal component entity websites are listed on page **##** of this document**.**

Schedule of Fiduciary Net Assets

	FY 2010	FY 2009
Department A	$ xxxxx	$ xxxxx
Department B	xxx	xx
Department C	xxxxx	xxxxx
Department D	xxxxxxx	xxxxxxx
All Other	x	x
Total	xxxxxxxxxxxxx	xxxxxxxxxxxxx

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Appendix D: Pro Forma Transactions

Note: The following pro forma transactions illustrate how the information for the fiduciary note disclosure can be recorded in a component Federal entity's financial system utilizing the U.S. Government Standard General Ledger.[23] The approach illustrated utilizes several general ledger accounts that are linked to a note disclosure and not to line items in the principal financial statements. Component entities are also permitted to utilize a separate financial system for fiduciary activities. Transactions and balances that crosswalk to the fiduciary note disclosure are shaded.

Table of Illustrations

Illustration #1 – Federal component entity receives and holds non-Federal party's cash as Fund Balance with Treasury (FBWT).

Illustration #2 – Federal component entity invests non-Federal party's FBWT in Treasury securities.
2A – Federal entity's purchase of Treasury securities on behalf of non-Federal party
2B – Receipt of appropriation by Bureau of Public Debt to pay interest on non-Federal party's Treasury securities
2C – Treasury Bureau of Public Debt pays interest on Treasury securities

Illustration #3 – Federal component entity invests non-Federal party's cash in non-Treasury securities.
3A – Federal entity purchases non-Treasury securities on behalf of non-Federal party
3B – Receipt of interest earned on non-Federal party's non-Treasury securities

Illustration #4 – Federal component entity disburses interest earned to non-Federal party.

Illustration #5 – Closing entries

Illustration #6 – Effect of pro forma transactions on the Federal Component Entity's Financial Statements.

Illustration #7 – Effect of pro forma transactions on the consolidation worksheet for the U.S. Government-wide financial report.

[23] Section 803(a) of the Federal Financial Management Improvement Act of 1996 (P.L. 104-208, Division A, Section 101(f), Title VIII) requires Federal agencies to implement the U.S. Government Standard General Ledger (USSGL) at the transaction level. Information about the USSGL can be found on the website of the Treasury Financial Management Service at www.fms.treas.gov/ussgl.

Illustration #1 – Federal component entity receives and holds non-Federal party's cash.

	DR	CR
Federal Component Entity		
Fiduciary Fund Balance with Treasury (FBWT)	**1,500**	
Fiduciary Collections Received from Beneficiaries		**1,500**
To record fiduciary cash collected.		
Treasury General Fund Entity		
Treasury's Government-Wide Cash Account	1,500	
Treasury General Fund Liability for Fiduciary FBWT		1,500
To record cash received and held by component entity as Fiduciary FBWT.		

Illustration #2 – Federal component entity invests Fiduciary FBWT in Treasury securities.

2A Federal component entity invests FBWT in Treasury securities

Federal Component Entity		
Fiduciary Investments in Treasury Securities	**1,000**	
Fiduciary FBWT		**1,000**
To record fiduciary Treasury securities purchased.		
Treasury General Fund Entity		
Treasury General Fund Liability for Fiduciary FBWT/Component Entity	1,000	
Treasury General Fund's Liability for FBWT/Treasury Bureau of Public Debt		1,000
To record purchase of Treasury securities.		
Treasury Bureau of Public Debt Entity		
FBWT	1,000	
Liability for Fiduciary Treasury securities		1,000
To record sale of Treasury securities.		

2B Treasury Bureau of Public Debt receives an appropriation to fund interest expense

Treasury General Fund Entity		
Treasury's Government-wide Cash Account	50	
Transfer-In from Federal Reserve		50
Treasury General Fund receives transfer of Federal Reserve earnings		
Appropriation Warrants Issued	50	
Treasury's Liability for FBWT/Bureau of Public Debt		50
Treasury issues appropriation warrant to the Bureau of Public Debt		

Treasury Bureau of Public Debt Entity

FBWT	50	
Appropriations Received[24]		50
To record appropriation received.		

2C Treasury Bureau of Public Debt pays interest on Treasury securities.

Treasury Bureau of Public Debt Entity

Interest expense	50	
FBWT		50
Unexpended Appropriations- Used	50	
Expended Appropriations		50
To record appropriation received and interest expense paid.		

Federal Component Entity

Fiduciary FBWT	**50**	
Interest revenue/Fiduciary		**50**
To record interest received on fiduciary investments.		

Treasury General Fund Entity

Treasury General Fund Liability for FBWT/Treasury Bureau of Public Debt	50	
Liability for Fiduciary FBWT/Component Entity		50
To record payment of interest by Treasury Bureau of Public Debt		

Illustration #3 – Federal component entity invests non-Federal party's assets in non-Treasury securities.

3A Federal component entity purchases non-Treasury securities on behalf of non-Federal party

Federal Component Entity

Fiduciary Investments in non-Treasury securities	**500**	
Fiduciary Fund Balance with Treasury		**500**
To record securities purchased on behalf of non-Federal parties.		

Treasury General Fund Entity

Treasury's Liability for Fiduciary FBWT/Component Entity	500	
Treasury's Government-wide Cash Account		500
To record cash withdrawal.		

[24] Note: Accounting for appropriations requires additional budgetary entries that are not displayed here. For additional information, refer to the Treasury Financial Manual Standard General Ledger Supplement at www.fms.treas.gov/ussgl.

3B Interest is received on non-Treasury securities and held as FBWT

Federal Component Entity		
Fiduciary FBWT	**10**	
Interest Revenue/Fiduciary		**10**
To record interest received on fiduciary investments held outside of the U.S. Treasury.		
Treasury General Fund Entity		
Treasury Government-wide cash account	10	
Treasury General Fund Liability for Fiduciary FBWT/Component Entity		10
To record cash received and deposited as fiduciary FBWT.		

Illustration #4 – Federal entity disburses interest earned to non-Federal beneficiaries

4. Disbursement to beneficiaries of interest earned.

Federal Component Entity		
Fiduciary Disbursements to Beneficiaries	**50**	
Fiduciary FBWT		**50**
Payment made to beneficiaries.		
Treasury General Fund Entity		
Treasury General Fund Liability for Fiduciary FBWT/Component Entity	50	
Treasury's Government-wide Cash Account		50
To record cash withdrawal.		

Illustration #5 – Closing Entries for Pro Forma Transactions Illustrated

Pre-closing trial balances after pro forma transactions:

	Component Entity	Treasury GF	Treasury BPD
Assets			
Fiduciary FBWT	**10**		
FBWT (Non-Fiduciary)			1,000
Government-wide Cash		1,010	
Fiduciary Investments in Treasury Securities	**1,000**		
Fiduciary Investments in non-Treasury Securities	**500**		
Liabilities			
Liability for Fiduciary FBWT		(10)	
Liability for FBWT		(1,000)	
Liability for Fiduciary Investments in Treasury Securities			(1,000)
Net Position			
Fiduciary Net Assets			
Unexpended Appropriations- Appropriations Received			(50)
Unexpended Appropriations- Used			50
Revenues and Other Financing Sources			
Fiduciary Collections- Contributions from Beneficiaries	**(1,500)**		
Interest Revenue/Fiduciary	**(60)**		
Transfer-In from Federal Reserve		(50)	
Expended Appropriations			(50)
Expenses and Miscellaneous Items			
Interest Expense			50
Fiduciary Disbursements to Beneficiaries	**50**		
Appropriation Warrants Issued		50	
Totals	0	0	0

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Closing entries:

Federal Component Entity		
Fiduciary Collections- Contributions from Beneficiaries	**1,500**	
Interest Revenue/Fiduciary	**60**	
Fiduciary Disbursements to Beneficiaries		**50**
Fiduciary Net Assets		**1,510**
Treasury Bureau of Public Debt Entity		
Cumulative Results of Operations	50	
Interest Expense		50
Unexpended Appropriations- Received	50	
Unexpended Appropriations- Cumulative		50
Unexpended Appropriations- Cumulative	50	
Unexpended Appropriations- Used		50
Expended Appropriations	50	
Cumulative Results of Operations		50
Treasury General Fund Entity		
Cumulative Results of Operations	50	
Appropriation Warrants Issued		50
Transfer-In of Federal Reserve Revenue	50	
Cumulative Results of Operations		50

Post-closing trial balances after pro forma transactions:

	Component Entity	Treasury GF	Treasury BPD
Assets			
Fiduciary FBWT	**10**		
FBWT (Non-Fiduciary)			1,000
Government-wide Cash		1,010	
Fiduciary Investments in Treasury Securities	**1,000**		
Fiduciary Investments in non-Treasury Securities	**500**		
Liabilities			
Liability for Fiduciary FBWT		(10)	
Liability for FBWT		(1000)	
Liability for Fiduciary Investments in Treasury Securities			(1,000)
Net Position			
Fiduciary Net Assets	**(1510)**		
Totals	0	0	0

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Illustration #6 – Illustration of Federal Component Entity Note Disclosure of Pro Forma Transactions

FEDERAL COMPONENT ENTITY SCHEDULE OF FIDUCIARY ACTIVITY FOR THE PERIOD ENDED SEPTEMBER 30, 20xx	FY 20x2	FY 20x1
Contributions from Beneficiaries	1,500	-
Interest on investments	60	-
Disbursements to Beneficiaries	(50)	-
Increase in Fiduciary Assets	1,510	-
Fiduciary Net Assets, Beginning of Year	-	-
Increase in Fiduciary Assets	1,510	-
Fiduciary Net Assets, End of Year	1,510	-

FIDUCIARY NET ASSETS AS OF SEPTEMBER 30, 20xx	FY 20x2	FY 20x1
Cash and Cash Equivalents	$ 10	$ -
Investments in Treasury Securities	1,000	-
Other Investments	500	-
Total Net Assets	$ 1,510	-

NOTE: The illustration above displays only the impact of the pro forma transactions upon the fiduciary note disclosure. See Appendix C for a more detailed illustration of the fiduciary note disclosure.

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Illustration #7 – Effect of Pro Forma Transactions upon Elimination Worksheet for Government-wide reporting

IMPACT ON GOVERNMENT-WIDE ELIMINATION WORKSHEET	Federal Component Entity Note Disclosure	Treasury Bureau of Public Debt	Treasury General Fund	Eliminations	Government-wide Balance Sheet	Government-wide Note Disclosure
ASSETS						
Fiduciary Fund Balance with Treasury	***$ 10***	$ -	$ -	$ -	$ -	***$ 10***
Fund Balance with Treasury	***-***	1,000	-	(1,000)		***-***
Fiduciary Investments in Treasury Securities	***1,000***	-	-	-		***1,000***
Fiduciary Investments in non-Treasury securities	***500***	-	-	-		***500***
Treasury's Government-wide cash account	***-***	-	1,010	-	1,010	
Total assets	***$ 1,510***	$ 1,000	$ 1,010	$ (1,000)	$ 1,010	***$ 1,510****
LIABILITIES						
Treasury's Liability for Fiduciary FBWT	***$ -***	$ -	$ 10	$ -	$ 10	***$ -***
Treasury's Liability for FBWT	***-***	-	1,000	(1,000)		
Treasury BPD Liability for Fiduciary Investments	***-***	1,000	-	-	1,000	
NET POSITION						
Fiduciary net assets	***$ 1,510***	$	-	-		***1,510***
Total liabilities and net position	***$ 1,510 ****	$ 1,000	$ 1,010	$ (1,000)	$ 1,010	***$ 1,510 ****

*** Note:**

- The Federal Component Entity's fiduciary assets, liabilities and net assets (shaded and in italics in the above table) are reported in the fiduciary note disclosure only, and not recognized on the face of the Component Entity's balance sheet or on the Government-wide balance sheet.
- Treasury General Fund liability for fiduciary FBWT is not eliminated.
- Treasury BPD liability for fiduciary securities is not eliminated.
- Note disclosure of fiduciary funds is required at the FR level.

– The illustration above displays only the impact of the pro forma transactions upon the eliminations for Government-wide reporting. See Appendix C for an illustration of the fiduciary note disclosure.

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Appendix E: List of Abbreviations

FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FR	Financial Report of the U.S. Government
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
Treasury BPD	Treasury Bureau of Public Debt
Treasury FMS	Treasury Financial Management Service
U.S.	United States
USSGL	U.S. Government Standard General Ledger

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David M. Zavada

FASAB Staff
Wendy M. Comes, Executive Director

Project Staff:
Eileen Parlow

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"

Statement of Federal Financial Accounting Standards 32

September 28, 2006

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."*

- *"Mission Statement: Federal Accounting Standards Advisory Board."*

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Table of Contents

Table of Contents 3
Introduction 4
Accounting Standard 5
Amendments to Existing Standards 5
Disclosure Requirements Applicable to the U. S. Government-wide Financial Statements 7
Inventory 7
Operating Materials and Supplies 8
Stockpile Materials 8
Seized Property 8
Forfeited Property 8
Foreclosed Property 9
Commodities 9
Property, Plant, and Equipment 9
Deferred Maintenance 9
Cleanup Cost 9
Taxes 10
Direct Loans and Loan Guarantees 10
References to Component Entity Reports 10
Required Note 1 on Significant Accounting Policies Disclosures 10
Appendix A: Basis for Conclusions 12
Background 12
Objectives of the Standard 12
Board Approval and Dissent 14
Appendix B: Relationship of Amendments to New Requirements 16
Appendix C: List of Abbreviations 31

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_32.pdf.

Introduction

1. Statement of Federal Financial Accounting Standards 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, issued in January 2003 clarified that all existing and future standards apply to all federal entities unless a standard specifically provides otherwise.

2. This standard amends standards issued prior to January 2003 to specify disclosure requirements appropriate for the Financial Report of the United States Government (CFR) based on the guidance contained in Statement of Federal Financial Accounting Concepts (SFFAC) 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*.

3. Some disclosure requirements contained in previously issued standards have been modified to allow aggregation and reduce detail for government-wide reporting while other disclosure requirements have been eliminated because of excessive detailed information required that is inappropriate for a government-wide report consistent with the guidance contained in SFFAC 4.

4. Appendix B provides a non-authoritative summary of the effect of these changes on disclosure requirements. It presents amended text of existing standards and related new requirements in a table format.

5. This standard also contains CFR disclosure requirements for Note 1 Significant Accounting Policies.

Scope

6. This statement provides financial accounting standards for the CFR. It does not change financial accounting standards for component entity reports.

Effective Date

7. This standard is effective for periods beginning after September 30, 2005.

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Accounting Standard

Amendments to Existing Standards

8. Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, is amended by inserting in par. 86 the following final sentence – "The U. S. government-wide financial statements need not include this disclosure."

9. SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, par. 56 is amended by inserting the following final sentence – "The U. S. government-wide financial statements need not include this disclosure."

10. SFFAS 3, *Accounting for Inventory and Related Property*, is amended as follows:

    a. The text "The above listed disclosure requirements are not applicable to the U. S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities." is added following the existing text of these paragraphs: Par. 28, 35, 50, 56, 66, 78, 91, and 109.

    b. The text "The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected net realizable value." is added to par. 30 as the final sentence.

    c. The text "The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price." is added to par. 55 as the final sentence.

    d. The text "The U.S. government-wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions." is added to par. 71 as the final sentence.

11. SFFAS 5, *Accounting for Liabilities of the Federal Government*, is amended as follows:

    a. The text "The U.S government-wide financial statements need not follow the required disclosures described below." is added to par. 117 as the final sentence.

    b. The text "The U.S. government-wide financial statements need not separately report or disclose all components of the liability for future policy benefits with a description of each amount and an explanation of its projected use and any other potential uses." is added to par. 121 as the final sentence.

12. SFFAS 6, *Accounting for Property, Plant, and Equipment*, is amended as follows:

    a. The text "The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable

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to the U.S. government-wide financial statements for these activities." is added following the existing text for par. 45.

b. The text "The above listed required supplementary information is not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for required supplementary information applicable to the U.S. government-wide financial statements for these activities." is added as a separate bullet following the existing text for par. 83.

c. The text "The U.S. government-wide financial statements need not separately report stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition as well as management's definition of these categories. SFFAS 32 provides for optional information applicable to the U.S. government-wide financial statements for these activities." is added to par. 84 as the final sentences.

d. The text "The U.S. government-wide financial statements need not disclose the sources of cleanup requirements." is added to par. 107 as the final sentence.

e. The text "The U.S. government-wide financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods." is added to par. 108 as the final sentence.

f. The text "SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E." is added to par. 109 as the final sentence.

g. The text "The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations." is added to par. 110 as the final sentence.

h. The text "The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations." is added to par. 111 as the final sentence.

13. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, is amended as follows:

a. The text "The U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue." is added to par. 43 as the final sentence.

b. The text "The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements." is added following the existing text for par. 46.

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c. The text "The U.S. government-wide financial statements need not disclose factors affecting collectibility and timing of categories of accounts receivable and the amounts involved." is added to par. 65.1 as the final sentence.

d. The text "The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements." is added to par. 65.3 as the final sentences.

14. SFFAS 10, *Accounting for Internal Use Software*, par. 35 is amended by inserting the text "The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities." is added following the existing text for par. 35.

15. SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, is amended as follows:

a. The text "The U.S. government-wide financial statements need not disclose a reconciliation between the beginning and ending balances of the subsidy cost allowance for the outstanding direct loans and the liability for outstanding loan guarantees reported in the U.S. government-wide financial statements." is added to par. 10 as the final sentence.

b. The text "The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities." is added following the existing text for par. 11.

Disclosure Requirements Applicable to the U. S. Government-wide Financial Statements

Inventory

16. The U.S. government-wide financial statements should include the following disclosures[1]:

a. broad descriptions of inventory categories,
b. a general reference to component entity[2] reports, and

[1] Disclosure is "Reporting information in notes or narrative regarded as an integral part of the basic financial statement."

[2] The term "component entity" is used to distinguish between the U. S. Federal government and its components. The U. S. Federal government is composed of organizations that manage

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c. balances for each of the following categories of inventory:

1) inventory held for current sale,
2) inventory held in reserve for future sale,
3) excess, obsolete, and unserviceable inventory; and
4) inventory held for repair.

Operating Materials and Supplies

17. The U.S. government-wide financial statements should include the following disclosures:

a. broad descriptions of operating materials and supplies categories,
b. a general reference to component entity reports, and
c. balances for each of the following categories of operating materials and supplies:
    1) operating materials and supplies held for use,
    2) operating materials and supplies held in reserve for future use, and
    3) excess, obsolete, and unserviceable operating materials and supplies.

Stockpile Materials

18. The U.S. government-wide financial statements should include the following disclosures:

a. broad descriptions of stockpile material categories,
b. a general reference to component entity reports, and
c. balances for each of the following categories of stockpile materials:
    1) stockpile materials, and
    2) stockpile materials held for sale.

Seized Property

19. The U.S. government-wide financial statements should include the following disclosures:

a. a broad description of seized property, and
b. a general reference to component entity reports.

Forfeited Property

20. The U.S. government-wide financial statements should include the following disclosures:

a. a broad description of forfeited property, and
b. a general reference to component entity reports.

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resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into sub organizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, *Entity and Display*, paragraphs 11-12)

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Foreclosed Property

21. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of foreclosed property, and
    b. a general reference to component entity reports.

Commodities

22. The U.S government-wide financial statements should include the following disclosures:

    a. a broad description of commodities, and
    b. a general reference to component entity reports.

Property, Plant, and Equipment

23. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of PP&E,
    b. the cost, associated accumulated depreciation, and book value by major class, and
    c. a general reference to component entity reports.

Deferred Maintenance

24. The U.S. government-wide financial statements should include the following required supplementary information:

    a. a broad description of deferred maintenance,
    b. amounts or ranges of amounts of deferred maintenance for each major asset category (i.e., general property, plant, and equipment; heritage assets, and stewardship land) for which maintenance has been deferred,
    c. a general reference to component entity reports, and
    d. optional reporting of the stratification between critical and non-critical amounts of maintenance needed to return each major asset category to its acceptable operating condition.

Cleanup Cost

25. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of cleanup cost,
    b. the unrecognized portion of estimated total cleanup costs associated with general PP&E, and
    c. a general reference to component entity reports.

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Taxes

26. The U.S. government-wide financial statements should disclose the cumulative cash collections and refunds by tax year and type of tax for the reporting periods.

Direct Loans and Loan Guarantees

27. The U.S. government-wide financial statements should include the following disclosures:

    a. a broad description of direct loan and loan guarantee programs,
    b. the face value of loans outstanding for direct loan and loan guarantee programs,
    c. the long term cost[3] of loans and guarantees outstanding for direct loan and loan guarantee programs,
    d. net loans receivable for direct loan programs,
    e. the amount guaranteed by the Government for guaranteed loan programs,
    f. the subsidy expense for the reporting year for direct loan and loan guarantee programs, and
    g. a general reference to component entity reports.

References to Component Entity Reports

28. For each "general reference to component entity reports" required in par. 16 through 27 above, it is required that the preparer indicate, in the relevant note, agencies that are disclosing significant detailed information about the item. Selecting individual agencies to refer readers to requires judgment. The preparer should consider both quantitative and qualitative criteria in selecting such agencies.

Required Note 1 on Significant Accounting Policies Disclosures

29. Describe the reporting entity and identify its major components. Summarize the accounting principles and methods of applying those principles that management has concluded are appropriate for presenting fairly the entity's assets, liabilities, net cost of operations, and changes in net position. Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles. In general, the disclosure should encompass important judgments as to the valuation, recognition, and allocation of assets, liabilities, expenses, revenues and other financing sources. Disclosures of accounting policies should not duplicate details presented elsewhere as part of the notes to the financial statements.

30. In addition, the summary of significant accounting policies should disclose any significant changes in the composition of the reporting entity or significant changes in the manner in which the reporting entity aggregates information for financial reporting purposes. These

[3] "Long-term cost of direct loans and loan guarantees" is the sum of (1) the subsidy cost allowance for post-1991 direct loans, (2) the liability for post-1991 and pre-1992 loan guarantees, and (3) allowance for uncollectible amounts for post-1991 direct loans and loan guarantees.

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changes, in effect, result in a new reporting entity, and their impact should be reported by restating the financial statements for all prior periods presented in order to show the new reporting entity for all periods presented.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

Background

31. The fiscal year 2003 CFR was discussed by the Board members at the April 2004 FASAB meeting. During the discussion of the FY 2003 CFR, several board members indicated a desire for the CFR to be more accessible to the intended audience identified in SFFAC 4: citizens and citizen intermediaries. The members believed this would require a concise presentation. The member representing the Department of the Treasury (Treasury) agreed and explained that the current CFR omitted certain required disclosures for a variety of reasons. Had these disclosure requirements been included the FY 2003 CFR it would have been much less accessible. The member noted that earlier FASAB standards made no distinction between component entity disclosure requirements and CFR disclosure requirements and to fully comply with all disclosure requirements would further lengthen the CFR.

32. Members agreed that it would be appropriate to review disclosure requirements established prior to the issuance of SFFAC 4 and tailor CFR disclosure requirements to meet the current concepts. This approach has been adopted for standards developed since SFFAC 4 was issued and the Board indicated a willingness to review past standards if resources were not diverted from ongoing projects. Chairman David Mosso asked Treasury to prepare a list of items it does not consider appropriate to the CFR in light of SFFAC 4.

33. At the October 2004 FASAB meeting, the Board considered a proposal prepared by Treasury's Financial Management Service (FMS). The project proposal included a table of items identified for amendment. Based on Treasury's offer to staff the project, the Board agreed to go forward with the project.

Objectives of the Standard

34. At the May 4-5, 2005 FASAB meeting, Board members held a general discussion of the issues associated with the project. SFFAC 4 notes that the CFR has grown in size and complexity and some have questioned whether the CFR is trying to satisfy too many audiences with different needs in one format. SFFAC 4 provides that citizens and citizen intermediaries should be the audience to whom the CFR is primarily directed and it is particularly fundamental that the CFR be timely and understandable to the primary audience.

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35. FASAB has been diligent in ensuring that its requirements are consistent with the guidance contained in SFFAC 4 since the January 2003 issuance of SFFAS 24. SFFAS 24 clarified that SFFAS's apply to all federal entities unless a current or subsequent standard specifically provides otherwise. Many earlier SFFAS's were issued without considering the need for less detailed disclosures for the CFR.

36. This SFFAS revisits standards issued before January 2003 and amends many of those standards to specify substitute disclosure requirements for the CFR or eliminate certain requirements. In its deliberations the Board assumed that the disclosures being amended were material disclosures but understood that SFFAC 4 was issued to provide guidance in addressing material items since immaterial items are not required to be reported or disclosed by FASAB standards.

37. The basis for the Board's actions with respect to this SFFAS emanates entirely from the need to implement SFFAC 4 and do retroactively what the Board has done prospectively since January 2003. However, the Board has indicated that disclosure requirements eliminated or modified for the CFR should not result in allowing the preparer to exclude significant unusual items needed to explain changes in balances between years.

38. This standard eliminates or modifies disclosure requirements that are useful for assessing operating performance for a particular program within an agency. For example, disclosures of restrictions on the use of foreclosed property and average holding period for foreclosed property have been eliminated. Also, disclosures of the gross cost associated with exchange revenue and certain pricing policies have been eliminated. If information relevant to assessing operating performance for individual programs were included in the CFR it would not be concise. A concise CFR will be more appealing and therefore more accessible to citizens and citizen intermediaries. The Board believes that including references to other sources of information appropriately balances the appeal of a concise CFR with the disaggregated information necessary to assess operating performance.

39. In general, the specific changes reduce the level of detail provided regarding specific assets and liabilities. Such disaggregated information is inconsistent with SFFAC 4. For readers seeking additional detail for particular items, the Board proposes to substitute a reference to component entity reports disclosing significant detailed information about the item.

40. Significant accounting policies disclosures are required by this Statement to ensure that the preparer of the CFR informs readers about management's conclusions regarding fair presentation and the basis of such conclusions. This is intended to address concerns about the sufficiency of disclosures in view of the elimination or modification of disclosures that are required for agency level reporting.

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Exposure Draft

41. FASAB published the exposure draft (ED) *Consolidated Financial Report of the United States Government Requirements: Implementing SFFAC 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"*, on October 27, 2005. Upon release of the ED, notices and/or press releases were provided to: The Federal Register, the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, *Government Accounting and Auditing Update*, *JFMIP News,* the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations commenting on past exposure drafts.

42. Twelve letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others	0	6
Auditors	2	1
Preparers and financial managers	3	0

Responses to the ED

43. The majority of the respondents agreed with the proposed changes to the disclosure requirements for the CFR. Additionally, a majority of respondents felt disclosure requirements for component entity reports should be the same as those required in the CFR.

44. Many respondents believed it would be useful to (a) provide a summary report designed for citizen users, (b) develop a central link to agency reports on the website, and (c) study the needs of citizen users. The Board agrees that these are useful ideas and will consider these suggestions as it prioritizes future work.

45. Specific concerns raised by respondents related to the omission of disclosures of liabilities not covered by budgetary resources, forfeited property not available for sale due to legal restrictions, details regarding modifications to loans and loan guarantees, and the process used by the Financial Management Service to prepare the CFR. The Board did not believe that the concerns outweighed the benefits derived from reducing the disclosures required for the CFR.

Board Approval and Dissent

46. This Statement was approved for issuance by nine members of the Board. Mr. Dacey dissented.

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47. Mr. Dacey believes differences in reporting between the CFR and other federal entities should be limited to unique or unusual reporting issues present in the federal reporting environment.

48. Mr. Dacey noted that other accounting standard setters do not differentiate reporting requirements between consolidated and component entities. However, based on materiality, the information presented in consolidated financial statements typically is aggregated and in less detail than in component entity financial statements. Mr. Dacey also noted that FASAB standards reinforce that the standards need not be applied to immaterial items.

49. Mr. Dacey believes that certain information that is (1) required in component entity reports, (2) generally consistent with requirements of other accounting standard setters, and (3) material to the CFR, should be required to be presented in the CFR. Such information, some of which is currently reported in the CFR, relates to disclosure of:

    a. the general composition of and the basis for determining values for inventory, operating materials and supplies, and stockpile materials,
    b. estimated useful lives and depreciation methods for each major class of property, plant, and equipment, and related capitalization thresholds, and
    c. certain credit reform information for material programs, currently reported in the CFR.

50. Based on the Government Accountability Office's analysis, Mr. Dacey believes that the incremental information necessary to report the above information and conform with existing FASAB standards would likely be nominal in relation to the current CFR (i.e., less than one page).

51. Mr. Dacey notes the "Basis for Conclusions" indicates that if the currently required information was included in the CFR, the CFR would be less accessible to users. In other words, it would lengthen the CFR and make it less appealing to users. However, Mr. Dacey does not believe that the length would be significantly affected. Also, requiring users to locate and read individual entity financial statements to obtain such information would increase the burden on users of the CFR and likely result in the information being less easily accessible to users. While Mr. Dacey strongly supports the notion that financial information about the federal government as a whole should be presented in a manner that appeals to the broadest range of potential users, he feels there are other means to meet this objective. For example, Mr. Dacey noted that several agencies publish brief summary annual reports, in addition to their financial statements, that are intended for broader distribution and are written to be more understandable to a non-financial user.

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Appendix B: Relationship of Amendments to New Requirements

The disclosure items addressed by this statement have either been modified to allow aggregation or rescinded to reduce detail for government-wide reporting consistent with guidance contained in Statement of Federal Financial Accounting Concepts 4 " Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government." (SFFAC 4) For purposes of understanding the impacts of the provisions of this statement, this appendix presents the text of amendments to existing standards along with the text of the new requirements applicable to the CFR.

Relationship of Amendments to New Requirements			
See Par.	Text of Amendment to Existing Standards	See Par.	Summary of Changes
8	The reporting entity should disclose the amount of current liabilities not covered by budgetary resources. The U. S. government-wide financial statements need not include this disclosure. (SFFAS 1.86)		No CFR disclosure would be required.
9	Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification. The U. S. government-wide financial statements need not include this disclosure. (SFFAS 2.56)	27 and 28	No CFR disclosure would be required regarding modifications of direct loans or loan guarantees. A general reference to agency reports would be provided.
10	The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage; and, (5) the likelihood that a	16, 28, 29 and 30	The CFR should provide: (1) broad descriptions of inventory categories; (2) a general reference to agency reports that disclose significant detailed information about inventory; and, (3) balances for each of the following categories of inventory – inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and

	supply of items will be available in the future. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 3.28) The difference between the carrying amount of the inventory before identification as excess, obsolete, or unserviceable and its net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected net realizable value. (SFFAS 3.30) Disclosures of (1) general composition of inventory; (2) basis for determining inventory values including the valuation method and any cost flow assumptions; (3) changes from prior year's accounting methods if any; (4) balances for each of the following categories of inventory – inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements; (5) restrictions on the sale of material; (6) the decision criteria for identifying the category to which inventory is assigned; and, (7) changes in the criteria for identifying the category to which inventory is assigned. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.		inventory held for repair. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

	(SFFAS 3.35)		
10	Disclosures of: (1) general composition of operating materials and supplies; (2) basis for determining operating materials and supplies values (including valuation method and any cost flow assumptions); (3) changes from prior year's accounting methods, if any; (4) balances for operating materials and supplies held for use, operating materials and supplies held in reserve for future use, and excess, obsolete and unserviceable operating materials and supplies; (5) restrictions on the use of material; (6) decision criteria for identifying the category to which operating materials and supplies are assigned; and, (7) changes in the criteria for identifying the category to which operating materials and supplies are assigned. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 3.50)	17, 28, 29 and 30	The CFR should provide: (1) broad descriptions of operating materials and supplies categories; (2) a general reference to agency reports that disclose significant detailed information about operating materials and supplies; and, (3) balances for each of the following categories of operating materials and supplies – operating materials and supplies held for use, operating materials and supplies held in reserve for future use, and excess, obsolete and unserviceable operating materials and supplies. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.
10	For stockpile materials held for sale, any difference between the carrying amount and their estimated selling price shall be disclosed. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price. (SFFAS 3.55) Disclosures of: (1) general composition of stockpile materials; (2) basis for valuing stockpile materials including valuation method and any cost flow assumptions; (3) changes from prior year's accounting	18, 28, 29 and 30	The CFR should provide: (1) broad descriptions of stockpile material categories; (2) a general reference to agency reports that disclose significant detailed information about stockpile materials; and, (3) balances for each of the following categories of stockpile materials – stockpile materials and stockpile materials held for sale. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

	methods if any; (4) restrictions on the use of materials; (5) balances for stockpile materials and stockpile materials held for sale; (6) decision criteria for categorizing stockpile materials as held for sale; and, (7) changes in criteria for categorizing stockpile materials as held for sale. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.56)		
10	Disclosures about seized property: (1) explanation of what constitutes a seizure and a general description of the composition of seized property; (2) method(s) of valuing seizures; (3) changes from prior year's accounting methods if any; (4) analysis of change in seized property including the dollar value and number of seized properties that are (a) on hand at the beginning of the year, (b) seized during the year, (c) disposed of during the year, and (d) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seized property and method of disposition where material. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.66)	19, 28, 29 and 30	The CFR should provide a broad description of seized property and a general reference to agency reports that disclose significant detailed information about seized property.
10	Forfeited property that cannot be sold due to legal restrictions but which may be either donated or destroyed shall be subject to the disclosure requirements described below (see paragraph 78). However, no financial value shall be recognized for these items. The U.S. government-	20, 28, 29 and 30	The CFR should provide a broad description of forfeited property and a general reference to agency reports that disclose significant detailed information about forfeited property.

	wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions. (SFFAS 3.71) Disclosures for forfeited property: (1) composition of forfeited property; (2) method(s) of valuing forfeited property; (3) restrictions on use or disposition of forfeited property; (4) changes from prior year's accounting method if any; (5) analysis of change in forfeited property providing the dollar value and number of forfeitures that (a) are on hand at the beginning of the year, (b) are made during the year, (c) are disposed of during the year and the method of disposition, and (d) are on hand at the end of the year (This information would be presented by type of property forfeited where material.); (6) if available an estimate of the value of property or funds to be distributed to federal state and local agencies in future reporting periods. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.78)		
10	Disclosures when the government acquires foreclosed assets in full or partial settlement of a direct or guaranteed loan: (1) valuation basis used for foreclosed property, (2) changes from prior year's accounting methods, if any, (3) restrictions on the use/disposal of the property, (4) balances in the categories described above (i.e., pre-1992 foreclosed property and post-1991 foreclosed property), (5) number of properties held and average holding period by type or category, (6) number of properties for which foreclosure proceedings are in process at the end of the	21, 28, 29 and 30	The CFR should provide a broad description of foreclosed property and a general reference to agency reports that disclose significant detailed information about foreclosed property.

	period. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.91)		
10	Disclosures for goods held under price support and stabilization programs (commodities): (1) basis for valuing commodities including the valuation method and any cost flow assumptions; (2) changes from prior year's accounting method if any; (3) restrictions on the use, disposal, or sale of commodities; (4) an analysis of change in the dollar value and volume of commodities, including those (a) on hand at the beginning of the year, (b) acquired during the year, (c) disposed of during the year by method of disposition, (d) on hand at the end of the year, (e) on hand at year's end and estimated to be donated or transferred during the coming period, and (f) that may be received as a result of surrender of collateral related to non-recourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 3.109)	22, 28, 29 and 30	The CFR should provide a broad description of commodities and a general reference to agency reports that disclose significant detailed information about commodities.
11	The U.S. government-wide financial statements need not follow the required disclosures described below. Disclosures required by applicable private sector standards: FASB SFAS 60 Accounting and Reporting by Insurance Enterprises, FASB SFAS 97 Accounting and Reporting by Insurance Enterprises for Certain Long-		No CFR disclosure would be required.

	Duration Contracts and for Realized Gains and Losses from the Sale of Investments, and FASB SFAS 120 Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts and AICPA Statement of Position (SOP) 95-1 Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises. (SFFAS 5.117)		
11	Additional whole life insurance disclosure required by FASAB: All components of the liability for future policy benefits (i.e., the net level premium reserve for death and endowment policy and the liability for terminal dividends) should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or reducing federal support in the form of appropriations related to administrative cost or subsidies). The U.S. government-wide financial statements need not separately report or disclose all components of the liability for future policy benefits with a description of each amount and an explanation of its projected use and any other potential uses. (SFFAS 5.121)		No CFR disclosure would be required.
12	The following are minimum general PP&E disclosure requirements: (1) the cost, associated accumulated depreciation, and book value by major class; (2) the estimated useful lives for each major class; (3) the method(s) of depreciation for each major class; (4) capitalization threshold(s) including any changes in threshold(s) during the period; and, (5) restrictions on the use or convertibility of general PP&E. The above listed	23, 28, 29 and 30	The CFR should provide: (1) a broad description of PP&E; (2) the cost, associated accumulated depreciation, and book value by major class; and, (3) a general reference to agency reports that disclose significant detailed information about PP&E. In addition, the CFR should disclose significant

	disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S government-wide financial statements for these activities. (SFFAS 6.45)		accounting principles used and the methods of applying those principles.
12	At a minimum, the following required supplementary information shall be presented for all PP&E: identification of each major class of asset for which maintenance has been deferred and the method of measuring deferred maintenance for each major class of PP&E. If the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E: (1) description of requirements or standards for acceptable operating condition; (2) any changes in the condition requirements or standards; and, (3) asset condition and a range estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition. If the total life-cycle cost method is used, the following should be presented for each major class of PP&E: (1) the original date of maintenance forecast and explanation for any changes to the forecast; (2) prior year balance of cumulative deferred maintenance amount; (3) the dollar amount of maintenance that was defined by professionals who designed, built, or manage (sic) the PP&E as required maintenance for the period; (4) the dollar amount of maintenance actually performed during the period; (5) the difference between forecast and actual maintenance; (6) any adjustments to scheduled amounts deemed necessary by PP&E managers; and, (7) the ending cumulative balance for the period for each major class of asset experiencing deferred maintenance. The above	24, 28, 29 and 30	The CFR should provide: (1) a broad description of deferred maintenance; (2) amounts for each major asset category (i.e., general property, plant, and equipment, heritage assets, and stewardship land) for which maintenance has been deferred; (3) a general reference to agency reports that report significant detailed information about deferred maintenance; and, (4) optional reporting of the stratification between critical and non-critical amounts of maintenance needed to return each major asset category to its acceptable operating condition. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

	listed required supplementary information is not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for required supplementary information applicable to the U.S government-wide financial statements for these activities. (SFFAS 6.83) Optional RSI reporting – Stratification between critical and non-critical amounts of maintenance needed to return each major class of asset category to its acceptable operating condition. If management elects to report critical and non-critical amounts, the report shall include management's definition of these categories. The U.S. government-wide financial statements need not separately report stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition as well as management's definition of these categories. SFFAS 32 provides for optional information applicable to the U.S. government-wide financial statements for these activities. (SFFAS 6.84)		
12	Disclosures of: The sources (applicable laws and regulations) of cleanup requirements. The U.S. government-wide financial statements need not disclose the sources of cleanup requirements. (SFFAS 6.107) The method for assigning estimated cleanup cost to current operating periods (e.g., physical capacity versus passage of time). The U.S. government-wide financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods. (SFFAS 6.108)	25, 28, 29 and 30	The CFR should provide: (1) a broad description of cleanup cost; (2) the unrecognized portion of estimated total cleanup costs associated with general PP&E; and, (3) a general reference to agency reports that disclose significant detailed information about cleanup cost. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

	For cleanup costs associated with general PP&E, the unrecognized portion of estimated total cleanup costs (e.g., the estimated total cleanup costs less the cumulative amounts charged to expense at the balance sheet date). SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E. (SFFAS 6.109) Material changes in total estimated cleanup costs due to changes in laws, technology, or plans and the portion of the change relating to prior periods. The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations. (SFFAS 6.110) The nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. (SFFAS 6.111)		
13	Exchange revenue should be recognized in determining the net cost of operations of the reporting entity during the period. The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the cost		No CFR reporting would be required.

	of outputs and the total net cost of operations of the reporting entity. The components of the net cost calculation should separately include the gross cost of providing goods or services that earned exchange revenue, less the exchange revenue earned, and the resulting difference. The components of net cost should also include separately the gross cost of providing goods, services, benefit payments, or grants that did not earn exchange revenue. The U.S. government-wide financial statements need not break-out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue. (SFFAS 7.43)		
13	Each reporting entity that provides goods or services to the public or another Government entity should disclose the following: (1) differences in pricing policy from the full cost or marketing pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, User Charges (July 8, 1993) or in subsequent amendments in circulars that set forth pricing guidance; (2) exchange transactions with the public in which prices are set by law or executive order and are not based on full cost or on market price; (3) the nature of intra-governmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, for disparities between the billing (if any) and full cost; and, (4) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable). The above listed disclosure		No CFR disclosure would be required.

	requirements are not applicable to the U.S. government-wide financial statements. (SFFAS 7.46)		
13	Disclosure of factors affecting collectibility and timing of categories of accounts (taxes) receivable and amounts involved. The U.S. government-wide financial statements need not disclose factors affecting collectibility and timing of categories of accounts receivable and the amounts involved. (SFFAS 7.65.1)		No CFR disclosure would be required.
	Disclosure of cumulative cash collections and refunds by tax year and type of tax. Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes. The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements. (SFFAS 7.65.3)	26	The CFR should disclose cumulative cash collections and refunds by tax year and type of tax for the reporting periods.
14	The disclosures required by SFFAS No. 6, paragraph 45, for general PP&E are applicable to general PP&E software. Thus, for material amounts, the following should	23, 28, 29 and 30	The CFR should provide: (1) the cost, associated accumulated depreciation, and book value; and, (2) a general reference to agency reports that

	be disclosed in the financial statements regarding the software: (1) the cost, associated amortization, and book value; (2) the estimated useful life for each major class of software; and (3) the method(s) of amortization. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 10.35)		disclose significant detailed information about PP&E. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.
15a	In a note to the financial statements, reporting entities should display a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported in the entities' balance sheet. The reconciliation is accomplished by adding to or subtracting from the beginning balance the dollar amounts of the following items: (a) the subsidy expense recognized in the four components as defined in paragraphs 25 through 29 (interest subsidy cost, the default cost, the present value of fees and other collections, and other subsidy costs) for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy re-estimates as defined in paragraph 32 (i.e., the subsidy cost allowance for direct loans and the liability for loan guarantees), and (c) other adjustments. For direct loans, the other adjustments include loan modifications, fees received, loans written off, foreclosed property or other recoveries acquired, and subsidy allowance amortization. For loan guarantees, the other adjustments include loan guarantee modifications, fees received, interest supplements paid, claim payments made to lenders, foreclosed property or other recoveries acquired, and	28	No reconciliation is required in the CFR. A general reference to agency reports would be provided.

	interest accumulated on the loan guarantee liability. The requirement to display reconciliation applies to direct loans and loan guarantees obligated or committed on or after October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. Reporting entities are encouraged but not required to display reconciliations for direct loans and loan guarantees obligated or committed prior to October 1, 1991, in schedules separate from the direct loans and loan guarantees obligated or committed after September 30, 1991. The U.S. government-wide financial statements need not disclose a reconciliation between the beginning and ending balances of the subsidy cost allowance for the outstanding direct loans and the liability for outstanding loan guarantees reported in the U.S. government-wide financial statements. (SFFAS 18.10)		
15b	Disclosure and Discussion Requirements: (A) Reporting entities should provide a description of the characteristics of programs and disclose for each program: (a) the total amount of direct or guaranteed loans disbursed for the current reporting year and the preceding reporting year, (b) the subsidy expense by components recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy re-estimates by components for those years. (B) Reporting entities should also disclose at the program level the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs, estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts. Each subsidy rate is the dollar amount of the total subsidy	27, 28, 29 and 30	The CFR should provide: (1) a broad description of direct loan and loan guarantee programs; (2) the face value of loans outstanding for direct loan and loan guarantee programs; (3) the long term cost of loans (e.g, the subsidy cost allowance for post-1991 direct loans and the allowance for uncollectible amounts for pre-1992 direct loans) and guarantees (e.g, the liability for loan guarantees) outstanding for direct loan and loan guarantee programs; (4) net loans receivable for direct loan programs; (5) amount guaranteed by the Government for guaranteed loan programs; (6) the subsidy expense for the reporting year for direct loan and loan guarantee programs; and, (7) a general reference to agency reports

	or a subsidy component as a percentage of the direct or guaranteed loans obligated in the cohort. Entities may use trend data to display significant fluctuations in subsidy rates. Such trend data, if used, should be accompanied with analysis to explain the underlying causes for the fluctuations. (C) Reporting entities should disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy re-estimates. The disclosure and discussion should also include events and changes that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date. Changes in legislation or credit policies include, for example, changes in borrowers' eligibility, the levels of fees or interest rates charged to borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed. (D) The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities. (SFFAS 18.11)		indicating agencies that are disclosing significant detailed information about direct loan and loan guarantee programs. In addition, the CFR should disclose significant accounting principles used and the methods of applying those principles.

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Appendix C: List of Abbreviations

CFR	Consolidated Financial Report of the United States Government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FMS	Financial Management Service (Treasury)
FY	Fiscal Year
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

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FASAB Staff
Wendy M. Comes, Executive Director

Project Staff:
Allan Lund (FMS, retired)
Gary Ward (FMS)

Federal Accounting Standards Advisory Board

441 G Street NW
Suite 6814
Mailstop 6K17V
Washington, DC 20548

Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates

Statement of Federal Financial Accounting Standards 33

October 14, 2008

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"

- "Mission Statement: Federal Accounting Standards Advisory Board"

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Summary

During its consideration of long-term obligations, the Board discussed the need to highlight gains and losses from changes in assumptions in federal financial reports. Some of the most significant changes in amounts on the statement of net cost for the consolidated Financial Report of the United States Government (CFR) and for certain component entities can result from gains and losses from changes in assumptions. This Statement addresses that need.

This Statement applies to federal entities that report liabilities and expenses for federal employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB) in general purpose financial reports prepared pursuant to Federal Accounting Standard Advisory Board standards.

This Statement requires gains and losses from changes in long-term assumptions used to estimate federal employee pension, ORB, and OPEB liabilities to be displayed on the statement of net cost separately from other costs. Separate display will provide more transparent information regarding the underlying costs associated with these liabilities.

This Statement also requires disclosure of the components of the expense associated with federal employee pension, ORB, and OPEB liabilities in notes to the financial statements. Such disclosure will provide useful information for analysis. The information will be comparable across agencies and between postemployment and retirement programs.

This Statement also provides a standard for selecting the discount rate assumption for present value estimates of federal employee pension, ORB, and OPEB liabilities. There is currently uncertainty in practice in this regard.

This Statement also provides a standard for selecting the valuation date for estimates of federal employee pension, ORB, and OPEB liabilities, which will establish a consistent method for such measurements.

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Table of Contents

Introduction 3
Purpose 3
Background 3
Proposed Accounting Standard 6
Display 7
Selecting Discount Rates 9
Selecting Valuation Date 9
Effect on Prior Standards 10
Appendix A: Basis for Conclusions 14
Display 14
Selecting Discount Rates 20
Selecting Valuation Date 28
Appendix B: Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions 32
Appendix C: Pro Forma Note Disclosure of OPEB Liabilities and Expense 33
Appendix D: Note 11 from FY 2006 Financial Report of the United States 34
Appendix E: Glossary 37
Appendix F: List of Abbreviations 39

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_33.pdf.

Introduction

Purpose

1. This statement requires the following:

   A. Gains and losses from changes in **long-term assumptions**[1] used to estimate federal employee pension, **other retirement benefit** (ORB), and **other postemployment benefit** (OPEB) liabilities should be displayed on the statement of net cost separately from other costs. This display will provide more transparent information regarding the underlying costs associated with certain liabilities.

   B. Components of the expense associated with federal employee pension, ORB, and OPEB liabilities should be disclosed in notes to the financial statements. Such disclosure will provide information useful for analysis. The information will be comparable across agencies and between postemployment and retirement programs.

2. This statement also provides standards for selecting:

   A. The discount rate assumption for pension, ORB, and OPEB liabilities. There is currently uncertainty in practice regarding the selection of discount rates in some situations.

   B. The valuation date for measuring pension, ORB, and OPEB liabilities, which will establish a consistent method for such measurements.

Background

Reporting Gains and Losses from Changes in Assumptions

3. During its discussions of long-term obligations the Board addressed the need to highlight certain gains and losses from changes in assumptions in federal financial reports. Some of the most significant changes in amounts on the statement of net cost for the consolidated Financial Report of the United States Government (CFR)[2] and for certain **component entities** can result from gains and losses from changes in assumptions. The Board is now requiring that such gains and losses be reported as a discrete line item on the statement of net cost.

Selecting the Discount Rates

4. SFFAS 5 provides standards for several types of liabilities, some of which require present value valuations. Federal accounting standards requiring present valuations

[1] Terms in the Glossary are shown in **boldface** the first time they appear in this document.
[2] See Appendix D containing Note 11, "Federal Employee and Veterans Benefits Payable," from the FY 2006 CFR.

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usually specify U. S. Treasury borrowing rates as the discount rates, although the terminology used differs.

5. With respect to the selection of assumptions for pension, ORB, and OPEB liabilities, including the discount rate assumption, SFFAS 5 emphasizes expected long-term future trends rather than recent past experience. For the discount rate, SFFAS 5 required either the entity's long-term investment yield on assets, if the benefit plan is being funded, or other long-term assumptions such as Treasury borrowing rates for securities of similar maturity to the period over which the payments are to be made.[3]

6. Some entities interpreted the SFFAS 5 standard with respect to **other postemployment benefits** (OPEB) to require the use of single-day Treasury rates for the discount rates. Single-day rates render liability projections susceptible to more volatility than, for example, rates based on long-term expectations or historical experience.

7. Liabilities for postemployment and retirement benefits can be very large. The combination of the magnitude of these liabilities and volatility of the projections has resulted in large variations in annual cost from year to year that reduces the usefulness of reported operating results.

8. FASAB standards that require the use of Treasury borrowing rates for discounting do not specify a precise method for selecting such rates. There were a number of options for the discount rate. However, the discount rate generally required in FASAB standards is the rate on **marketable Treasury securities** of similar maturity to the cash flows of the obligation in question.

9. This Statement provides a standard for selecting discount rates for present value measurements of federal employee pension, ORB, and OPEB liabilities.

Selecting the Valuation Date

10. This Statement provides a standard regarding selecting valuation dates for present valuations of federal employee pension, ORB, and OPEB liabilities. Few FASAB standards currently address the valuation date per se.

11. In Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997), the Board addressed the valuation date issue with respect to measuring federal civilian and military employee pension and retirement health care liabilities in general purpose financial reports prepared pursuant to SFFAS 5. Interpretation 3 requires that pension and retirement health care liabilities in general purpose federal financial reports prepared pursuant to SFFAS 5 be measured as of the end of the reporting period. However, a full actuarial valuation as of the end of the reporting period is not required. The Interpretation allows the measurement to be based on an actuarial valuation performed as of an earlier date during the fiscal year, including the beginning-of-year, adjusted or "rolled forward" for the effects of changes during the year in major factors such as pay raises and cost of living adjustments.

[3] SFFAS 5, pars. 66, 83, and 95.

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12. In this Statement the Board is extending the Interpretation 3 approach to expense and liability measurement for OPEB liabilities.

13. This Statement is effective for fiscal years beginning after September 30, 2009.

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Proposed Accounting Standard

Scope

14. This Statement applies exclusively to entities that report liabilities for federal employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB), including veterans' compensation,[4] in general purpose financial reports prepared pursuant to Federal Accounting Standard Advisory Board (FASAB) standards. This Statement does not apply to the Federal Employees Compensation Act (FECA) program.

15. This Statement requires the display of gains and losses from changes in long-term assumptions used to estimate liabilities for federal employee pensions, ORB, and OPEB, including a discount rate assumption. For the purpose of this Statement, assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, the entire series should be considered the event and, thus, projected payments may commence within one year but would be required to extend at least five years. Otherwise, assumptions would be considered short-term.

16. This Statement does not preclude entities from displaying or disclosing any information about the effect of changes in any assumptions with regard to other types of activities.

17. In addition, except for the change in terminology to characterize the preparer's "best estimate" as "reasonable estimate," this Statement does not apply to social insurance programs for which the FASAB has specifically provided standards in SFFAS 17, *Accounting for Social Insurance*. The preparation and display of the expense and liability, related disclosures, and the statement of social insurance follows the standards promulgated in SFFASs 17, 25,[5] and 26.[6]

18. This Statement applies to information provided in general purpose federal financial reports. It does not affect statutory or other special-purpose reports, such as pension or ORB reports.

[4] The pension program for veterans of the Department of Veterans' Affairs (DVA) is not accounted for as a "federal employee pension plan" under SFFAS 5 and the obligation therefore is not recorded as a liability due to differences between its eligibility conditions and those of federal employee pensions. The veterans' pension obligation is currently measured internally by the DVA in a manner consistent with the DVA's compensation program.

[5] *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessments*, July 17, 2003.

[6] *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, November 1, 2004.

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Display

Component Entities

19. Component entities should display gains and losses from changes in long-term assumptions used to measure liabilities for federal civilian and military employee pensions, ORB, and OPEB, including veterans' compensation, as a separate line item or line items on the statement of net costs. See the pro forma illustration in Appendix B.

20. Selecting the gains and losses to display from changes in individual pension, ORB, and OPEB liability assumptions to be displayed on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from the gain or loss and the size of the gain or loss relative to the liability; and qualitative factors including whether the gain or loss would be of interest to decision-makers and other users. Nothing in this standard should be construed to preclude an entity from displaying gains or losses from changes in short-term assumptions.

21. Pursuant to SFFAS 5, some component entities report the liability and expense for pensions, ORB, or OPEB, while other component entities report only **normal (or service) cost**.[7] The Office of Personal Management is an example of the former with respect to the Federal Employees Retirement System (FERS), and federal component entities with employees participating in FERS are examples of the latter. Component entities that report pension, ORB, or OPEB liabilities should display a discrete line item for gains and losses from changes in assumptions on its statement of net cost when the conditions in paragraphs 19-20 above are met. Component entities reporting only the normal or service cost should not display such gains and losses.

22. Component entities should disclose in notes to the financial statements the following reconciliation of beginning and ending pension, ORB, and OPEB liability balances:

[7] The terms "employer entity" and "administrative entity" are used in SFFAS 5 to distinguish between entities that employ federal workers and thereby incur the employee costs, including pension cost, and those that are responsible for managing and/or accounting for the pension or the other employee plan. For example, entities that receive "salaries and expense" appropriations are employer entities, while the Office of Personnel Management (OPM) is an administrative entity because it administers the civilian retirement benefit plans. See especially SFFAS 5, pars. 71-2 and 88. An entity may be both an employer entity and an administrative entity, for example, when it, rather than OPM, administers a pension plan for its employees. In such instances, that entity would be responsible for reporting gains and losses from changes in assumptions if the conditions in paragraph 19-20 are satisfied.

Beginning liability balance	$X,XXX
Expense:	
Normal cost*	XX
Interest on the liability balance	XX
Actuarial (gain)/loss:	
From experience	XX
From assumption changes	XX
Prior service costs*	X
Other	(X)
Total expense	XXX
Less amounts paid	(XX)
Ending liability balance	$X,XXX

23. This reconciliation must provide all material components of pension, ORB, or OPEB expense consistent with the components identified in the table immediately above, if applicable. Additional sub-components may be presented. The line item for **actuarial gains and losses** should be broken out into the sub-components "from experience" and "from assumptions changes." Significant pension, ORB, and OPEB programs should be presented individually in a separate column along with an "all other" column, if applicable, and a "total" column for each line item.

24. Component entities that report pension, ORB, or OPEB liabilities should disclose the information required in paragraph 22. Component entities reporting only the normal or service cost should not disclose the information required in paragraph 22.

25. Component entities holding non-Treasury securities as assets to fund their pension, ORB, or OPEB programs should disclose the rates of return, specific maturities, and allocation by type (stocks, bonds, etc.) of such assets.

Governmentwide Entity

26. The governmentwide entity should display gains and losses from changes in assumptions as a separate line item or line items on the statement of net cost after a subtotal for all other costs and before total cost. See the pro forma illustration in Appendix B.

27. The governmentwide entity should disclose in the notes to the financial statements a reconciliation consistent with information required in paragraph 22 above for pension, ORB, and OPEB liabilities. At a minimum, reconciliations for liabilities classified as civilian, military, and veterans compensation must be presented. See Appendix C for an example.

* See the glossary for this standard's definition of "normal cost."

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Selecting Discount Rates

28. Discount rates as of the reporting date for present value measurements of pension, ORB, and OPEB liabilities should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted. The discount rates should be matched with the expected timing of the associated expected cash flow. Thus, cash flows projected in each period should have a discount rate associated with them. However, one discount rate may be used for all projected future cash flows if the resulting present value is not materially different than the resulting present value using multiple rates. A change to or from multiple rates from or to a single rate should be disclosed.

29. The discount rates as of the reporting date should reflect average historical rates on marketable Treasury securities rather than giving undue weight to the current or very recent past experience of such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. The discount rate, the underlying inflation rate, and the other economic assumptions should be consistent with one another.

30. In developing average historical Treasury rates, a minimum of five historical rates as of the reporting date (e.g., at the current and four prior fiscal year ends) should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g., 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of fiscal year 2007 for a payment due in 10 years (i.e., in fiscal 2017), a minimum of the five most recent fiscal year-end historical rates on 10-year Treasury securities should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one of the five historical rates used in the average, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities as of the end of fiscal years 2003 through 2007 would be included in the average.

31. The number of historical rates used in the calculation of the average as explained in paragraph 30, e.g., five fiscal year-end rates, should be consistent from period to period. The entity's accounting policy disclosures should include its policy regarding consistency from one reporting period to the next.

32. In the determination of the historical Treasury rates used, for cash flows that are projected to occur in future years for which Treasury securities are or were not available or that are expected beyond the maturities at which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate into the determination of the discount rate interest rates interpolated or extrapolated from historical Treasury rates.

Selecting Valuation Date

33. Estimates of pension, ORB, and OPEB liability and expense in general purpose federal financial reports should be measured as of the end of the fiscal year (or other reporting period if applicable). Measurements based on an actuarial valuation may be performed as of an earlier date during the fiscal year, including the beginning of the year, with

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adjustments for the effects of changes during the year in major factors such as the pay raise and cost of living adjustment. A full actuarial valuation as of the end of the reporting period is not required. Measurements should reflect the entity's assumptions about the major factors that would be reflected in a full actuarial valuation, such as the actual pay raise, the actual cost of living adjustment, and material known changes in the number of participants covered (enrollment) that cause a change in the liability.

34. The valuation date in the full actuarial valuation utilized by the entity should be consistently followed from year to year.

Reasonable Estimates

35. The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. The entity's own assumptions about future cash flows may be used. However, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and Product Accounts and, if its assumptions do not reflect such data, explain why it is inappropriate to do so.

Effect on Prior Standards

36. This Statement provides additional requirements for display, disclosure, discount rates, and valuation dates for federal civilian and military employee pensions, ORB, and OPEB in SFFAS 5. Interpretation 3 is rescinded. In addition, this Statement replaces "best estimate" with "reasonable estimate" in SFFAS 5, SFFAS 7, and SFFAS 17.

SFFAS 5

37. This Statement also affects current standards for selecting discount rates. SFFAS 5, *Accounting for Federal Liabilities*, is amended as follows:

> *65.* ***Assumptions****—For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS),* ~~*the best available*~~ *actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4,* Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board. Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.* [footnote omitted]

> *66. In addition to complying with the guidance in the preceding paragraph,* ***the discount rate assumption for present value measurements pension***

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liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which cash flows are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates. ~~*the interest rate assumption should be based on an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term Federal government borrowing rate)*~~*. The underlying inflation rate and the other economic assumptions should be consistent.* ~~*The rate used to discount the pension obligation should be equal to the long-term expected return on plan assets.*~~ ***The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. In developing the average historical Treasury rates, a minimum of five historical rates as of the appropriate reporting dates should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g. 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of the fiscal year 2007 for a payment due in 10 years, i.e., in 2017, a minimum of five 10-year Treasury rates should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one rate, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities for the years 2003 through 2007 were included in the average. The number of historical rates used for the average, e.g., five yearly rates, should be consistent from period to period. The entity should explain that its accounting policy is to be consistent in this regard from period to period. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.***

83. ***Assumptions****—Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for* ***federal employee*** *pensions and (2) a* ***long-term*** *health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The* ***discount rate assumption for present value measurements of ORB liabilities should be developed in accordance with paragraph 66 of this standard.*** ~~*be equal to the long-term expected return on plan assets if the plan is*~~

> *~~being funded or on other long-term assumptions (for example, the long-term Federal government borrowing rate) for unfunded plans.~~ The administrative entity should disclose the assumptions used.*

> *95. The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the* ***interest rate on marketable*** *Treasury ~~borrowing rate for~~ securities of similar maturit**ies** to the period over which the payments are to be made.* ***The discount rate assumption for present value measurements of OPEB liabilities should be developed in accordance with paragraph 66 of this standard.***

> *157. Second, assumptions ought to be consistent across federal employee* ***pension, other*** *retirement* ***benefit, and other postemployment benefit*** *systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of ~~the best available~~* ***reasonable*** *estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.*

SFFAS 7

38. This Statement also affects current standards that use the term "best estimate." SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, is amended as follows:

> *67.1 Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial responsibilities:*
>
> > *67.1 The estimated realizable value, as of the end of the reporting period, of compliance assessments and, if reasonably estimable, preassessment work in process. The amounts furnished should represent management's ~~best~~ estimate of additional revenues* ***reasonably expected*** *~~likely~~ to be collected from compliance assessments and from pre-assessment work in process, appropriately qualified as to their reliability. A range of amounts may be provided for pre-assessment work in process if estimable. The change in the total(s) of compliance assessments and of pre-assessment work in process during the reporting period also should be provided.*

> *67.2 If reasonably estimable, other claims for refunds that are not yet accrued but are likely to be paid when administrative actions are completed. If estimated, unasserted claims for refunds should be provided separately from claims filed and may be expressed as a range of amounts. The amounts furnished should represent management's ~~best~~ **reasonable** estimate~~s~~, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.*

SFFAS 17

39. Paragraphs 24-27 and 32-33 of SFFAS 17 provide the standard for required supplementary information (sub-paragraph 27(3) and 32(3) were re-classified as basic information by SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*). Paragraph 25 of SFFAS 17 is changed as follows:

> *25. The projections and estimates used should be based on the entity's ~~best~~ **reasonable** estimates of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.*

40. Paragraph 27(2) of SFFAS 17 requires the ratio of contributors to beneficiaries as supplementary information. Paragraph 27(2) is changed as follows:

> *27(2) Ratio of Contributors to Beneficiaries - With respect to the OASDI and HI programs, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio") during the same projection period as for cashflow projections (e.g., 75 years), using the program managers' ~~best~~ estimate. At a minimum, the ratio should be reported for the beginning and end of the projection period*. [footnote omitted]

41. Paragraph 27(4) (a) of SFFAS 17 requires sensitivity analysis as supplementary information. The phrase "best estimate cost" before the word "assumptions" is changed as follows:

> *27(4) (a) For all programs except UI illustrate the sensitivity of the projections and present values required by paragraphs 27(1) and 27(3) to changes in the most significant individual assumptions. For example, using the entity's ~~"best estimate"~~ **reasonable** cost assumptions as a baseline, show the effect of varying several significant assumptions ….*

Effective Date

42. This Statement is effective for fiscal years beginning after September 30, 2009.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

Comments Received

A1. The Board did not rely on the number in favor or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A2. Eight written responses were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	1	
Preparers and financial managers	5	

Summary of Comments

Display

What the Exposure Draft Proposed regarding Display

A3. During its consideration of long-term obligations the Board discussed how financial statement display might be modified to show the fluctuations in cost caused by changes in assumptions. Some of the most significant changes in amounts on the operating statement for the Financial Report of the United States Government (CFR) and on the statement of net cost for some component entities often result from gains and losses from changes in assumptions. Note 11[8] to the FY 2006 CFR disclosed that the expense for military employee pension benefits was $112.2 billion. Of this amount $20.1 billion was for changes in assumptions, and $6.1 billion was from differences between actual experience and what was assumed. And even more dramatically, Note 11 in the CFR for FY 2005 disclosed that of the $123 billion expense for post-retirement healthcare benefit for military personnel, $53 billion was attributed to changes in assumptions and $5 billion was from differences between actual experience and what was assumed.

A4. The issue of volatility in reported annual expense was first brought to the Board's attention with respect to year-to-year volatility in veterans' compensation expense

[8] See Appendix D for Note 11.

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amounts reported by Department of Veteran's Affairs (DVA). Large percentage changes in net cost resulted from DVA's need to estimate future outflow for veteran's compensation benefits based on complex assumptions and cost models. Other agencies need to make similar estimates. Small changes in the discount rate assumption, for example, produce large fluctuations.

A5. The Board decided to propose a general standard rather than focus solely on DVA and other employee compensation liabilities because many programs are affected by changes in long-term assumptions. Although pension, ORB, and OPEB programs employ long-range assumptions to estimate liabilities and periodic expense, other programs also involve long-term assumptions for liability and cost estimates the dollar amounts of which are very large relative to other financial statement items. For example, environmental liabilities require the use of long-term assumptions.

A6. The exposure draft proposed that gains or losses from changes in assumptions, if any, should be presented as discrete line items not assigned to programs on the statement of net cost (SNC). The Board believed that this disaggregation would enhance the usefulness of the information provided on the statement of net cost. Separate display highlights the effects of changes in assumptions, which can be significant. Expenses assigned to programs would be distinguished from the gains and losses from changes in assumptions. The user would be better able to understand the operating performance of the entity as well as the role of gains and losses from changes in assumptions.

A7. The Board believed that the discrete display of such gains and losses would enhance users' understanding of liabilities and periodic expense. Users, including entity managers, would understand more about how liabilities and expense are measured; about the uncertainty of the measurement of individual liabilities; and about what causes changes in liabilities. Managers would benefit from having information about the volatility of assumptions in their programs. Extreme volatility might indicate the assumptions chosen and/or the assumption-selection process needs re-evaluation. Volatility may affect the entity's funding requests and long-term planning. It will at least raise a flag for further investigation.

A8. The proposed Statement provided certain exceptions to the display requirement. Assumptions used to estimate receivables, payables, inventory and related property and other short-term assumptions were excepted because they will be proved or disproved within a relatively short period of time. Also, those assumptions used for direct loans and loan guarantees were excepted because the FASAB has already provided accounting procedures.

Respondents' Comments regarding Display

A9. Most respondents agreed that the separate display of gains and losses from changes in assumptions on the SNC would be informative and useful. One respondent recommended displaying more detail about assumption changes on the face of the SNC, for example, the nature of the assumption change, within a category of assumptions (i.e., economic, demographic, etc.) and the amount of change.

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A10. Most of the respondents who commented on the question about the criteria for short – and long-term assumptions found the 5-year criteria useful. One respondent commented that there is some ambiguity in the wording and suggested the following three improvements: (1) explicitly allow display of gains/losses from assumption changes involving estimates for less than five years, (2) include the size of the gain/loss relative to the actuarial liability as part of the guidance in the proposed standard (ED paragraph 21) as another criterion for deciding what to display, and (3) include a discussion of the need to distinguish between benefit changes and assumption changes in the basis for conclusions. Another respondent commented that the glossary should be clearer regarding what is meant by long-term assumptions.

A11. One respondent did not believe the 5-year division is appropriate "to define liabilities." In addition, this respondent thought there would be situations where changes in short-term assumptions could result in material gains and losses.

A12. Another respondent commented that the proposed standard did not provide satisfactory guidance based on their belief that it (1) would apply to a very limited federal audience, (2) uses high-level generalities, and (3) should be directed to the administrative entities for the primary federal employee benefit programs.

A13. Several respondents commented that the proposed standard is not clear with respect to how it applies to non-actuarially prepared liability estimates. For example, one respondent thought that it may not be feasible to identify separate components of an annual change in non-actuarial liabilities. Another respondent asked for more guidance with respect to paragraph 21 in the exposure draft, which directed the preparer to use judgment in selecting the long-term assumptions for which gains and losses from changes are to be displayed individually on the statement of net cost.

The Board's Conclusions regarding Display

A14. The Board decided to limit the standard to federal employee pension, ORB, and OPEB liabilities. This decision is based on the Board's desire to address more immediately its primary concern, which is to display the effect of assumption changes on employee compensation liabilities. The Board considered the requests from some respondents for more guidance regarding how the standard would apply to other than pension, ORB, and OPEB activities. Although in principle a broader application is desirable, the Board believes that developing additional guidance would significantly delay implementation of a broad standard. Therefore, the Board concluded that limiting the scope to pension, ORB, and OPEB liabilities would address the specific issue presented at this time. In addition, the need for information about the effect of assumption changes is more acute for pension, ORB, and OPEB liabilities than for other liabilities where the combination of factors that the preparer would have to consider is more complex. Legal contingencies, for example, involve an array of considerations that are not as clear-cut as for employee benefits.

A15. This decision effectively renders moot several of the respondents' concerns. First, it addresses the concern of some respondents that the guidance was not specific enough with respect to which assumptions are subject to the standard. Second, it addresses the

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concern that the disclosure requirement of ED paragraphs 22-23 were too pension-oriented and preparers may be confused regarding how to classify annual changes in, for example, environmental cleanup liabilities or contingent liabilities.

A16. Narrowing the scope of the standard also meant that the examples of liabilities to which the standard does not apply were not necessary. Paragraph 14 now explicitly states that the standard applies exclusively to pensions, ORB, and OPEB. The Board decided that the ED paragraphs containing examples of other liabilities to which the standard would not apply (e.g., liabilities that employ long-term assumptions where the FASAB has specifically provided standards such as loans and loan guarantees, or to assumptions that are short-term in nature, including estimates or receivables, payables inventory, and claims incurred but not reported) were redundant and potentially confusing, and they have been removed.

A17. With respect to concern that the proposed standard did not provide satisfactory guidance regarding how it applies to administrative and employer entities as defined in SFFAS 5, specific guidance has been added. The standard now states that, in cases where an entity does not report the pension, ORB, or OPEB liability, that entity is not responsible for reporting gains and losses from changes in assumptions. For example, most civilian federal employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS) pension plans, which are administered by the Office of Personal Management (OPM). Federal reporting entities whose employees participate in CSRS and FERS (other than OPM itself) report only a portion of the annual cost of the employee benefits. This portion is called the “normal cost” (or, “service cost’). The OPM reports the liability and all costs components, as described in SFFAS 5. Thus, the OPM, which is called the “administrative agency” in SFFAS 5, is responsible for reporting the gains and losses from changes in assumptions as a discrete line item on its SNC.

A18. An entity may function both as an employer and an administrator entity. For example, it may administer a pension benefit for its employees rather than participate in CSRS or FERS. In such instances, that entity would report the liability and all costs. Thus, that entity would report gains and losses from changes in assumptions, if the conditions in paragraphs 19-20 are satisfied. The Board believes that the display of the effect of changes in assumptions will be meaningful for all entities that report a pension, ORB, or OPEB liability.

A19. The Board considered the applicability of this standard to the Federal Employees Compensation Act program. The Board concluded that it was not appropriate or necessary for the Department of Labor to provide the information concerning gains and losses from changes in assumptions to the employer agencies, nor for the employer agencies to separately report or disclose such information. Under the particular circumstances of FECA accounting and reporting, the Board decided that the value of the FECA information provided pursuant to this standard would not offset the burden and cost of providing it.

A20. Regarding the distinction between “short-term assumptions” and “long-term assumptions,” the Board believes the standard provides sufficient guidance.

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Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events, the entire series should be considered the event and, thus, projected payments may commence within one year but would be required to extend at least five years. Otherwise, assumptions would be considered short-term. The Board believes that limiting the scope of the standard to federal employee pensions, ORB, and OPEB will reduce the potential for misunderstanding.

A21. Regarding the comment that information about changes in short-term assumptions might be informative, the Board agrees that there might be instances where the display of gains and losses from changes in assumptions that are by definition "short-term" in nature might be informative. Although it does not require such display, the final standard does not preclude displaying the effect of changes in short-term assumptions (see paragraph 16).

A22. Regarding the comment about the propriety of the 5-year criteria for distinguishing long-term liabilities, the proposed standard did not define "long-term liabilities." It used that term generally to describe the types of liabilities for which components of expense should be disclosed and for which estimates are undertaken using "long-term assumptions." The proposed standard defined long-term assumptions as those where the underlying event about which the assumption is made will not occur for five years or more. The Board understands the respondent's comment to involve a question about the sufficiency of the general usage of "long-term liability" in the standard. The Board believes that the usage of "long-term liability", along with the specific focus on assumptions involving events of 5 years or more, is sufficient. However, in order to make the standard as clear as possible, in the final standard the Board uses the word "long-term" primarily to modify the word "assumption" and does not apply it to the word "liability." Rather, the standard refers to liabilities and/or estimated liabilities that involve long-term assumptions.

Note Disclosures

What the Exposure Draft Proposed regarding Disclosure

A23. The proposed standard required certain note disclosures. First, the components of expense associated with liabilities involving long-term assumptions were to be disclosed. The Treasury Department and other users advocated a disclosure that will allow increased comparability between federal civilian and military employee and veteran benefits programs. The Board believed that disclosing the components of expense will provide information about the government's annual accrued costs and about increases and decreases in the associated liability that will be useful for decision-making. The Treasury Department prepares the CFR and must explain any wide swings in certain liabilities. For some time Treasury has sought to improve the disclosure for federal employee and veteran benefits payable and currently discloses the information shown in Appendix D. The desire for more transparency in this regard is not only the goal of the Treasury Department but also apparent in comments from other CFR users, most notably the Federal Reserve. Most of the information required in this Statement is

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already presented in the CFR but some data is missing. The proposed standard was intended to fill these gaps.

A24. In addition to the components of expense, the exposure draft proposed disclosure of market rates for Treasury securities with 10-, 20-, and 30-year maturities. The Board believed that market rates would be a useful benchmark for comparison with the discount rate(s) the entity is using. The discount rate affects expense and liability amounts and a comparison with market rates would provide useful context. The Board considered but decided not to require the note disclosure to include the entity's analysis of the effect on expense and liability amounts of using current market rates. The burden of such a requirement on some preparers was deemed to outweigh the benefits of the information provided. However, the proposed note disclosure would allow interested parties to begin such an analysis.

Respondents Comments regarding Disclosure

A25. Most respondents commented that the note disclosure would be informative. One respondent recommended more detailed information about gains and losses from assumption changes. For example, display the type of assumption within a category of assumptions (i.e., categories are economic, demographic, discount rates, etc.) and the amount of each change. Another respondent recommended disclosure of (1) the assumed rate of return on the plan assets, if the reporting entity has such assets – that is, not just the return on Treasury securities, (2) the specific maturities for the Treasury securities, and (3) the allocation of the fund's assets by asset general category. Another respondent recommended requiring the reporting entity to determine its financial position using both the discount rate on Treasury securities and the discount rate on the actual assets of the fund, if any, to show the actual impact of these different rates.

A26. Another respondent commented that the disclosure would be neither meaningful nor informative. They found the standard too vague to determine whether long-term construction contacts or procurements would be included. They cited issues involving their Standard General Ledger accounts and accounting system.

A27. One respondent commented that the disclosure of market rates would be informative and provide transparency. However, another respondent found the benchmark comparisons unnecessary and potentially confusing. This respondent favored merely stating the basis for selecting assumptions in the notes; for example, that a board of experts decided the rates are appropriate.

A28. One respondent commented that the proposed standard appeared to eliminate the requirement in SFFAS 5, par. 88, for disclosure of gains and losses due to changes in the medical trend assumptions as a separate item because it could be included in disclosure of all other such gains and losses. The Board notes that this is not the case; the requirement in par. 88 is not affected by this standard.

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The Board's Conclusions regarding Disclosure

A29. With respect to the suggestion that more detail be disclosed, the proposal in the exposure draft did not require as much detail on the face of the financial statement or as much disclosure as recommended by some respondents. The Board's decision to limit the scope of the final standard to pensions, ORB, and OPEB reduces the need for additional detail. At the same time the Board added a requirement for disclosure of information about non-Treasury assets, if any. As noted above, the exposure draft did not and the standard does not preclude display or disclosure of short-term gains and losses or other material components.

A30. Regarding the comments about disclosing current market rates for certain Treasury securities, the Board decided to eliminate this requirement. Some believe that this disclosure would be a useful benchmark for comparison with the discount rate used by the entity. They note that current market rates are used in many other contexts. Moreover, others believe that the current market rate for Treasury securities is the best indicator of the government's borrowing cost. However, others question the usefulness of the disclosure for several reasons. First, they note that the exposure draft did not require the entity to provide an analysis of the effect of using current market rates on the entity's liability and periodic cost, because the Board concluded that the benefit of such an analysis was outweighed by the burden of producing it. Second, the entity was not required to disclose the average historical Treasury rates it was using for discounting and therefore a direct comparison would not be possible. Finally, some believe that the disclosure is not a good benchmark because the Board is requiring another discount rate; and, if a benchmark were to be disclosed, it should be closer to what the Board is requiring. The Board decided that, given the lack of unanimity on its information value, the disclosure should not be required.

A31. Similarly, a respondent recommended using both the discount rate on Treasury securities and the discount rate on the actual assets of the fund, if any, to show the impact of these different rates. The Board believes this disclosure would be informative but concluded that its informational value did not clearly overcome the burden that preparing two calculations would have imposed on the preparer, and therefore reporting such information should be optional.

A32. Regarding the request for more guidance about administrative and employer entities, the standard now explains that, as indicated in paragraphs A17-A18 above, the entity that reports the pension, ORB, or OPEB liability should display the gains or losses from changes in assumptions and disclose the relevant liability components.

Selecting Discount Rates

What the Exposure Draft Proposed regarding Discount Rates

A33. The Board became aware of an issue affecting preparers with respect to the selection of discount rates for present value measurements of expense and liability amounts. A preparer noted that, with respect to OPEB accounting, SFFAS 5 requires that the liability be estimated using as the discount rate the U. S. Treasury borrowing rate for securities

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of similar maturity to the period over which the payments are to be made.[9] The preparer asked whether the discount rates should be based on a single day's interest rates, or were other alternatives acceptable, such as an average of interest rates over a period of time. The preparer currently uses one-day Treasury "spot" rates consistent with the expected timing of future cash flows relating to the program, believing that that is what the Board intended by the standard in SFFAS 5, paragraph 95. As a result, its liabilities have been susceptible to extreme volatility.

A34. Several current FASAB standards require present valuations and discounting. For example, federal civilian and military employee pensions, ORB, OPEB, including veterans' compensation, require discounting. Federal activities that incur such liabilities typically involve similar types of demographic and economic assumptions.

A35. The FASAB standard for federal civilian and military employee pensions and ORB includes general guidance with respect to assumptions.[10] These standards state that federal pension plans should be guided by Actuarial Standards of Practice (ASOP), e.g., ASOP 4, *Measuring Pension Obligations*, and ASOP 27, *Selection of Assumptions for Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board (ASB). The ASB is a board associated with the American Academy of Actuaries that sets professional standards of actuarial practice in the United States. The Board referenced ASB standards because it considers them accepted actuarial practice.

A36. Consistent with ASOPs, SFFAS 5, paragraph 65 requires actuarial assumptions to be based on the actual experience of the covered group and to emphasize expected long-range future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the standard requires that the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.

A37. With respect to discount rates for pension and ORB accounting, SFFAS 5 requires the interest rate used for discounting to be based on

> an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term federal government borrowing rate). …[11]

A38. The FASAB standard for OPEB differs somewhat from that for pensions and ORB. For OPEB, SFFAS 5 requires employer entities to estimate the amount and timing of future payments and to discount the future cash flows using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.[12] This difference is attributable to the fact that, unlike most federal civilian and military

[9] SFFAS 5, par. 95.
[10] See SFFAS 5, pars. 65 and 83, respectively, for pensions and ORB.
[11] SFFAS 5, par. 66.
[12] SFFAS 5, par, 95.

employee pension and ORB plans, the federal employee OPEB generally are not funded and thus the long-term yield on investments was not thought to be relevant. For plans that are not funded the standards have been essentially the same: the objective is an expected long-term rate that reflects the government's expected borrowing costs.

A39. The Board concluded in SFFAS 5 that the discount rate for pensions and ORB, which are funded, should reflect the long-term expected return on plan assets. The Board explained that the expected long-term rate reduces volatility, reflects the actual experience and expectations of the primary federal plans, and is consistent with the assumptions used in the budget.[13]

A40. As previously stated, current FASAB standards provide two approaches for selecting discount rates. The first approach is the expected long-term return on plan assets. The second approach involves unfunded plans where an expected long-term return on plan assets is not available and a Treasury borrowing rate is required. The proposed standard employed one approach for all instances not otherwise expressly provided in FASAB standards: discount rates for present value measurements of estimated liabilities that involve long-term assumptions should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the benefit payment for which the estimate is being made.

A41. The Board believed that discount rates for present value measurements of expense and liability amounts should be average historical rates for marketable Treasury securities because they reflect the government's borrowing cost with the public. Also, expected long-term rates reduce volatility, reflect the actual experience and expectations of the primary federal plans, and are consistent with the assumptions used in the budget.

A42. The proposed standard eliminated the plan's investment yield as an option for discount rates for present value measurements of expense and liability amounts. The discount rate assumption for liabilities is used most significantly to calculate the present value of the obligation and the **annual cost increments** of net periodic cost, for example, the normal cost component of pension expense. Both of those uses are conceptually independent of a plan's assets, if any. If two employers have made the same benefit promise, the FASAB believes the annual cost increments and the present value of the obligation should be the same even if one expected to earn an annual return of 6 percent on its plan assets and the other had an unfunded plan.

A43. The Board noted that the Pension Protection Act of 2006[14] requires fund managers to focus on long-term interest rates instead of their particular asset holdings. The Act requires them to calculate pension liabilities based on current bond rates rather than the expected rate or return from an asset portfolio. Thus, high expected gains from stock holdings will no longer be able to help diminish benefit liabilities since they will no longer be part of the calculation.

A44. The FASAB believes that the objective of discount rates is to reflect **the time value of money**. The time value of money should reflect the single amount that, if invested at the

[13] SFFAS 5, par. 159.
[14] PL No. 109-280

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measurement date in risk-free investments with maturities like those of the future benefit payments being measured, would generate the necessary cash flows to pay the benefits when due. Marketable U.S. Treasury securities are deemed risk free because they pose neither uncertainty in timing nor risk of default to the holder. This single amount is the gross liability. It would equal, conceptually, the current market value of a portfolio of Treasury zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. In the absence of a portfolio of such zero coupon Treasury securities, however, the federal preparer should incorporate in assumed discount rates the re-financing rates expected to be available on marketable Treasury securities in the future, which should be extrapolated from historical experience.

A45. With respect to Treasury rates the Board considered average historical rates as well as current market rates as of the reporting date. Some prefer current market rates, arguing that interest rates can move significantly from year to year and the use of interest rates from a prior year (or smoothing this year's rates with those from prior years) can therefore result in significant misstatements about the current value of future cash flows. They argue further that changing interest rate assumptions annually would result in more accurate but also more volatile estimates of liabilities and changes in net cost than the current actuarial practice in the federal government of revisiting interest rate assumptions every 3 to 5 years. They argue that the proposed display standard is the best way to deal with volatility, i.e., by reporting on a separate line changes in net cost due to changes in actuarial assumptions.

A46. The FASAB decided to propose average historical rates rather than single-day or market rates on the reporting date. The Board believed that single-day rates would not reflect the long-term orientation of most federal programs.

A47. The proposed standard was not intended to change the Board's preference, expressed in SFFAS 5 and elsewhere, for expected future trends rather than giving undue weight to recent past experience. With respect to assumptions in general, FASAB standards have emphasized expected future trends.

A48. Regarding the method of discounting cash flow in future years, the FASAB believed that discount rates used to measure the present value of the annual cost increments of expense should be selected that are applicable to the various benefit periods in question. The Board believed that annual cost increments will be more representationally faithful if individual discount rates applicable to various benefit deferral periods are selected. For future years extending beyond the last for which Treasury rates are available, e.g., beyond 30-year maturities, the proposed standard required the preparer to incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates. However, the proposed standard allowed that a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates, or for cases in which discount rates have limited influence on current liability estimates.

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A49. The proposed standard provided for the discount rates to be reviewed at each annual reporting date and changed if materially different from the existing rate. However, the Board preferred a stable discount rate that would result from applying historical averages, rather than current market rates. The Board stated that current market rates produce a degree of volatility that is not a faithful representation of the time value of money in long-term federal programs. The Board also stated that implicit in the notion of stable rates is the fact that the discount rate normally would not change every year. The preparer would change the rate based on a significant change in the historical average Treasury rate, as determined by the preparer, which would reflect long-term expectations rather than the current market rate. Thus, the proposed standard neither required nor precluded annual changes in the discount rate. Current Office of Personnel Management practice is to maintain a constant discount rate for civilian pensions and other retirement benefits for five years. The Board does not anticipate that the proposed standard would necessarily affect that practice because Treasury borrowing rates normally change very slowly.

A50. The discount rate standard in the proposed Statement did not apply to instances where the FASAB has required or permitted a discount rate to capture risk, i.e., to be other than the risk-free Treasury borrowing rate. However, the proposed standard did apply to all instances where risk-free Treasury borrowing rates are appropriate.

Respondents Comments regarding Discount Rates

A51. The majority of respondents commented that long-term Treasury rates are appropriate for discounting liabilities the estimates for which involve long-term assumptions. One respondent favored current market rates over average historical Treasury rates, believing them to be a better reflection of the cost of issuing Treasury securities to extinguish liabilities at the financial statement date. In addition, this respondent believes current market rates would provide more comparability and would be consistent with fair value accounting; but if average historical rates are used, this respondent believes the time period allowed for average historical Treasury rates should be limited to 5 years, which would better reflect the current market than longer horizons.

A52. One respondent commented that it uses statutory rates and that such rates supersede SFFASs.

A53. One respondent found the requirement (ED paragraphs 27 and A33) to use year-specific discount rate "fundamentally" inconsistent with the Aggregate Entry Age Normal (AEAN) cost method required by SFFAS 5. The current FASAB pension and ORB standards for selecting cost attribution methods (paragraphs 63 and 82, SFFAS 5, respectively) direct the preparer to use AEAN (or other actuarial cost methods if the results are not materially different). The AEAN method is one of several cost attribution methods available. The private sector pension standard, SFAS 87, used another approach called "projected unit credit" (PUC). The primary reason given in SFFAS 5 for directing the use of AEAN was that the major federal pension plans at OPM and DoD were using it, and the Board was advised by actuaries that the results would not be substantially different than the unit benefit approach required by SFAS 87 (see SFFAS 5, par. 153).

A54. In addition, the respondent did not believe that allowing a single rate if the "result" is not materially different, as was done in the ED paragraph 27, would sufficiently address the cost attribution method issue. This respondent did not believe that year-specific discount rates should be required, even if the Board wants to allow them.

A55. This respondent also commented that the perspective of the government's borrowing cost with the public is not necessarily relevant from the point of view of the employer entity in the case of a funded plan. Although this respondent's plan is a federal plan holding federal securities, from this respondent's perspective, the plan is funded. Therefore, this respondent believes the investment yield perspective for the discount rate has relevance. From the employers' perspective, this respondent did not believe the statement in paragraph A25 of the exposure draft about the equivalence of two plans with the same benefit provisions (one funded and one not), is necessarily correct.

A56. This respondent stated that, from the overall federal government perspective, it is not clear what constitutes the best basis for the discount rate assumption. This respondent believes the statement in paragraph A24 of the exposure draft that the rationale for using marketable Treasury securities for the discount rate is that they reflect the government's borrowing cost with the public is questionable. This respondent asserted that a private company would not value a given future obligation at its own borrowing cost.

A57. This respondent acknowledged that, in the sense that Treasury securities represent risk-free investments (as described in paragraph A27, of the exposure draft) arguments can be made for their use as the discount rate basis. However, this respondent asserted that two circumstances make an investment yield approach preferable. First, when the entity employs an independent actuarial board, the respondent believes that board's assumptions for the financial statement valuations make the most sense, especially when Congress has created the independent expert for setting the assumptions. Second, an investment yield approach is preferable when the funding in a trust fund is comprised entirely of investments that mirror marketable US Treasury securities. This respondent states that arguments that the discount rate should not be impacted by the particular portfolio of securities in a trust fund at a given time are not valid in the context of an alternative involving "a vague, undefined 'historical' average."

A58. Another respondent commented that the phrase "average historical Treasury rates" is unclear but consistent with ED paragraph 28 with respect to the need for the reporting entity to use judgment, and with the notion of Congressionally-established expert Boards for trust funds restricted to investing in securities that mirror marketable US Treasury securities.

A59. Other respondents prefer more guidance regarding the time-period for and meaning of average historical rates. Several respondents recommended limiting the time-period to 5 years, if average historical rates are used, feeling it would better reflect the current market than longer horizon and that that would be a sufficiently long period.

A60. One respondent asked for more explanation and guidance with respect to the phrase "extrapolated from historical Treasury borrowing rates." It is possible for projected cash flows to extend beyond the maturities for which Treasury securities are available, e.g.,

beyond the 30-year security. The proposed standard required the preparer to incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates, that is, use the historical rates as indicative of what future rates will be.

The Board's Conclusions regarding Discount Rates

A61. The Board decided to retain the average historical Treasury rate approach proposed in the exposure draft. Thus, the entity should employ Treasury borrowing rates associated with each future year involving relevant cash flow. This is sometimes called the "yield curve" approach.

A62. With respect to the attribution methods, the Board does not believe the standard is inconsistent with the Aggregate Entry Age Normal (AEAN) attribution method required in SFFAS 5. The change in the discount rate applied to a particular future cash flow would be a function of (1) the passage of time and (2) the market rate for each maturity, as evidenced by historical rates. It would not represent a change in assumption per se. In other words, the discount rate does not necessarily change, the period changes. There would be a one-year rate, a two-year rate, a 5-year rate, etc., that would not (necessarily) change each year. The average historical rate would change only when the data dictated. The mere fact that a payment that was due in 5 years is now due in 4 years would not constitute an assumption change. The Board does not believe that the requirement is conceptually inconsistent with the AEAN or other provisions of SFFAS 5, paragraphs 63 and 82.

A63. Regarding whether to use the entity's investment return for determining a discount rate, the Board continues to believe that discount rates for present value measurements of federal pension, ORB, and OPEB liabilities should be average historical rates for marketable Treasury securities because it reflects the government's borrowing cost with the public and therefore the time value of money for the government. The Board also believes that there should be consistency among federal entities. The discount rate is used to calculate the present value of the obligation and annual cost increments and should be the same, everything else being equal, between funded and unfunded pension, ORB, and OPEB programs. Moreover, overly optimistic assumptions about investment returns have provided inaccurate financial information about public and private sector pensions.

A64. The Board believes that the average historical Treasury rate standard is clear and well defined. The objective is a principle-based requirement where the reporting entity would use its judgment when developing the rate.

A65. The Board considered the request for more guidance regarding the number of instances to include in an average historical rate. The Board decided to establish a minimum number of five historical Treasury rates to include for the average. The exposure draft did not specify a minimum or maximum number of historical Treasury rates for developing an average. The Board believes that setting a minimum number of historical rates to include in the average would ensure that the discount rate captures richer experience and avoids undue focus on the current market rate. In addition, a standard

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requiring a minimum of five periodic rates for the average would not encourage the use of so many historical rates as to render the average rate antiquated.

A66. The Board was concerned regarding the possibility that the entity would frequently change the number of Treasury rates included in the average rate. The Board's believes that the reporting entity should be consistent from period to period with respect to the number of rates included in the average. SFFAC 1, *Objectives of Federal Financial Reporting*, and SFFAC 2, *Entity and Display*, states that consistency is one of the qualitative characteristic of accounting information.[15] The Board concluded that the standard should require the entity's accounting policy disclosure to include the policy of consistency in this regard, which is the intent of paragraph 31.

A67. The Board notes that a respondent criticized as vague the exception provided in the exposure draft allowing entities to use a single rate for discounting if the resulting present value is "not materially different" than the resulting present value using the approach in the standard. The respondent commented that the single rate would need to be compared to the various components of expense to not materially differ. Nonetheless, the Board believes that this exception may be useful to preparers. If the result of applying a single composite discount rate to the cash flows vs. individual rates is not materially different, then the preparer may use the single rate. This exception is a continuation of one currently in FASAB pension and ORB standards and has been in effect since October 1996. However, the standard now specifies that the resulting present value of the entity's single rate should not be materially different than the resulting present value using the approach in the standard.

A68. With respect to a respondent's comment about the use of expert actuarial boards, the Board notes that such boards provide assumptions for funding and other purposes and presumably also would provide assumptions for general-purpose financial statements. However, for the latter, under the standard, they would look at the broader historical market for Treasury securities for context. Actuaries work with requirements appropriate to specific objectives. The Board concludes that the general requirement for average historical rates should be retained.

A69. With respect to the request for additional guidance regarding the phrase "extrapolate from historical Treasury borrowing rates" where projected cash flows extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year maturity, the Board notes that there are several methods that can be applied to extend a yield curve for terms beyond the last available rate in the market. The International Actuarial Association's Risk Margin Working Group's (RMWG) recent exposure draft[16] on measuring liabilities for insurance contracts mentions that the simplest approach is to use the last available rate (for example the 20-year rate for a 30-year cash flow), and that a more advanced method would be to extrapolate the yield curve with a constant slope assuming that the forward rate observed between the last two market rates stays constant. In addition, the RMWG ED states that a model can be applied to extend the

[15] See SFFAC 1, par. 163, and SFFAC 2, par. 109.
[16] Risk Margin Working Group, *Measurement of Liabilities for Insurance Contracts: Current Estimate and Risk Margins*, March 24, 2008 ("RMWG ED").

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yield curve and cites several examples. The Board believes these approaches are reasonable.[17]

Selecting Valuation Date

What the Exposure Draft Proposed regarding Valuation Dates

A70. The FASAB has addressed the issue of valuation dates for present valuations in various ways. The sections of SFFAS 5 dealing with pensions, ORB, and OPEB do not mention valuation dates, but the Board did address it in Interpretation 3, *Measurement Date for Pension and Retirement Health Care Liabilities* (August 1997). In Interpretation 3 the Board decided that pension and retirement health care liabilities should be measured for general purpose federal financial reports as of the end of the reporting period, and that such measurement should be based on an actuarial valuation within a year of the end of the reporting period.

A71. In Interpretation 3 the Board had been asked to endorse use of an actuarial valuation date as of the beginning of the fiscal year, which had been the practice in some of special purpose financial reports on pension plans prepared pursuant to statutory provisions. Some actuaries were concerned that differences between actuarial measurements used in different reports would cause problems and confusion. Some people who supported using a beginning-of-year valuation also were concerned about the potential for disagreements between auditors and preparers if projections or estimates were used instead of a full actuarial valuation. However, other people believed that liability measurements in financial statements prepared pursuant to SFFAS 5 should be as of the end of the reporting period, and that a measurement based on a projection or "roll forward" of a full actuarial valuation would be appropriate if it were not feasible to perform a full actuarial valuation as of year end.

A72. SFFAS 17, *Accounting for Social Insurance*, does address the valuation date, specifying that it should be as of any time within a year of the reporting date.

A73. Although it does not explicitly discuss the valuation date, SFFAS 5 implicitly calls for measurement at the reporting date for pension, ORB, and OPEB liabilities, which are reported as of the balance sheet date.

A74. FASB's Statements 87 and 106 allowed preparers to use a valuation date for measuring pension and other postretirement liabilities up to three months earlier than the reporting date. However, FAS 158 published under Phase I of FASB's pension project requires the measurement of plan assets and benefit obligations to be as of the date of the sponsoring employer's statement of financial position. The FASB concluded that this will more accurately reflect the economic status of defined benefit plans and further improve the understandability of the financial statements.[18]

[17] RMWG ED, page 31.
[18] FAS 158, par. B16.

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A75. In Statement 27 and Statement 45, the GASB did not require the valuation date to be the employer's balance sheet date. Statement 27 requires the expense/expenditure amount to be based on the results of an actuarial valuation performed in accordance with the parameters as of a date not more than 24 months before the beginning of the employer's fiscal year. Statement 45 requires that the actuarial valuation date generally should be the same date each year (or other applicable interval). However, in both instances a new valuation would be required if, since the previous valuation, significant changes occurred that affect the results of the valuation, including significant changes in benefit provisions, the size or composition of the population covered by the plan, or other factors that impact long-term assumptions.

A76. The Board believes that the approach in Interpretation 3 is preferable. Pension, ORB, and OPEB liabilities should be measured as of the end of the reporting period based on a full actuarial valuation within a year of the end of the reporting period. Thus, "full actuarial valuations," as that term is used by actuaries, can be performed as of an earlier date during the fiscal year than year end, including a beginning-of-year date, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise and cost of living adjustment. Such adjustments are sometimes referred to as a measurement based on a "projection" or "roll-forward."

Respondents Comments regarding the Valuation Date

A77. Most of the respondents who commented on the proposed valuation date standard commented that it was appropriate. One respondent asserted that its valuation dates are based on statutory requirements.

The Board's Conclusions regarding Valuation Date

A78. The Board continues to believe that pension, ORB, and OPEB liabilities should be measured as of the end of the reporting period based on a full actuarial valuation within a year of the end of the reporting period.

Reasonable Estimates

What the Exposure Draft Proposed regarding Reasonable Estimates

A79. The proposed Statement also addressed an issue with respect to the meaning of "best estimate." The proposed Statement provided that estimates should be reasonable under the circumstances (see paragraph 31). The notion of "best estimate" has been used in several FASAB standards, for example, in SFFAS 5, paragraph 65, SFFAS 7, *Accounting for Revenue and Other Financing Sources …*, paragraph 67.1, and in various instances in SFFAS 17. However, preparers and auditors have reported disagreements regarding the meaning of the word "best," which is sometimes defined as "excelling all others." Thus, the Board proposed to replace the term "best estimate" in FASAB standards with "reasonable estimate."

A80. Actuarial Standards of Practice (ASOP) provide guidance regarding the meaning of "best estimate" in ASOP 10, *Methods and Assumptions for Use in Life Insurance Financial*

Statements Prepared in Accordance with GAAP, and ASOP 27, *Selection of Economic Assumptions for Measuring Pension Obligations.* ASOP 27 instructs actuaries to select a specific economic assumption from within his or her "best estimate range" with respect to that assumption, which it defines as "the narrowest range within which the actuary reasonably anticipates that the actual results … are more likely than not to fall"[19] [emphasis added]. ASOP 27 provides, generally, that

> "[b]ecause no one knows what the future holds with respect to economic and other contingencies, the best an actuary can do is to use professional judgment to estimate possible future economic outcomes based on past experience and future expectations, and to select assumptions based upon that application of professional judgment. Therefore, an actuary's best-estimate assumption is generally represented by a *range* rather than one specific assumption. The actuary should determine the best-estimate range for each economic assumption, and select a specific point from within that range. In some instances, the actuary may present alternative results by selecting different points within the best-estimate range" [emphasis added].[20]

A81. The Board concluded that ASOP 10 and 27 apply a standard of reasonableness regarding "best estimate," and that that is an appropriate approach. Therefore, paragraph 31 of the exposure draft called for the preparer's estimate to reflect what is reasonable to assume under the circumstances, rather that the preparer's "best estimate."

Respondents Comments regarding Reasonable Estimates

A82. One respondent objected to the proposed requirement that the preparer compare assumptions used for the liability estimate with assumptions generally used in the federal government as evidenced by independent sources, unless their actuarial board is considered an "independent source." Another respondent was concerned that the proposed standard may prove inconsistent with the historical rates used in setting discount rates, because it permits the use of the entity's own assumptions as long as they can be justified if they deviate from independent sources. They suggest this possible inconsistency be discussed in the guidance. Another respondent commented that the requirement is not clear regarding whether it applies to pension and actuarial valuations or other estimated liabilities that employ long-term assumptions such as environmental liabilities and, if so, as to what independent source should be used.

The Board's Conclusions regarding Reasonable Estimates

A83. Paragraph 35 of the standard requires the preparer to compare its assumptions with assumptions used generally in the federal government as evidenced by sources independent of the reporting entity and, if its assumptions do not reflect such data, explain why it is inappropriate to do so. A respondent suggested that the Board consider specifying a set of federal assumptions for this purpose. Some assumptions will involve general economic parameters while others will be particular to the entity.

[19] ASOP 27, Section 2.1.
[20] ASOP 27, Section 3.1.

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A84. The Board's objective in this regard is for the entity to inform the reader about the reasonableness of the assumptions used in the preparation of its financial reports. With respect to sources for assumptions generally in use in the federal government, the standard offers the example of Bureau of Economic Analysis' assumptions but does not require the use of these or other particular sets of federal assumptions. The Board decided not to change the standard in this regard. The Board believes a comparison with a benchmark is likely to be meaningful to users. The preparer should use its judgment to select assumptions used generally in the federal government that are relevant to its activities and estimates. In addition, the narrowing of the scope of the standard to pensions, ORB, and OPEB will narrow the comparison as well.

Board Approval

A85. This Statement was approved for issuance by all members of the Board.

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Appendix B: Pro Forma Statement of Net Cost Displaying Separate Line Item for Gains and Losses Due to Changes in Assumptions

Component Entity: Pro forma *Statement of Net Cost for the Year Ended September 30, 2007*

	2007 (billions)
ABC Program	
ABC expenses	$ 223
Less: exchange revenue	24
Net expense before gain/loss from changes in assumptions	199
(Gain)/loss on assumption changes:	
Discount rate assumption	200
Other assumptions	(50)
Net (gain)/loss on assumption changes	150
Net cost	$349

Governmentwide Entity: Pro Forma *Statements of Net Cost for the Year Ended September 30, 2007*

	Gross Cost	*Earned Revenue (billions)*	*Net Cost*
ABC Agency……	$ 199	$ 24	$ 223
OPM……	***	**	***
DVA……	***	**	***
XYZ……	***	**	***
* * *			
Other agencies……..	146	92	54
Cost ***before gains/losses from changes in assumptions***…….	3,060	226	2,834
Less: ***loss (plus gain) from changes in assumptions***:			
ABC……	150	0	150
OPM……	100	0	100
DVA……	110	0	110
Total cost ……	$ 3,420	226	$ 3,194

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Appendix C: Pro Forma Note Disclosure of OPEB Liabilities and Expense

Post Employment Actuarial Liabilities
(in billions)

	Civilian	Military	Veterans	Balance Sheet Total
Beginning balance	1,496.3	1,563.0	924.8	4,062.1
Expense				
Normal cost	41.5	33.4	XXX	
Interest on the liability balance	92.4	96.9	XXX	
Assumption changes	0.2	58.5	XXX	
Plan amendments (prior service cost)	-	25.8	XXX	
Actuarial (gain)/loss	1.9	4.6	XXX	
Other	(0.2)		XXX	
Total expense	135.8	219.2	XXX	
Less benefits paid	(67.6)	(52.9)	XXX	
Subtotal of pension and health	1,564.5	1,729.3	XXX	
Ending balance, other benefits	48.5	26.9	-	
Total post employment actuarial liabilities	1,613.0	1,756.2	1,122.6	4,491.8

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Appendix D: Note 11 from FY 2006 Financial Report of the United States

Note 11. Federal Employee and Veteran Benefits Payable

The Government offers its employees life and health insurance, as well as retirement and other benefits. These benefits, which include actuarial and amounts due and payable to beneficiaries and health care carriers, apply to civilian and military employees.

The Federal Government administers more than 40 pension plans. OPM administers the largest civilian plan. DOD, meanwhile, administers the largest military plan. Other significant pension plans with more than $10 billion in accrued benefits payable include those of the Coast Guard and the Foreign Service. The changes in the accrued post-retirement pension and health benefit liability and components of related expense for the years ended September 30, 2006, and 2005, respectively, are presented below.

Federal Employee and Veteran Benefits Payable as of September 30

	Civilian		Military		Total	
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Pension and accrued benefits	1,349.0	1,273.8	967.1	895.4	2,316.1	2,169.2
Post-retirement health and accrued benefits	295.2	290.7	837.2	833.9	1,132.4	1,124.6
Veterans compensation and burial benefits	N/A	N/A	1,153.8	1,122.6	1,153.8	1,122.6
Life insurance and accrued benefits	34.2	32.9	-	-	34.2	32.9
FECA benefits	14.4	14.3	22.2	22.7	36.6	37.0
Liability for other benefits	1.5	1.3	4.4	4.2	5.9	5.5
Total Federal employee and veteran benefits payable	1,694.3	1,613.0	2,984.7	2,878.8	4,679.0	4,491.8

Change in Pension and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued pension liability as of September 30, 2005	1,273.8	895.4	2,169.2
Pension Expense:			
Normal costs	26.8	15.6	42.4
Plan amendment changes	-	0.1	0.1
Assumption changes	1.0	35.4	36.4
Interest on liability	78.0	55.0	133.0
Prior (and past) service cost	-	-	-
Actuarial (gains)/losses	29.7	6.1	35.8
Total pension expense	135.5	112.2	247.7
Less benefits paid	60.3	40.5	100.8
Actuarial accrued pension liability as of September 30, 2006	1,349.0	967.1	2,316.1

Significant Long-Term Economic Assumptions Used in Determining Pension Liability and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.00%	6.25%
Rate of inflation	3.50%	3.25%	3.00%	3.00%
Projected salary increases	4.25%	4.00%	3.75%	3.75%

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2005	290.7	833.9	1,124.6
Post-Retirement Health Benefits Expense:			
Normal costs	11.2	21.0	32.2
Interest on liability	17.1	52.9	70.0
Other actuarial (gains)/losses	(12.5)	(53.8)	(66.3)
Total post-retirement health benefits expense	15.8	20.1	35.9
Less claims paid	11.3	16.8	28.1
Actuarial accrued post-retirement health benefits liability, as of September 30, 2006	295.2	837.2	1,132.4

Significant Long-Term Economic Assumptions Used in Determining Post-Retirement Health Benefits and the Related Expense

	Civilian		Military	
(In percentages)	2006	2005	2006	2005
Rate of interest	6.25%	6.25%	6.25%	6.25%
Rate of health care cost inflation	7.00%	7.00%	6.25%	6.25%

Separate boards of actuaries for OPM and DOD determine the actuarial assumptions used in calculating the pension liability and the post-retirement health benefit liability for the civilian and military personnel. Both boards use generally accepted actuarial methodologies. The board for OPM uses a fixed rate of inflation and projected salary increases over all years for both the pension and post-retirement health benefit liabilities. These rates are shown in the tables above. The board for DOD uses a range of rates for the inflation and the projected salary increases, with an ultimate rate for the long term. The board for DOD also uses different health care cost inflation rates for inpatient, outpatient, and prescription drugs. The long-term ultimate rate is shown in the tables above.

The long-term ultimate rate for fiscal year 2006 of 6.25 percent is shown in the tables above. For disclosure and comparison purposes, DOD's estimate of a single equivalent fixed rate of health care cost inflation for fiscal year 2006 is 7.20 percent, which is an approximation of the single equivalent rate that would produce that same actuarial liability as the actual rates used.

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Appendix E: Glossary

Actuarial Gains and Losses

A change in the value of an estimated liability (or the benefit plan's assets) resulting from experience different from that assumed or from a change in an actuarial assumption. Past experience is reflected in current costs through actuarial gains and losses.

Annual Cost Increment

The annual cost increment component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. See **Normal Cost** below for pensions, ORB, and OPEB.

Component Entity

The term "component entity" is used to distinguish between the U.S. Federal Government and its components. The U.S. Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, *Entity and Display*, pars. 11-12). Use of "component entity" in this standard is only intended to distinguish between the U.S. Federal Government's consolidated financial statements and financial statements of its components.

Long-term Assumptions

Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events the entire series should be considered the event and, thus, the payment may commence within one year but would be required to extend at least five years. Otherwise, the asset or liability would be classified as short-term.

Marketable Treasury Securities

Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

Normal (or Service) Cost

The normal cost component of expense is the actuarial present value of the future cash outflows for which a reporting entity becomes obligated during the reporting period. For pensions, ORB, and OPEB, it represents that portion of the actuarial present value of benefits and expenses attributed to the valuation year by the benefit plan formula to work in covered employment or

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other service rendered by the participant in the period. The normal cost is a component of the annual expense and liability of the program and is not affected by the funded status of the plan.

Postemployment Benefits, Other (OPEB)

Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or **Retirement Benefit, Other** plans.

Prior Service Costs

The cost of retroactive benefits granted in a plan amendment or accomplished through administrative change, legislation, or other means. In some cases there will not be a formal "plan" per se to amend, for example, certain postemployment benefits, and a program is amended through other means than a formal "amendment."

Retirement Benefits, Other (ORB)

Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

Risk-free Interest Rate

The rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows. See Time Value of Money below.

Time Value of Money

The time value of money is represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows (risk-free interest rate). For present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate **risk-free interest rate**. U.S. Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

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Appendix F: List of Abbreviations

ANPV	Actuarial net present value
CFS	Consolidated financial statements
CPI	Consumer Price Index
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
OMB	Office of Management and Budget
OPEB	Other postemployment benefits
ORB	Other retirement benefits
PV	Preliminary Views
RSI	Required supplementary information
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards

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Federal Accounting Standards Advisory Board

The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board

Statement of Federal Financial Accounting Standards 34

July 28, 2009

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Summary

The Federal Accounting Standards Advisory Board (FASAB) is the body designated by the American Institute of Certified Public Accountants (AICPA) as the source of generally accepted accounting principles (GAAP) for federal reporting entities.[1] As such, the FASAB is responsible for identifying the **GAAP hierarchy** for federal reporting entities. The GAAP hierarchy consists of the sources of accounting principles and the framework for selecting the principles used in the preparation of general purpose financial reports[2] of federal reporting entities that are presented in conformity with generally accepted accounting principles. However, the hierarchy for selecting the principles used in the preparation of general purpose financial reports by federal reporting entities was set forth in the AICPA Statement on Auditing Standards (SAS) No. 91, *Federal GAAP Hierarchy*, rather than in the authoritative literature of the FASAB. This Statement incorporates the hierarchy into the FASAB's authoritative literature.

Incorporating the GAAP hierarchy into the authoritative literature of the FASAB is not intended to cause a sudden and dramatic change in practice for federal entities. This Statement permits those federal entities currently applying financial accounting and reporting standards issued by the Financial Accounting Standards Board (FASB) to continue to do so. In addition, given that the FASAB is the source of GAAP for federal entities, the Statement clarifies that a federal entity that is preparing GAAP-based general purpose financial reports for the first time is required to implement FASAB standards unless, in consultation with its auditors and bodies with oversight authority, the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards.

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[1] Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, discusses the criteria for defining federal reporting entities. Also, the terms federal reporting entity and federal entity are used interchangeably throughout this Statement.

[2] The term general purpose financial report is used throughout this Statement as a generic term to refer to the report that contains the entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report is known as the Performance and Accountability Report or the Agency Financial Report.

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Table of Contents

Summary **3**

Introduction **5**

Purpose 5

Materiality 5

Effective Date 6

Accounting Standards **7**

Scope 7

The Hierarchy of Generally Accepted Accounting Principles 7

Other Accounting Literature 8

Application of Standards Issued by the Financial Accounting Standards Board 9

Effective Date 10

Appendix A: Basis for Conclusions **11**

Project History 11

Application of Standards Issued by the Financial Accounting Standards Board 11

Application to Legislative and Judicial Branches 12

Exposure Draft 13

Clarifying the GAAP Hierarchy and Other Accounting Literature 14

Entities Following FASB GAAP 15

Board Approval 16

Appendix B: Abbreviations **17**

Appendix C: Glossary **18**

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_34.pdf.

Introduction

Purpose

1. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of general purpose financial reports of federal reporting entities[3] that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy).

    a. This Statement responds to a request from the American Institute of Certified Public Accountants (AICPA) that FASAB incorporate the GAAP hierarchy, which currently resides in the professional auditing literature, into the accounting literature.

    b. This Statement also addresses (1) whether federal entities currently applying standards issued by the Financial Accounting Standards Board (FASB) may continue that practice, and (2) whether federal entities that are preparing GAAP-based general purpose financial reports for the first time may also apply FASB standards.

Materiality

2. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[3] Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, provides criteria for identifying federal reporting entities. In addition, the Board is currently developing standards defining the federal reporting entity.

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Effective Date

3. The requirements in this standard are effective upon its issuance.

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Accounting Standards

Scope

4. This Statement applies to the general purpose financial reports of all federal reporting entities that are presented in conformity with generally accepted accounting principles (GAAP).[4]

The Hierarchy of Generally Accepted Accounting Principles

5. The hierarchy of generally accepted accounting principles, hereafter referred to as the GAAP hierarchy, governs what constitutes GAAP for federal reporting entities. It lists the priority sequence of pronouncements that a federal reporting entity should look to for accounting and financial reporting authoritative guidance. The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows:

   a. Officially established accounting principles consist of FASAB Statements of Federal Financial Accounting Standards (Standards) and Interpretations. FASAB Standards and Interpretations will be periodically incorporated in a publication by the FASAB.

   b. FASAB Technical Bulletins and, if specifically made applicable to federal reporting entities by the AICPA and cleared[5] by the FASAB, AICPA Industry Audit and Accounting Guides.[6]

   c. Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

[4] The AICPA has designated the FASAB as the source of GAAP for federal reporting entities. Therefore, FASAB GAAP would be the appropriate accounting standards for federal reporting entities in the executive, legislative, and judicial branches.
[5] For purposes of interpreting category (b), the word *cleared* means that the FASAB does not object to the pronouncement's issuance.
[6] Such pronouncements specifically made applicable to federal reporting entities are presumed to have been cleared by the FASAB, unless the pronouncement indicates otherwise.

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d. Implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

6. If the accounting treatment for a transaction or event is not specified by a pronouncement in category (a), a federal reporting entity should consider whether the accounting treatment is specified by an accounting principle from a source in another category. In such cases, if categories (b)–(d) contain accounting principles that specify accounting treatments for a transaction or event, the federal reporting entity should follow the accounting treatment specified by the accounting principle from the source in the highest category—for example, follow category (b) treatment over category (c) treatment.

7. If the accounting treatment for a transaction or event is not specified by a pronouncement or established in practice as described in categories (a)–(d), a federal reporting entity should then consider accounting principles for similar transactions or events within categories (a)–(d) before considering Other Accounting Literature discussed in paragraph 8. For example, it might be appropriate to report the event or transaction by applying, in a similar manner, an accounting principle established within categories (a)-(d) for an analogous transaction or event on the basis of its substance.[7] A federal reporting entity should not follow the accounting treatment specified in accounting principles for similar transactions or events in cases in which those accounting principles either (a) specifically prohibit the application of the accounting treatment to the particular transaction or event or (b) indicate that the accounting treatment should not be applied to other transactions or events by analogy.

Other Accounting Literature

8. Other Accounting Literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in category (b) of paragraph 5 when not specifically made applicable to federal reporting entities by the FASAB; pronouncements of other accounting and financial reporting standards-setting bodies, such as the FASB, Governmental Accounting Standards Board, International Accounting Standards Board, and

[7] Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. Consideration should be given to whether the substance of transactions or events differs materially from their form.

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International Public Sector Accounting Standards Board; professional associations or regulatory agencies; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category.

Application of Standards Issued by the Financial Accounting Standards Board

9. Some federal entities, including government corporations listed in the Government Corporation Control Act and certain others, such as the United States Postal Service, continue to publish financial reports pursuant to the accounting and reporting standards issued by the FASB. Some entities also may be required to prepare statements pursuant to standards set by a regulatory agency (e.g., the Federal Energy Regulatory Commission (FERC)). General purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports.[8]

10. Except as provided in paragraph 11, a federal entity that is preparing GAAP-based general purpose financial reports for the first time should implement FASAB standards as FASAB is the preferred method of reporting for federal entities.

11. In rare instances, a federal entity that is preparing GAAP-based general purpose financial reports for the first time may, in consultation with its auditors and bodies with oversight authority, elect to apply standards issued by the FASB if the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards. Unique user needs can arise from various sources that include, but are not limited to, investors, SEC requirements, bondholders, and customers. Entities may determine that the application of standards issued by the FASB more

[8] The FASAB has an existing project underway that will assist the Board in determining whether certain federal entities should be permitted to continue applying FASB GAAP and, if so, whether additional reporting should be required. This project will also consider whether federal entities should be permitted to convert from FASB standards to International Financial Reporting Standards published by the International Accounting Standards Board.

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appropriately meets these unique user needs. This determination should involve a number of considerations. Examples of factors to consider include but are not limited to:

a. The entity's primary funding is derived from a source other than through annual federal appropriations.

b. The entity has been delegated the financial and operational authority to carry on its activities in a manner similar to private business enterprises.

c. The entity sells goods and/or services to individuals outside of the government reporting entity as its principal activity.

d. The entity is intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the federal government reporting entity.

e. It is desirable to compare general purpose financial reports of the federal entity that is preparing GAAP-based general purpose financial reports for the first time with an existing entity that is already following FASB GAAP.

12. While the application of standards issued by the FASB may be acceptable for a limited number of federal entities as noted above, entities that have already implemented standards issued by the FASAB should continue to apply the federal standards, as FASAB is the preferred method of reporting for federal entities.

Effective Date

13. The requirements in this standard are effective upon its issuance.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting and reporting for specific transactions, events, or conditions.

Project History

A1. Representatives of the American Institute of Certified Public Accountants (AICPA) requested that the U.S. accounting standards-setters consider adopting certain guidance for accounting and financial reporting issues that now reside in the professional auditing literature. In July 2008, the FASAB joined the Governmental Accounting Standards Board in responding to this request.

A2. In October 1999, The AICPA designated the FASAB as the standards-setting body for federal entities. As such, the FASAB is responsible for identifying the sources of accounting principles and providing federal entities with a framework for selecting the principles used in the preparation of general purpose financial reports that are presented in conformity with GAAP (GAAP hierarchy). The Board believes that incorporation of the GAAP hierarchy into the FASAB's authoritative literature would more clearly convey that financial statement preparers are responsible for selecting the sources of the principles to be used in the preparation of general purpose financial reports that are presented in conformity with GAAP. The structure presented in this Statement generally carries forward the hierarchy as set forth in SAS 91 and the Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements.

Application of Standards Issued by the Financial Accounting Standards Board

A3. Although the FASAB's standards have been recognized as GAAP for federal entities (FASAB GAAP) since October 1999, some federal entities follow GAAP for nongovernmental entities promulgated by the private sector Financial Accounting Standards Board (FASB GAAP). For example, federal government corporations, the U.S. Postal Service, certain component entities of the U.S. Department of the Treasury, and

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some smaller entities in the executive and legislative branches have historically applied FASB GAAP and continue to do so.

A4. In early 2000, the FASAB recognized this practice as acceptable for those entities that had been following FASB GAAP to avoid an immediate and unanticipated requirement that these federal entities follow federal GAAP after the FASAB was recognized as the Rule 203 standards-setting body for the federal government. This guidance was published in the January – March 2000 issue of *FASAB News*[9] and was intended as a temporary measure in light of the unanticipated consequences of Rule 203 recognition. The existence of the issue has also been acknowledged in Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display* (paragraph 78); Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* (inside front cover and Appendix A, paragraph 142); SFFAS 8, *Supplementary Stewardship Reporting* (Introduction paragraph 40); and, SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government* (Appendix A, paragraph 20).

A5. Providing interim guidance on the application of standards issued by the FASB serves to proactively address entity concerns that moving the hierarchy of generally accepted accounting principles into the accounting literature without addressing the use of FASB GAAP would require a sudden and dramatic change in practice.

Application to Legislative and Judicial Branches

A6. The FASAB's sponsors do not prescribe accounting standards for the legislative and judicial branches. The legislative and judicial branches, and most entities within those branches, are not currently required to prepare general purpose financial reports and those that do prepare statements are not subject to any requirements by the FASAB's sponsors to follow FASAB GAAP or prepare a reconciliation between FASAB GAAP and FASB GAAP. However, as the source of GAAP for federal reporting entities, FASAB GAAP would be the appropriate accounting standards for these entities to adopt if they prepare GAAP-based general purpose financial reports.

[9] FASAB News, Jan.-March 2000, p. 2.

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Exposure Draft

A7. The Board published the exposure draft (ED), *The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board*, on December 2, 2008, with comments requested by February 3, 2009. Upon release of the ED, notices and press releases were provided to: The Federal Register, *FASAB News, The Journal of Accountancy, AGA Today*, the *CPA Journal, Government Executive*, the *CPA Letter*, and *Government Accounting and Auditing Update*, The CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council, and committees of professional associations generally commenting on EDs in the past.

A8. This broad announcement was followed by direct mailings of the ED to the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate; and the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives.

A9. The Board received 31 response letters from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		3
Auditors	5	1
Preparers and financial managers	22	
Totals	27	4

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. Respondents generally agreed that the hierarchy of GAAP that currently resides in the professional auditing literature should be incorporated into

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the FASAB's authoritative literature. Also, respondents generally agreed that: 1) general purpose financial reports prepared in conformity with accounting standards issued by the FASB should be regarded as being in conformity with GAAP for those federal entities that have in the past issued such reports, and 2) a federal reporting entity that is preparing GAAP-based general purpose financial reports for the first time should implement FASAB standards unless the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards.

A12. However, some respondents believed it would be useful to clarify certain aspects of the Statement. Some respondents believed it would be useful to clarify where administrative directives (e.g. OMB, Government Accountability Office, and Department of the Treasury guidance) would be considered in the hierarchy. Some respondents questioned if "Other Accounting Literature" was a part of or separate from the hierarchy.

A13. In addition, some respondents believed that those federal entities following FASB standards could be required to reconsider their practices. For example, if they receive federal appropriations, they should follow FASAB standards.

Clarifying the GAAP Hierarchy and Other Accounting Literature

A14. Paragraph 5 of the Statement presents the GAAP hierarchy for federal entities, and the Board expects practice to be governed by this hierarchy. The hierarchy presented in the ED referred to AICPA Statements of Position (SOP) and Practice Bulletins specifically made applicable to federal reporting entities and cleared by the FASAB. However, the FASB is codifying its accounting standards and SOPs and Practice Bulletins will generally be incorporated into the codification and have no continued authority. Because of this matter and because no SOPs and Practice Bulletins have been specifically made applicable to federal reporting entities and cleared by the FASAB, these sources were removed from the hierarchy.

A15. In addition, while some respondents believed that it would be useful to discuss the location of administrative directives within the hierarchy, the FASAB believes that incorporating the GAAP hierarchy in the accounting standards should be accomplished expeditiously due to the AICPA's planned removal of the hierarchy from the auditing standards. Since FASAB is unaware of any practice problems arising due to the absence of explicit guidance placing each type of administrative directive within the

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hierarchy, immediate action on this request is not warranted.[10] FASAB also notes that there are multiple sources of administrative directives, many types of directives, and varying processes for developing directives. Resolving placement for all administrative directives may require significant study. Therefore, the Board is acting to adopt the GAAP hierarchy essentially as it currently exists in the AICPA audit literature and does not intend to change current practices.

A16. Paragraphs 6 and 7 of the Statement provide guidance to assist readers in understanding how the hierarchy should be considered when preparing general purpose financial reports in conformity with GAAP.

A17. Paragraph 7 also discusses when to consider literature not discussed in the GAAP hierarchy - Other Accounting Literature. The phrase "Other Accounting Literature" is capitalized in the Statement and included under a separate heading to indicate its distinction from the GAAP literature. Other Accounting Literature is presented separately from the hierarchy because the items in this category do not establish GAAP and cannot amend existing FASAB standards, interpretations, technical bulletins or releases, or staff implementation guidance. Other Accounting Literature may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of literature in paragraph 5 of the Statement.

A18. The Board also recognizes that other standards-setting bodies are currently considering codifying their pronouncements. As a result, listing the titles of specific pronouncements in Other Accounting Literature may cause difficulty in referencing those documents in the future. Thus, paragraph 8 of the Statement refers to pronouncements of other standards-setting bodies rather than listing specific pronouncements.

Entities Following FASB GAAP

A19. As noted above, the Board primarily intended to incorporate the GAAP hierarchy into the FASAB's accounting literature and did not intend to change existing practices at this time. The Board is continuing a separate project on reporting by federal entities that primarily apply standards issued by the FASB. The project intends to determine whether certain federal

[10] This request will be considered when the Board reviews its technical agenda to select new projects.

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entities should be permitted to continue following FASB GAAP and what additional reporting, if any, is needed for stand-alone financial reports of federal entities that are permitted to continue applying FASB accounting standards.

A20. Paragraph 9 of the Statement states that those federal entities preparing general purpose financial reports in conformity with FASB accounting and reporting standards are permitted to continue current practices. The Statement does not preclude those entities from reconsidering those practices.

Board Approval

A21. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IASB	International Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
OMB	Office of Management and Budget
SAS	Statement on Auditing Standards
SFFAC	Statement of Federal Financial Accounting Concepts

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Appendix C: Glossary

GAAP Hierarchy: the sources of accounting principles used in the preparation of general purpose financial reports of federal reporting entities that are presented in conformity with generally accepted accounting principles and the framework for selecting the principles.

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FASAB Board Members

Tom L. Allen, Chair

Congressional Budget Office

Robert F. Dacey

John A. Farrell

Norwood J. Jackson, Jr.

James M. Patton

Nancy Fleetwood

Alan H. Schumacher

Harold I. Steinberg

Danny Werfel

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Ross Simms
Julia Ranagan

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Estimating the Historical Cost of General Property, Plant, and Equipment

Amending Statements of Federal Financial Accounting Standards 6 and 23

Statement of Federal Financial Accounting Standards 35

October 14, 2009

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Summary

This standard amends Statement of Federal Financial Accounting Standard (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, which was issued in November 1995. SFFAS 6 provides implementation guidance and permits estimation of the amount to be capitalized but is not specific regarding allowable methods of estimation.

This standard also amends SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, which was issued in May 2003. SFFAS 23 provides guidance for estimating historical cost and accumulated depreciation consistent with SFFAS 6, as amended, but offers more detail regarding permissible documentation and methods.

This standard clarifies that reasonable estimates of original transaction data historical cost may be used to value general property, plant, and equipment (G-PP&E). The use of reasonable estimates is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities have decided to use estimates to determine the historical cost values of G-PP&E.

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Table of Contents

Summary 3

Table of Contents 4

Introduction 5

Purpose 5

Materiality 6

Effective Date 6

Accounting Standard 7

Scope 7

Estimation of G-PP&E Historical Cost 7

Adjustment to Cumulative Results of Operations 9

Appendix A: Basis for Conclusions 11

Project History 11

Initial Proposal for Implementation Guidance 12

Member Views 12

Exposure Draft 15

Board Approval 16

Appendix B: Abbreviations 17

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_35.pdf.

Introduction

Purpose

1. Statement of Federal Financial Accounting Standard (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, was effective for periods beginning after September 30, 1997. SFFAS 6 provides implementation guidance and permits estimation of the amount to be capitalized but is not specific regarding allowable methods of estimation. SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, provides guidance for estimating historical cost and accumulated depreciation consistent with SFFAS 6, as amended, but offers more detail regarding permissible documentation and methods. SFFAS 23 was issued May 8, 2003, and became effective in fiscal year 2003.

2. This standard amends SFFAS 6 and 23 to clarify that reasonable estimates of original transaction data historical cost may be used to value G-PP&E. The objective of this amendment is to establish a cost effective method to comply with SFFAS 6. The use of reasonable estimates is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities have decided to use estimates to determine the historical cost values of general property, plant, and equipment (G-PP&E).

3. Note that this amendment will not extend the effective date[1] of SFFAS 6 as amended, but will clarify that methods deemed acceptable by SFFAS 23 continue to be acceptable. This amendment to SFFAS 6 clarifies that it is acceptable to use estimates to approximate the historical cost values of G-PP&E.

4. The Board encourages those federal entities that use estimates to approximate the historical cost values of G-PP&E to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the G-PP&E historical cost valuation requirements.

[1] Thus, entities must comply with the provisions of SFFAS 6 as amended in order to obtain an unqualified audit opinion. This ensures comparability among federal reporting entities receiving unqualified audit opinions.

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Materiality

5. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

6. The Statement will be effective upon issuance to ensure that any cost savings available are realized as soon as possible.

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Accounting Standard

Scope

7. This Statement amends SFFAS 6 and 23 to provide for reasonably estimating the historical cost and accumulated depreciation of G-PP&E.

8. This Statement is also applicable to internal use software when the software meets the criteria for G-PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software,* and provides for reasonably estimating the historical cost and accumulated amortization of that G-PP&E.

Estimation of G-PP&E Historical Cost

9. This standard amends SFFAS 6 and 23 to clarify that reasonable estimates of original transaction data historical cost may be used to value G-PP&E. Reasonable estimates may be used upon initial capitalization as entities implement G-PP&E accounting for the first time, as well as by those entities who previously implemented G-PP&E accounting.

10. This standard clarifies that federal entities should report their G-PP&E based on historical cost information in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended. However, reasonable estimates of historical cost may be used to value G-PP&E assets.

11. This standard also allows the use of reasonable estimates when an entity determines it is necessary to revalue G-PP&E assets previously reported.

12. The text of SFFAS 6, par. 40 and 45, and SFFAS 23, par. 10 through 18, is amended as shown below (original paragraph numbers are retained).

(SFFAS 6)

[40.] Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of ~~existing~~ G-PP&E, in accordance with the asset recognition and measurement provisions herein. ~~For existing general PP&E, if historical cost information necessary to comply with the above recognition and measurement provisions has not been maintained, estimates of historical~~

~~cost are required.~~ Estimates may ~~shall~~ be based on:

- cost of similar assets at the time of acquisition, ~~or~~

- current cost of similar assets discounted for inflation since the time of acquisition (i.e., deflating current costs to costs at the time of acquisition by general price index), or

- other reasonable methods, including those estimation methods specified in SFFAS 23 paragraph 12.

Disclosure Requirements

[45.] The following are minimum ~~general~~ G-PP&E disclosure requirements:

- the cost, associated accumulated depreciation, and book value by major class;
- the use and general basis of any estimates used;
- the estimated useful lives for each major class;
- the method(s) of depreciation for each major class;
- capitalization threshold(s) including any changes in threshold(s) during the period; and
- restrictions on the use or convertability of ~~general~~ G-PP&E.

(SFFAS 23)

[10.] The ~~initial~~ capitalization amount for G-PP&E assets previously considered ND PP&E should be based on historical cost in accordance with the ~~asset recognition~~ provisions of SFFAS 6, as amended, and should be the initial historical cost for the base unit[4A] ~~items~~, including any major improvements or modifications.

[11.] ~~This standard recognizes that determining initial historical cost for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate not be reasonable or practical.~~

[12.] When establishing the historical cost of ~~existing~~ G-PP&E, in accordance with the asset recognition and measurement provisions of SFFAS 6, as

[4A] "Base unit" refers to the level of detail considered in categorizing PP&E. Generally, the base unit is the smallest or least expensive item of property to be categorized. The term "base unit" may be used by others to have a different meaning--the meaning intended in this standard is limited to that specified above [from SFFAS 6 fn 25].

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amended, reasonable estimates may be used. ~~If obtaining initial historical cost is not practical, estimated historical cost may be used.~~ Estimates may be based on ~~Other~~ information such as, but not limited to, budget, appropriations, ~~or~~ engineering documents, contracts, or ~~and~~ other reports reflecting amounts to be expended ~~may be used as the basis for reasonably estimating historical cost~~.

[13.] Alternatively, estimates of historical cost may be derived by estimating the current replacement costs of similar items and deflating those costs, through the use of price-level indexes, to the in-service ~~acquisition~~ year or estimated in-service ~~acquisition~~ year if the actual in-service year is unknown. Other reasonable approaches for estimating historical cost may also be utilized. For example, latest acquisition cost may be substituted for current replacement cost in some situations.

[13A.] In estimating the year that the base unit was placed in service, if only a range of years can be identified then the mid-point of the range is an acceptable estimate of the in-service date.

[14.] A contra asset account--accumulated depreciation--for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS 6, as amended.

[15.] For military equipment that is eligible for capitalization ~~in service upon implementation of~~ under this standard, cleanup cost liabilities should be adjusted, as needed.[5]

Adjustment to Cumulative Results of Operations

[16.] ~~Initial application~~ Changes to previously reported G-PP&E amounts resulting from the application of this standard ~~by an entity previously reporting G-PP&E~~ should be treated as ~~a~~ corrections of an error in accordance with SFFAS 21. ~~The cumulative effect of adopting this accounting standard should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position, for the period the change is made.~~

~~[17.] Prior year financial statements presented for comparative purposes should be presented as previously reported.~~

[18.] ~~The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial~~

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~~statements of subsequent periods need not repeat the disclosures.~~[6]

[Footnotes:]

[5] Under the provisions of SFFAS 6, paragraph 97, a portion of the estimated total cleanup costs shall be recognized as expense during each period that ~~general~~ G-PP&E is in operation and a liability accumulated over time as expense is recognized. This adjustment may be needed because the DoD may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS 6, as amended.

[6] ~~SFFAS 21, Reporting Corrections of Errors and Changes in Accounting Principles, paragraphs 12 and 13.Recognition and Measurement~~

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by members in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors. The guidance enunciated in the standards – not the material in this appendix – should govern the accounting for specific transactions, events or conditions.

Project History

A1. At the FASAB September 2007 meeting, the Board discussed technical agenda options. During the discussion, members expressed support for an effort to reduce the cost expected to be incurred at the Department of Defense (DoD) as it establishes the historical cost for G-PP&E during the coming years.

A2. The discussion documented a number of concerns relating to DoD accounting. In addition, concerns regarding group and composite depreciation have been raised since the meeting. Collectively, concerns regarding G-PP&E were summarized as follows:

a. Continued use of estimates in the absence of a system
b. Options for group/composite depreciation
c. Accounting for assets deployed to a war zone
d. Cost accounting (assignment of R&D, support and overhead to G-PP&E)
e. Evaluation of existing standards and the potential for adopting fair value as the measurement basis

A3. In considering these issues, the Board agreed that issues a. through d., can and should be addressed quickly due to the potential that more costly solutions will be used in the absence of guidance. The Board agreed that these issues could be addressed without significantly affecting the Board's ongoing projects.

A4. With respect to issue e., evaluation of existing standards, the Board agreed that this issue should be considered when the Board makes decisions on its technical agenda. As noted by one of the members, considerable time has been devoted to the question of G-PP&E accounting. A project on this topic is likely to be controversial and demand staff and Board time. Therefore, undertaking the project should be considered in the broad context of agenda setting. In August 2008, the Board agreed to add a

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project regarding evaluation of existing standards and plans to address the PP&E standards as one component of that project.

Initial Proposal for Implementation Guidance

A5. Regarding the permissibility of estimates (issue a), the Board agreed that it should consider amending the standards. It is not unreasonable to read SFFAS 6, as amended, to provide for the use of the SFFAS 23 initial capitalization methods only when assigning cost to G-PP&E acquired before the effective dates of SFFAS 6 or 23. The Board agreed to clarify this through a relatively narrow amendment of SFFAS 23. A draft exposure draft (omitting the Board's basis for conclusions) was presented at the December 2007 FASAB meeting. The draft (1) provided an additional five year window for the Department of Defense and a rolling five year window for agencies not previously producing financial reports to rely on SFFAS 23 methods and (2) provided new guidance regarding estimation of the in-service date. Subsequent Board discussions discouraged a proposal that would establish a date-certain timeframe for the use of reasonable estimates when determining the historical cost values of G-PP&E.

A6. Staff did not request immediate action by the Board on the draft ED. The Board generally supported the proposal so staff's next steps were to inquire with selected agencies and members of the audit community to confirm that the guidance is needed. In addition, staff reviewed fiscal year 2007 agency reports to determine if agencies other than the Department of Defense face similar challenges with respect to developing G-PP&E systems, using SFFAS 23 methods, and could be expected to incur significant costs to arrive at acceptable estimates absent explicit guidance.

A7. With respect to the three remaining issues noted in par. A3., (group/composite depreciation, deployed assets, and cost accounting), staff recommended and the Board agreed to request that the Accounting and Auditing Policy Committee (AAPC) consider these issues. Staff suggested that a task force develop implementation guidance within the boundaries of the current standards. The AAPC has accepted the project and a task force is actively engaged in developing guidance.

Member Views

A8. SFFAS 6 was issued in November 1995 and was effective in fiscal year 1998. In addition, SFFAS 23, *Eliminating the Category National Defense PP&*E, was issued in May 2003 and was effective in fiscal year 2003. In 2002, the Accountability of Tax Dollars Act established a requirement for many agencies that did not previously produce audited financial statements

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to do so. As a result, in fiscal year 2003 many agencies were required to comply with SFFAS 6 for the first time. Therefore, certain entities were not afforded an implementation period because they began preparing financial statements after the effective date of SFFAS 6.

A9. This Statement permits continued application of the SFFAS 23 initial capitalization guidance. The Statement's primary objective is a cost effective method for attaining compliance with SFFAS 6 as amended. This method is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities decide to use estimates to determine the historical cost values of G-PP&E.

A10. An entity may find that it is not practical to determine the historical cost of G-PP&E based on the original transaction data because it is either not cost effective to do so or documentation is inadequate. Cost effectiveness may be based on an analysis of various cost factors associated with determining those historical cost values. An entity may also determine it impractical when the original transaction data historical cost documentation has not been maintained or when the historical cost data has been maintained but not in a manner that facilitates the timely valuation of G-PP&E. An entity's inadequate systems and/or processes that do not facilitate the ready and timely collection of data for the valuation of G-PP&E may lead to an assessment that valuation based on original transaction data is not cost effective.

A11. The Board initially included "cost effectiveness" and "practical" as the basic criteria to be met before the use of reasonable estimates when valuing G-PP&E in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended, would be permitted. The Board later decided against including the above basic criteria. Such criteria are open to interpretation and likely to lead to subjective and inconsistent application.

A12. The Board stresses to federal entities that the measurement basis for G-PP&E remains historical cost; however, reasonable estimates are allowed. The Board believes entities should use judgment regarding the decision to use estimated historical cost in lieu of original transaction based data. The Board also notes that estimates are widely used throughout the financial statements. In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.

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A13. The Board is aware that these amendments will not resolve all the concerns surrounding accounting for G-PP&E. However, allowing estimates as entities are working towards implementing systems and processes that can capture historical data would be beneficial. The Board is also relying on other means, such as laws and regulations relating to systems and controls, to encourage entities to continue to develop adequate systems and processes.

A14. The Board also debated at length whether to establish a date-certain time frame or have an open-ended approach for the use of reasonable estimates when determining the historical cost values of G-PP&E. The debate included both pros and cons to a date-certain approach. One of the pros to the date-certain approach is that entities will have a specific goal (i.e., time frame) to work towards. The con to the date-certain approach is that there is a risk that the benefits of the standard could be voided if the entity does not or cannot meet the date-certain time frame. The debate also included pros and cons to an open-ended approach. The pros include flexibility and the opportunity to test various methodologies when determining the best estimation method. The cons include the prolonged use of estimates when not appropriate.

A15. The Board decided against a proposal that would establish a date-certain time frame for the use of reasonable estimates when determining the historical cost values of G-PP&E. The Board does not want to penalize an entity simply because it may take the entity longer to implement the necessary systems and processes to ensure the adequate capture of historical cost values. In addition, the Board believes that the use of reasonable estimates is proper given the appropriate disciplines surrounding the use of estimates.

A16. The Board encourages those federal entities that use estimates to approximate the historical cost values of G-PP&E to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the G-PP&E historical cost valuation requirements.

A17. The Board believes that acknowledging the continuing appropriateness of estimates based on non-traditional documentation as provided by SFFAS 23 is prudent under the current circumstances. Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

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Exposure Draft

A18. FASAB published the exposure draft (ED), *Estimating the Historical Cost of General Property, Plant, and Equipment -- Amending Statements of Federal Financial Accounting Standards 6 and 23* on November 14, 2008. Upon release of the ED, notices and/or press releases were provided to: The Federal Register, the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, *Government Accounting and Auditing Update,* the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations commenting on past exposure drafts.

A19. Thirty-one comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		7
Auditors	3	1
Preparers and financial managers	20	

A20. A majority of the respondents agreed with the Board that reasonable estimates may be used upon initial capitalization as entities implement G-PP&E accounting for the first time, as well as by those entities who previously implemented G-PP&E accounting.

A21. Based on comments received on the exposure draft, the Board agreed that internal use software, when the software meets the criteria for G-PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software,* should also be included in the scope of this standard. SFFAS 10 specifies that if internal use software meets the criteria for G-PP&E it should be classified as G-PP&E and the costs should be capitalized.

A22. Some ED respondents raised questions about the revaluing of G-PP&E that has previously been reported. The Board believes that there may be instances when the documentation for the original valuation is no longer available or it is not practical to revalue the reported cost of G-PP&E based on the original data because it is either not cost effective to do so or the documentation is inadequate. An entity may also determine it impractical when the original documentation has not been maintained or when the data has been maintained but not in a manner that facilitates the ready and timely valuation of G-PP&E. Therefore the Board agreed to allow the use of

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reasonable estimates when an entity determines it is necessary to revalue G-PP&E assets previously reported.

Board Approval

A23. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Abbreviations

FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office (formerly General Accounting Office)
G-PP&E	General Property, Plant, and Equipment
OMB	Office of Management and Budget
SFAC	Statements of Financial Accounting Concepts
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
U.S.	United States

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FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Monica R. Valentine

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

Statement of Federal Financial Accounting Standards 36

September 28, 2009

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Summary

This standard requires:

1. A basic financial statement in the consolidated financial report of the U.S. Government (CFR) presenting for all the activities of the federal government:
   a. the present value of projected receipts and non-interest spending under current policy without change,
   b. the relationship of these amounts to projected Gross Domestic Product (GDP), and
   c. changes in the present value of projected receipts and non-interest spending from the prior year.
2. Required Supplementary Information (RSI) that explains and illustrates
   a. the projected trends in:
      (1) the relationship between receipts and spending,
      (2) deficits or surpluses,
      (3) Treasury debt held by the public as a share of GDP,
   b. possible results using alternative scenarios, and
   c. the likely impact of delaying corrective action when a fiscal gap exists.
3. Disclosures that explain and illustrate:
   a. the assumptions underlying the projections,
   b. factors influencing trends, and
   c. significant changes in the projections from period to period.

These requirements will be implemented following a three-year transition period beginning in fiscal year (FY) 2010 during which all information may be presented as RSI. Beginning in FY 2013, the required information will be presented as a basic financial statement, disclosures and RSI as designated within the standards.

The required information will help readers of the CFR assess "whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due."[1] Such an assessment is an important objective of federal financial reporting requiring prospective information about receipts and spending, the resulting debt, and how these amounts relate to the economy.

[1] Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraphs 135 and 139.

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Table of Contents

Summary 3
Introduction 5
Purpose 5
Materiality 7
Effective Date 7
Accounting Standards 8
Scope 8
Definitions 8
Policy, Economic, and Demographic Assumptions 9
Valuation Date 12
Projection Periods 13
Basic Financial Statement 13
Disclosures 14
Required Supplementary Information 15
Supporting Data (Other Accompanying Information) 17
Effective Date 17
Appendix A: Basis for Conclusions 18
Project History *18*
Assumptions: Limitations of "Current Law" Assumptions *21*
Fiscal Sustainability Task Force Input Regarding Policy Assumptions *22*
Policy Assumptions *23*
Economic and Demographic Assumptions *25*
Basic Financial Statement *25*
Effective Date for Basic Information *26*
Summary Measures *27*
Per Capita Measures *29*
Time Horizon for Projections *30*
The Concepts of Fiscal Gap and Fiscal Imbalance *32*
Foreign Holdings of U.S. Treasury Debt *34*
Alternative Policy Proposals *35*
Inter-period or Inter-generational Equity *35*
Other comments *36*
Board Approval *37*
Appendix B: Example Formats and Illustrations 38
Basic Financial Statement 38
Examples of Selected Narrative and Graphics 39
1. Rising Cost of Health Care *39*
2. Demographic Trends *42*
3. Relationship of Projected Receipts and Spending *44*
4. Trends in Deficit Spending *45*
5. Trends in Treasury Debt Held by the Public *46*
6. Impact of Delaying Action *47*
7. Alternative Scenarios (Range Information) *48*
8. Fiscal Gap *48*
9. Disclosure on Funding Mechanisms *49*
10. Other Required Information *49*
Appendix C: Frequently Asked Questions (FAQs) 50
Appendix D: Abbreviations 53
Appendix E: Fiscal Sustainability Reporting Task Force 54
Appendix F: Glossary 55

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_36.pdf.

Introduction

Purpose

1. In Statement of Federal Financial Accounting Concepts (SFFAC) 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.[2] The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

2. Objective 3, Stewardship, is the primary focus for this Statement. Objective 3 states that:

   > Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.[3]

3. Sub-objective 3B states that:

   > Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services[4] and to meet obligations as they come due.[5]

4. While federal financial reporting is not expected by itself to accomplish the stewardship reporting objective, it can contribute to meeting the objective.[6] This Statement's contribution relates primarily to the federal government's operations and financial condition; it does not extend to an assessment of the nation's financial condition.

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[2] SFFAC 1, par. 109.
[3] SFFAC 1, par. 134.
[4] In this standard, "public services" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, transfer payments (such as Social Security benefits) or other financial benefits (such as loan guarantees), as well as national defense, transportation safety and national parks.
[5] SFFAC 1, par. 139.
[6] SFFAC 1, par. 235.

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5. The Board believes that comprehensive long-term fiscal **projections**[7] make an essential contribution to meeting the stewardship objective and especially sub-objective 3B because it is concerned with the future and the resources needed in the future.

6. Long-term fiscal projections serve as the basis for key measures presented in the basic financial statement as well as narrative and illustrations required in the consolidated financial report of the U.S. Government (CFR). The more detailed objectives presented below were developed as one means of guiding the Board in developing the basic financial statement and in identifying the most important areas to be addressed through narrative, tables and/or graphics.

Objectives of Basic Financial Statement (Comprehensive Long-Term Fiscal Projections for the U.S. Government) and Accompanying Disclosures and Required Supplementary Information

7. In this Statement, "**Fiscal Sustainability Reporting**" is the short term for the basic financial statement, disclosures, and **Required Supplementary Information** (RSI) required in the CFR. Fiscal Sustainability Reporting should provide information to assist readers of the CFR in assessing whether future budgetary resources of the U.S. Government will likely be sufficient to sustain public services and to meet obligations as they come due,[8] assuming that current policy for federal government public services and taxation is continued without change (hereafter referred to as "**current policy without change**").[9]

8. Such an assessment is important not only because of its financial implications but also because it has social and political implications. For example, users of financial reports should be provided with information that is helpful in assessing the likelihood that the government will continue to provide public services to constituent groups and to assess whether financial burdens without related benefits were passed on by current-year taxpayers to future-year taxpayers.[10] Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.

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[7] Terms defined in the Glossary are shown in **bold-face** the first time they appear.
[8] SFFAC 1, par. 139.
[9] Note that fiscal sustainability reporting does not extend to supporting a detailed assessment of whether current policy without change regarding federal public services and taxation is optimal; rather, it addresses the fiscal outlook if current policy is continued without change.
[10] The latter notion is sometimes referred to as "interperiod equity."

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9. Fiscal Sustainability Reporting should be understandable to the intended users of the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the media, public interest and advocacy groups, and others). The CFR should be easily understandable to the "average citizen" who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence.

Materiality

10. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

11. This Statement provides for a phased-in implementation, but earlier implementation is encouraged. All information will be reported as RSI for the first three years of implementation (fiscal years 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information will be presented as a basic financial statement, disclosures, and RSI as designated within the standard.

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Accounting Standards

Scope

12. The reporting requirements in this Statement apply to the consolidated financial report of the U.S. Government (CFR). They do not apply to financial statements prepared at the component entity level. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.

Definitions

13. Fiscal Gap

    The **fiscal gap** is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of **gross domestic product** (GDP).[11] More specifically, the fiscal gap is the net **present value** of projected spending[12] minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at or below the target percentage of GDP for the stated projection period. The fiscal gap may be expressed as:
    a. a summary amount in present value dollars,
    b. a share of the present value of the GDP for the projection period, and/or
    c. a share of the present value of projected receipts or projected non-interest spending.

14. Policy Assumptions

    Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address projected spending rules for both **mandatory** and **discretionary spending**[13] as well as the framework for assessing taxes and fees.

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[11] GDP is the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are: private sector consumption and investment, government consumption and investment, and net exports (exports-imports).
[12] Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest ("non-interest spending").
[13] In the federal budget process, "discretionary spending" refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not "mandatory." "Mandatory spending" includes entitlement

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15. Current Policy Without Change

    In this standard, "current policy without change" refers to the continuation of policies in place as of the valuation date (in other words, no policy change).

16. Economic Assumptions

    Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

17. Demographic Assumptions

    Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

18. Public Services

    In federal financial reporting, "**public services**" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, cash (such as Social Security benefits) or other financial benefits (such as loan guarantees), or services such as national defense, transportation safety, and the operation of national parks.

Policy, Economic, and Demographic Assumptions

19. Fiscal Sustainability Reporting for the U.S. Government should provide information that helps the reader to determine whether current policy without change is likely to produce future budgetary resources sufficient to sustain public services and to meet obligations as they come due. Long-term projections should help the reader to understand the fiscal implications of continuing current policy without change regarding public services and taxation along with other factors such as projected economic and demographic trends.

20. Projections of deficits, surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under

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authority such as Social Security and Medicare and payment of interest on the national debt. Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation acts. For additional information, see *A Glossary of Terms Used in the Federal Budget Process,* GAO-05-734SP. Available at: http://gaoweb.gao.gov (accessed May 7, 2009)

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various conditions–for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

21. Long-term projections are derived from models that rely heavily on assumptions. There is an expectation that such models will evolve over time. Therefore, this Statement provides guiding principles for selecting assumptions. The guiding principles address three types of assumptions: policy, economic, and demographic.

22. Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government.

23. Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

24. Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

25. When combined, policy, economic, and demographic assumptions determine the future projected receipts and spending.

26. To illustrate the distinction between policy, economic and demographic assumptions: consider the application of policy, economic and demographic assumptions to the Social Security program. Assumptions relating to future Social Security eligibility and benefit formulas represent policy assumptions. Assumptions about productivity growth and inflation represent economic assumptions. Assumptions about the future population represent demographic assumptions.

27. Policy assumptions should reflect reasonable assumptions about the future course of receipts and spending assuming the continuation of current policy without change. The guiding principle for selecting policy assumptions is to base selections on assumptions consistent with the continuation of policies in place as of the valuation date.

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28. Current law is the best place to start when identifying "current policy without change." However, a simple projection of "current law" would not always reflect current policy without change.

    a. Cases where a departure from current law may be appropriate include but are not limited to those in which current law

        (1) expires almost immediately,

        (2) contains provisions that are internally inconsistent, or

        (3) has been changed in a consistent direction over time (i.e., there is a recurring history of change).

    b. The following examples demonstrate how a simple projection of current law may be inconsistent with the guiding principle:

        (1) Legislation providing for discretionary spending provides funding that extends at most a few years into the future. A current-law policy assumption would show discretionary spending falling to zero within a few years. In this situation a simple projection of "current law" would not reflect the implicit "current policy without change."

        (2) Current law may contain inconsistent provisions in certain situations. For example, current law may contain provisions for scheduled social insurance benefit payments as well as provisions that restrict spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare **trust fund accounts**, respectively, plus inflows of **earmarked revenues**. A current law policy assumption would not be feasible in this case since both requirements can not be met simultaneously. Thus, an interpretation of "current policy without change" will be necessary.

        (3) Current law may include provisions that have been changed in a consistent direction over a period of time. For example, the statutory limit on federal debt has been consistently raised. A current-law policy assumption would be that Treasury borrowing will never increase beyond the dollar amount of the current statutory limit. In such situations a simple projection of current law would not reflect the implicit "current policy without change."

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29. Assumption of a uniform growth rate for all types of receipts and spending is not required. Assumptions may be based on, but are not limited to, the notion that non-interest spending or receipts are likely to:
    a. maintain a constant share of GDP,
    b. grow with inflation,[14] or
    c. maintain a constant real[15] per capita level.[16]

30. Judgment should be applied in selecting assumptions. Policy assumptions representing the worst case scenario are not required. The preparer's objective should be to produce unbiased projections.

31. The same economic and demographic assumptions generally should be used for the basic financial statement for Fiscal Sustainability Reporting and for Social Security and/or Medicare in the Statement of Social Insurance (SOSI) although exceptions may be necessary when considering all projected receipts and spending. For example, an appropriate unified discount rate for all projected receipts and spending in the basic financial statement may differ from either the Social Security or Medicare discount rate. (See paragraph 40.c.)

32. The projection of current policy without change is intended to show the long-term results of current policy without change. The projection of current policy without change is <u>not</u> a forecast or prediction. This distinction must be clearly explained in the narrative accompanying the principal financial statement, the disclosures and the RSI.

Valuation Date

33. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

[14] Inflation is growth in a general measure of prices, usually expressed as an annual rate of change.
[15] In economic terms, "real" means adjusted to remove the effects of inflation.
[16] As applicable, the characteristics of the population should be considered for expenditures that benefit identifiable subgroups.

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34. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible,[17] as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

Projection Periods

35. Projections in the basic financial statement should be for a finite projection period sufficient to illustrate long-term sustainability.

    If the projection period in the basic financial statement is not consistent with the projection period used for Social Security and Medicare in the SOSI, the disclosures should display the subtotal and total line items of the basic financial statement calculated for the projection period that was used for Social Security and Medicare in the SOSI.[18]

Basic Financial Statement

36. The basic financial statement, *Long-Term Fiscal Projections for the U.S. Government,* should state the projection period and display the following projected amounts as both present value dollars and as a percentage of the present value of GDP for the projection period indicated:

    a. receipts, disaggregated by major programs such as Medicare, Social Security, and all other receipts, and total receipts;[19]

[17] Factors affecting feasibility include but are not limited to the timing of the enactment of legislation and the ability of the preparers to revise the financial statements and/or the ability of the auditors to audit the revised information prior to the issuance of the financial statements and/or the audit opinion.
[18] The SOSI projection period is required to be "sufficient to illustrate long-term sustainability (for example, traditionally the "Social Security" or OASDI, program has used a projection period of 75 years for long-term projections)." See SFFAS 17, paragraph 27.
[19] Full payment of amounts due to Social Security and Medicare HI Trust Funds must be included as receipts for Medicare and Social Security, and outlays for "rest of government."

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b. non-interest spending, disaggregated by major programs such as Medicare, Medicaid, Social Security, and all other non-interest spending, total non-interest spending; and

c. the difference between projected receipts and projected non-interest spending.

37. After the initial year of implementation, the basic financial statement should also present comparative amounts for the current year and prior year, and the net change for each line item from the prior year as both present value dollars and as a percentage of the present value of GDP for the projection period indicated.

38. Fiscal gap information should be provided, either on the face of the financial statement or in the disclosures.

Disclosures

39. Disclosures should include an explanation of the following limitations:

a. Forward-looking projections require assumptions and estimates relating to future events, conditions, and trends; actual results may differ materially from those that are projected.

b. Forward-looking projections focus on future cash flows, and do not reflect either the accrual or modified-cash basis of accounting.

c. Projections are not forecasts or predictions; they are designed to answer the question “what if?” – for example, what would be the impact on federal borrowing if current policies without change were continued for a long period of time?

d. Forward-looking projections may also encompass hypothetical future trends or events that are not necessarily deemed probable (for example, the assumed ability to continue issuing new public debt indefinitely).

e. Fiscal Sustainability Reporting is limited to the activity of the federal government, and does not include activities of state and local governments or the activities of the private sector.

f. The summary measures cover a finite period and consideration should be given to trends following the end of the projection period.

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Disclosures should refer the readers to the RSI for a further discussion of this limitation.[20]

40. Disclosures should also include:

    a. a "plain English" explanation of present value and interest rates used to calculate present value.

    b. significant policy assumptions used in making the projections.

    c. any significant differences in economic and demographic assumptions from those used for Social Security and/or Medicare in the preparation of the SOSI and a reference to the note presenting assumptions used in the SOSI.

    d. an explanation of the most significant departures from current law– for example, allowing for exceeding the statutory limit on federal debt.

    e. the significant reasons for the changes when year-by-year comparisons are displayed. For example, significant changes may be attributable to the following broad causes:

        (1) valuation period (for example, the beginning of the projection period is one year later);

        (2) changes in policies (legislation); and

        (3) changes in assumptions or estimates.

    f. The net excess of non-interest spending over receipts disaggregated between (1) programs funded by the government's general revenues (which would currently[21] include Federal Supplementary Medical Insurance (Medicare Parts B and D), as well as other programs), and (2) major programs that are funded by payroll and self-employment taxes and that are not financed in any material respect by the government's general revenues (which would currently consist of Social Security (Old Age, Survivors and Disability Insurance (OASDI)) and Medicare Part A), accompanied by a discussion of the different funding mechanisms for the two types of programs.

Required Supplementary Information

[20] See paragraph 42.
[21] "Currently" means as of the date of Board approval of this SFFAS in June 2009.

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41. RSI should explain and illustrate:

    a. trends in:

        (1) historical and projected Treasury debt held by the public as a share of GDP,

        (2) historical and projected receipts and spending, and

        (3) historical and projected deficits and surpluses

        for a progression of years beginning at least 20 years before the current year and, at a minimum, extending to the end of the projection period used in the basic financial statement. These amounts should be presented at regular time intervals (for example, every five years or ten years).

    b. the major factors that are expected to have a significant impact upon projected receipts and spending, and how such factors are expected to change over time. For example, two such factors may be (1) the rising cost of health care and (2) demographic trends. Information about how such factors have changed and are expected to change over time is necessary to assist the reader in understanding the factors that influence fiscal projections.

    c. if an excess of projected non-interest spending over projected receipts is indicated by the projections, the likely impact of delaying action. For example, graphics could illustrate the progressive increase in the change that would be needed to close the fiscal gap by (1) reducing non-interest spending, or (2) increasing receipts.

    d. the results of alternative scenarios that are consistent with current policy without change. Alternative scenarios are projections in which one or more significant assumptions is varied from the assumptions used in the projections presented in the basic financial statement. The choice of alternative scenarios presented should consider both those that result in larger as well as those that result in smaller net differences between the present value of projected receipts and non-interest spending. Projections for alternative scenarios may be displayed in a table format. The major causes of the differences between the results of the alternative scenarios and the basic financial statement should be explained.

42. RSI should also include an explanation of the significance of the data presented or other information that puts the data into context. Options for context may include but are not limited to:

    a. comparison of the data/trend with past U.S. trends and trends in other developed nations,

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b. where to find information about outside organizations that use similar data to assess the long-term implications for an entity or sovereign government, for example, the role of rating organizations and/or European Union rules for member nations, and/or

c. information that may be helpful to readers in assessing whether financial burdens without related benefits were passed on by current-year taxpayers to future-year taxpayers.

43. RSI should discuss the implications of the trends in receipts and spending for periods following the end of the projection period. This requirement may be met by providing projections for an infinite horizon or a narrative discussion.

Supporting Data (Other Accompanying Information)

44. The quantitative data supporting the basic financial statement, disclosures and RSI may be provided in or referenced as other accompanying information.[22]

Effective Date

45. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2012.

a. These standards are effective for periods beginning after September 30, 2009.

b. Information should be reported as RSI for the first three years of implementation (fiscal years 2010, 2011, and 2012).

c. Beginning in fiscal year 2013, the required information should be presented as specified in paragraphs 12 - 42.

d. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

[22] For example, a link to a more detailed report such as the President's Budget, a Congressional Budget Office report, or the Trustees Report (*Status of the Social Security and Medicare Program)* may be provided. Note that the Trustees Report is available at: http://www.ssa.gov/OACT/TR/ (accessed May 7, 2009).

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. This project was initiated to address the Board's Reporting Objective 3, in particular sub-objective 3b, below:

> ***Objective 3: Stewardship***
> Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether
> a. the government's financial position improved or deteriorated over the period,
> b. future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
> c. government operations have contributed to the nation's current and future well-being.[23]

A2. The FASAB considered what information would most likely help readers of the consolidated financial report of the U.S. Government (CFR) assess whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due.

A3. Discussion of such long-term fiscal issues has been described in terms such as "fiscal sustainability." In the exposure draft (ED), the Board's working definition of "fiscal sustainability" was the federal government's ability to continue, both now and in the future, current policy without

[23] *Statement of Federal Financial Accounting Concepts* (SFFAC) 1, pars. 134-145, available at http://www.fasab.gov/codifica.html (accessed May 7, 2009).

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change regarding public services and taxation without causing debt to rise continuously as a share of GDP.[24]

A4. Throughout this project, the Board considered expert comments from a Fiscal Sustainability Reporting Task Force ("task force") whose participants have technical knowledge relevant to the issues and/or communication expertise relevant to the challenge of how to effectively communicate complex information on long-term fiscal issues.

A5. The task force participants included representatives from the American Enterprise Institute, the Cato Institute, the Brookings Institution, and the Urban Institute; the Chief Actuaries for Social Security and Medicare; technical experts from the Treasury Department, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), and the Congressional Budget Office (CBO); members of Congress; and academics in the areas of public policy and communication.

A6. FASAB staff also researched existing reporting on comprehensive government-wide long-term projections published in English by other countries (for example, the United Kingdom, Australia, New Zealand, and Canada) and studies by the European Commission, and conferred with staff of the International Public Sector Accounting Standards Board (IPSASB).

A7. The ED, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, was issued on September 5, 2008 with comments requested by January 5, 2009. The ED proposed standards for reporting comprehensive long-term fiscal projections for the U.S. Government via a basic financial statement and disclosures. The ED proposed that the reporting requirements would be subject to a phased implementation as Required Supplementary Information (RSI) for fiscal years 2010, 2011 and 2012, and as a basic financial statement and related disclosures beginning in fiscal year 2013. Based upon public comments and Board deliberations, the final Statement provides for all information to be reported as RSI for the first three years (FY 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information will be presented as a basic financial statement,

[24] Determining how much a government can depart–in magnitude and/or duration–from this general notion of fiscal sustainability is beyond the scope of the Board's efforts.

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disclosures and RSI as designated within the accounting standards (paragraphs 12 - 42).[25]

A8. Upon release of the ED, notices and press releases were provided to:
   a. the Federal Register;
   b. *FASAB News;*
   c. the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter,* and *Government Accounting and Auditing Update;*
   d. the CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council; and
   e. committees of professional associations generally commenting on exposure drafts in the past.

A9. This broad announcement was followed by direct mailings of the ED to majority and minority staff directors of relevant congressional committees, over 300 think tanks and public interest groups, and past respondents on similar issues, such as the FASAB's *Preliminary Views: Accounting for Social Insurance* (issued in October 2006).

A10. There were 22 responses from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		14
Auditors	3	
Preparers and financial managers	5	

A11. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized for each major issue addressed below.

A12. In addition, a public hearing was held on February 25, 2009. The public hearing addressed two EDs: this ED and another ED,

[25] See paragraph A38 for a discussion of the effective date for basic information.

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Accounting for Social Insurance, Revised. Seven speakers addressed this ED:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		5
Auditors	1	
Preparers and financial managers	1	

Assumptions: Limitations of "Current Law" Assumptions

A13. Projections are the central feature of Fiscal Sustainability Reporting and require that assumptions be made. The Board believes that the most useful projections will reflect current policy without change regarding federal public services and taxation.

A14. Although current law is a reasonable starting point in selecting policy assumptions, a simple projection of "current law" would not always reflect current policy without change regarding public services or taxation. The Board's proposal includes a guiding principle for selecting policy assumptions but acknowledges the role of judgment in filling voids in current law (for example, when current law expires almost immediately) or departing from current law provisions.

A15. Major provisions of current law often do not extend far enough into the future to be used as a basis for a long-range projection. Discretionary spending is primarily based upon annual appropriation acts, and even some mandatory spending programs are subject to authorizing legislation that expires in the near future. For example, the legislation authorizing several mandatory programs (such as Food Stamps, student assistance for higher education, and agricultural price supports) expires and legislative action would be required for the programs to continue past the expiration date.

A16. Current law may contain provisions for scheduled social insurance benefit payments as well as provisions that restrict spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare trust fund accounts, respectively, plus inflows of earmarked receipts. A current law policy assumption would not be feasible in this case since both requirements can not be met simultaneously. Thus, an interpretation of "current policy without change" will be necessary. .

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A17. Current law also may include tax provisions that expire within several years, along with a historical trend of extending those tax provisions before they expire—but only for a short period, such as one year. In such situations, current law would indicate that the tax provisions will expire on schedule, while a projection based upon current policy without change for taxation together with reasonable expectations based on recent historical trends may indicate that the tax provisions will be extended.

Fiscal Sustainability Task Force Input Regarding Policy Assumptions

A18. A majority of the task force technical experts agreed that policy assumptions for the basic financial statement that are consistent with current policy without change[26] regarding federal public services and taxation would be useful for readers of the CFR in assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

A19. A majority of the task force technical experts believe that for mandatory spending on social insurance programs, a modified version of current law (ignoring the exhaustion of the Social Security and Medicare Hospital Insurance trust fund accounts — see paragraph A16), which might also be termed "current services," represents the most useful assumption for projecting spending for social insurance programs. However, a minority believe that any deviation from current law requires a subjective judgment that can be biased.

A20. The technical experts also acknowledged that projections for discretionary spending are more uncertain than projections for mandatory spending, since current law often only addresses the next one or two years. However, there was some agreement among the group that projecting discretionary spending growth at the same rate as assumed GDP per capita would be an example of a reasonable option for some programs.

[26] "Current policy without change" as defined in this Statement is not equivalent to constant dollar amounts. Current policy without change is to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

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A21. A report issued by the GAO[27] illustrates the tension between choosing current law versus current policy without change regarding federal public services and taxes. The report's primary display contains two different projections in a single graphic presentation: the 10-year CBO baseline, which is then projected into the future (called "baseline extended") and a different projection (called an "alternative simulation"), which includes modifications that are described in the narrative. The "baseline extended" projection is based on assumptions that focus on current law. Those assumptions are changed in the GAO's "alternative simulation" to reflect historical trends and recent policy preferences.

A22. The GAO's approach of showing two different sets of numbers provides a more complete picture than selecting one or the other. However, this approach does not achieve one of the most important characteristics of effective communication. All of the communication experts and many of the technical experts on the task force strongly emphasized the importance of simplicity of presentation. The Board noted that one of the greatest challenges inherent in Fiscal Sustainability Reporting is the tension between technical rigor and simplicity of presentation.

Policy Assumptions

A23. The Board believes that the most useful reporting on fiscal sustainability would illustrate the long-term effects of current policy without change regarding public services and taxation. However, there are numerous ways of projecting current policy into the future. For example, it could be assumed that discretionary spending will continue as a constant share of GDP. Another alternative would be to assume constant real spending per capita (which could give a different result from assuming growth at a constant share of GDP). Yet another alternative would be to assume constant growth at the rate of inflation, which may be different than the growth of GDP.[28] (Historically, nondefense discretionary spending has grown roughly with GDP while defense discretionary spending has grown slightly faster than inflation but less than GDP, often in a nonlinear pattern.)

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[27] The Nation's Long-Term Fiscal Outlook, August 2007 Update (GAO-07-1261R).

[28] For example, the CBO projects that the rate of inflation will be lower than the rate of GDP growth for 2007-2017. See page xi, *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007). Available at: http://www.cbo.gov (accessed May 7, 2009).

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A24. The Board believes that the details of the assumptions for projecting current policy without change should be left to the judgment of the preparer, subject to review by the auditor. Regardless of which assumptions are used for the basic financial statement, the disclosures should include an explanation of the assumptions used and alternative scenarios, as well as the reasons for and the effect of changes in assumptions that result in significant changes from amounts reported in the prior period financial statement. Readers will have access to important explanatory material.

A25. Current law may contain inconsistent provisions in certain situations (for example, regarding the impact on benefit payments upon the exhaustion of the balances in the Medicare Hospital Insurance trust fund account). As noted previously, although current law limits spending to the amounts available in the trust fund account and current earmarked revenue, current law provides for benefits that would exceed such a limit. Thus, current law contains inconsistent provisions and does not provide an answer.

A26. When current law contains inconsistent provisions, the Board believes that in selecting assumptions, the projections should reflect current policy regarding federal government public services and taxation, and should answer the question “what if current policy without change were continued over time?” The resulting projection should be accompanied by a narrative that explains what would happen if an alternative event occurs (in the example in paragraph A25, the narrative could explain what percentage of Medicare reimbursements could not be paid if legislation does not provide for maintaining current reimbursement rates).

A27. In drafting the final Statement, the Board also improved the clarity of the requirements for policy assumptions by re-ordering the content of this section. The guiding principles for when a departure from current law may be appropriate are stated first, followed by specific examples.

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Economic and Demographic Assumptions

A28. Economic and demographic assumptions are different in scope from policy assumptions. Economic and demographic assumptions include such factors as economic growth, inflation, birth rates, net immigration, and longevity. The elements of economic and demographic assumptions are generally influenced more by a variety of external factors than by direct legislative impact.

A29. The ED proposed that the reporting requirements for Fiscal Sustainability Reporting should not dictate specific economic and demographic assumptions, but should require that the primary displays for Fiscal Sustainability Reporting should use economic and demographic assumptions that are consistent with the economic and demographic assumptions for Social Security and Medicare in the SOSI.

A30. Although a majority of respondents concurred with the ED's proposed broad and general guidance on economic and demographic assumptions, the GAO noted that in some cases, the assumptions, particularly the economic assumptions, may need to differ. For example, an appropriate unified discount rate for all projected receipts and non-interest spending in the basic financial statement may differ from either the Social Security or Medicare discount rates. Increasing the flexibility in the requirement would allow the use of the most appropriate discount rate and permit changes to other assumptions as appropriate. The GAO noted that such differences in assumptions used in the basic financial statement and those in the SOSI for Social Security and Medicare should be appropriately disclosed.

A31. The Board decided to allow the flexibility recommended by the GAO and to require disclosure for significant differences. (See paragraphs 31 and 40.c.)

Basic Financial Statement

A32. The basic financial statement will report amounts in (a) present value dollars and (b) as a percentage of the present value of GDP for the projection period. The basic financial statement will be presented as RSI for a period of three years and will then become a basic financial statement.

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A33. Elements considered for inclusion as mandatory requirements for the basic financial statement were:
   a. total projected non-interest spending and receipts, disaggregated by major programs such as Medicare and Social Security
   b. the net total of all projected receipts and non-interest spending
   c. amounts displayed as both (present value) dollars and percent of GDP
   d. year-to-year (for example, side-by-side) comparison with prior year
   e. net change from year-to-year as a separate column
   f. alternative scenario information

A34. A majority of the members decided that (a) through (e) above should be included as minimum requirements for the basic financial statement, with the format of the elements left to the discretion of the preparer. An illustrative statement is included in Appendix B. In addition, the Board concluded that the concept of fiscal gap should be explained and reported, either on the face of the financial statement or in the disclosures. An illustrative example is shown in Appendix B on the face of the illustrative basic financial statement.

A35. The Board concluded that disaggregation of specific major programs would be left to the discretion of the preparer.

A36. A majority of respondents agreed with the general guidance proposed in the ED: that major programs should be shown separately. However, respondents' suggestions that named specific examples of major programs indicated that many respondents interpreted the illustrative financial statement in Appendix B as authoritative and inferred that social insurance programs are the federal government's only "major programs."

A37. The Board decided to edit the illustrative basic financial statement in Appendix B by adding two additional lines, "Major Program A" and "Major Program B" to clarify the fact that social insurance programs are not the only major programs of the federal government.

Effective Date for Basic Information

A38. The ED proposed that the financial statement and disclosures be designated as basic information rather than continue as RSI beginning in fiscal year 2013. For three years prior to fiscal year 2013, the information in the basic financial statement and disclosures would be

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presented as RSI. A majority of respondents addressing this issue, including the GAO, which will have the responsibility of auditing the basic information, agreed that the proposed implementation schedule is reasonable and appropriate. The GAO did identify several requirements that should remain RSI permanently, and the Board incorporated that recommendation into the requirements of the final Statement.

A39. Given the potential for flexibility (within and between years) of policy assumptions underlying the projections, one member believes that significant disagreements between preparer and auditor are likely when the information becomes basic in fiscal year 2013. For example, paragraph 28.b(3) provides an example of a situation where departure from current law may be appropriate if historically consistent changes have been made. That member notes that it remains to be seen how historically consistent the changes must be to qualify and how departures from previously consistent patterns in policy will be addressed. In addition, based on its "but not limited to" language, paragraph 28 allows for an open-ended set of exceptions which have yet to be specified and defended. He believes, therefore, that the projection information should remain RSI until such time as preparation and audit procedures concerning exceptions to the "current law" approach to "current policy without change" can be developed and agreed upon.

A40. The majority Board member view is that the preparer and auditor will resolve such disagreements by reference to the guiding principle – current policy without change. The Board is aware that significant judgment will be required. If any irreconcilable issues arise during the three-year transition period, the Board would be called upon to (1) offer implementation guidance or (2) defer the transition from RSI to basic information.

Summary Measures

A41. The Fiscal Sustainability Task Force technical experts did not agree on the usefulness of summary measures such as the present value amounts intended to be presented on the basic financial statement. Although some of the technical experts believe that summary measures convey important information, others believe that due to the inherent weakness of summary measures, they should be de-emphasized.

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A42. The inherent weaknesses of summary measures that were identified by the Fiscal Sustainability Task Force and considered by the Board include but are not limited to the following:

a. A specific time horizon must be used in order to calculate any summary measure. There are no potential time horizons that do not have inherent weaknesses. Those weaknesses are discussed in paragraphs A50 - A57 below.
b. Summary measures for long-term fiscal projections for the U.S. government are likely to produce very large numbers that readers find difficult to relate to. One potential remedy for this would be to report the numbers on a per capita basis, but that approach has weaknesses. Those weaknesses are discussed in paragraphs A46- A49 below.
c. Potential "bottom-line" summary measures include fiscal imbalance and fiscal gap, both of which have inherent weaknesses. Those weaknesses are discussed in paragraphs A58 - A61 below.

A43. In spite of the inherent weaknesses of summary measures, many of the technical experts and all of the communication experts recommended that summary measures, including a "bottom line" summary measure, are important and should be required. Among other reasons, summary measures are valuable for evaluating proposals and also for comparison of the prior reporting year to the current reporting year. For example, one technical expert said that highlighting changes resulting from such actions as the passage of new entitlement programs should be the "acid test" for any proposed reporting on fiscal sustainability. Such reporting (on whether a projected shortfall increased or decreased during the reporting period) can best be accomplished through the use of summary measures. Furthermore, a study by the Organisation for Economic Co-Operation and Development (OECD) found that 10 of 12 nations producing fiscal sustainability analyses included summary measures.[29]

A44. In order to address the difficulty that some readers may have with summary amounts that are expressed as very large present-value dollar amounts, the Board decided that each line item in the basic financial statement that is displayed in present-value dollar amounts

[29] OECD draft report, *Fiscal Futures, Institutional Budget Reforms, and Their Effects: What Can Be Learned?*, to be published in *OECD Journal on Budgeting in 2009.*

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should also be displayed as a percentage of the present value of GDP for the projection period.

A45. A majority of respondents agreed that the Board's proposed basic financial statement, which requires summary measures, would be understandable and meaningful to readers. However, some respondents expressed the view that trend information is more understandable than summary measures. The Board decided to retain the basic financial statement as proposed in the exposure draft.[30] While users' preferences among individual items in the fiscal sustainability reporting package will vary, the Board believes that each requirement in the Statement is meaningful and necessary.

Per Capita Measures

A46. The Board considered whether to include per capita measures in the summary display. The technical experts serving on the Fiscal Sustainability Task Force did not come to agreement regarding the display of summary numbers on a per capita, per worker, and/or per household basis.

A47. A majority of the technical experts on the task force recommended against per capita measures, for the following reasons:
   a. Several technical experts strongly objected to the use of per capita summary numbers using current-year population for the denominator. They said that such measures would imply that the current-year population is solely responsible for funding program shortfalls into the distant future. They believe that any changes needed to address the shortfalls projected through, for example, the next 75 years, should be spread across the population throughout that 75-year period.
   b. Other technical experts noted that per capita measures may be useful in conveying the magnitude of projected fiscal imbalances and could be displayed if summary amounts are divided by the population that parallels the horizon indicated and a narrative is included that explains present value and the nature of the numerator and denominator.
   c. Per capita measures for infinite-horizon projection periods present special problems. It is uncertain how a reasonable per capita

[30] See additional discussion of the basic financial statement in paragraphs A32 through A37.

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denominator for an infinite horizon ratio would be selected and explained, especially if the denominator includes an estimate of all individuals that enter the population during the projection period.

d. Two technical experts believe that even present value per capita amounts can be misinterpreted, because the reader will compare the amount with current salary levels and not understand the role of potential future productivity increases.
e. One technical expert objects to per capita amounts because they represent amounts distributed equally among individuals with widely different abilities to pay.

A48. After a discussion of the above issues, the Board decided not to include per capita measures in the proposed reporting requirements. Several of the respondents to the ED indicated strong support for per capita amounts. Three respondents recommended per capita amounts on the face of the financial statement. One respondent specifically recommended a detailed per capita format titled “U.S. Taxpayer Personal Credit Card Statement.”

A49. The Board decided that the technical arguments described in paragraph A47 were compelling and that the standard should not require per capita information.

Time Horizon for Projections

A50. There was strong disagreement among the task force participants regarding the selection of a time horizon for projections, in particular a finite horizon (for example, 75-year) versus an infinite horizon. One task force participant believes that only infinite-horizon projections should be displayed but others believe that infinite-horizon projections should not be shown. Some participants suggested that information using both finite and infinite-horizon projections be included.

A51. A majority of the communication experts believe that information for both finite and infinite-horizon projections should be provided to readers, but not necessarily both within a primary display.

A52. Arguments in favor of a finite horizon:

a. A finite period would be sufficient to cover essentially all of the working and retirement years for current participants.
b. A finite period is subject to less uncertainty than an infinite horizon.

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c. A finite period is meaningful to readers. For example, readers can relate to a time period that will include the retirement of the youngest members of the current workforce. An infinite horizon is less meaningful to readers. Readers are less likely to relate to or be concerned about the U.S. Government's fiscal condition in 200, 500, or 1,000 years in the future.
d. Infinite-horizon projections are no more informative to policymakers than 75-year projections, in part because projections beyond the 75-year horizon are subject to significant uncertainty. A more detailed version of this argument is made in an article in the National Tax Journal:

> …many people already believe that the 75–year horizon is too distant to be meaningful, and that detailed projections over longer horizons suggest a false precision. A simpler projection assumption is that after 75 years (or some other interval, T), the system will have settled into a steady state in which rates of growth of costs and tax revenues are thereafter constant, although not necessarily equal.[31]

A53. Arguments in favor of an infinite horizon:
a. Unless trends are level towards the end of the period, projections may be subject to the "moving window" effect, where shortfalls (or surpluses) increase significantly from one reporting year to the next due to the change in the projection period. For example, if a projection period is 75 years, the activity in "year 76" is outside the projection period for that year, but will be included in the projection period for the following year. An infinite horizon would avoid the "moving window" effect that occurs when there are significant changes to an estimate from one year to the next that are caused by the passage of time.
b. Some have argued that a finite projection period essentially assumes zero for years beyond the projection period. Infinite-horizon projections would not assume zero for years beyond the cutoff point for projections.

A54. The Board believed that the advantages of both finite and infinite horizons were sufficiently compelling to propose in the ED that both finite and infinite-horizon information should be provided, although only one projection period should be used for the basic financial statement. The ED proposed that whichever type of projection period is selected

[31] *Sustainable Social Security- What Would It Cost?* National Tax Journal, Vol. LVI, No. 1, Part 1, March 2003, page 34. Available at http://ntj.tax.org /wwtax/ntjrec.nsf/5DC000487120304885256D8E0054C858/$FILE/Lee.pdf (accessed May 7, 2009).

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for the primary display, the other type of projection period would have been presented with the disclosures.

A55. The Board also believed that one of the projection periods used (in either the basic financial statement or the narrative section) should be consistent with that used for the SOSI. This would ensure consistency between major line items in the SOSI (for example, projected earmarked receipts and spending for Social Security and Medicare) and corresponding line items in the basic financial statement or the disclosures.

A56. A majority of respondents disagreed with the Board's proposal to require reporting projected data for both finite and infinite time horizons. Respondents said that requiring projected data for an infinite time horizon would be: too much information, irrelevant, and unacceptably uncertain due to many major events that are very difficult or impossible to predict, such as depressions, natural disasters, and wars. A majority of respondents disagreed with the Board's proposal not to specify a time horizon for projected data. Several respondents recommended a specific time horizon of 75 years.

A57. The Board decided not to require reporting on the infinite horizon and to explicitly require a finite horizon for the basic financial statement. The Board addressed the issue of trends beyond the end of the projection horizon by adding a requirement that the RSI should discuss the implications of the sustainability information, particularly the information in the basic financial statement, after the end of the projection period. This requirement may be met by providing projections for an infinite horizon. (See paragraph 42.)

The Concepts of Fiscal Gap and Fiscal Imbalance

A58. The Board considered two potential summary measures for presentation below the other required elements on the basic financial statement or separate disclosure: fiscal gap and fiscal imbalance.
   a. The fiscal gap is the change in non-interest spending or receipts that would be necessary to maintain public debt at or below a target percentage of GDP.

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b. The fiscal imbalance is the net present value of existing federal debt plus projected non-interest spending,[32] minus projected receipts. In other words, it is the fiscal gap when the target level of federal debt at the end of the projection period is zero. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected non-interest spending, and repayment of debt for a stated projection period.

A59. Several of the Task Force technical experts indicated that the fiscal imbalance, as defined above, overstates the size of the problem over any finite time period such as 75 years. The fiscal imbalance is defined as the existing federal debt plus projected non-interest spending less projected receipts. If projected receipts are large enough to set the fiscal imbalance to zero after 75 years (or any other fixed time period), this would imply the debt was paid off at the end of the period. Many of the technical experts argued that this is not necessary for continued solvency provided the economy is expected to last longer than 75 years. A positive level of debt is viewed by many to be fiscally acceptable at the end of the projection period, provided it is not too large or growing too fast.

A60. The fiscal gap measure does not require a target debt level of zero; instead, it allows for a positive level of debt at the end of the forecast horizon. In order to report the fiscal gap as a single amount (in present value dollars or as a percentage of GDP, projected receipts or projected non-interest spending), a target debt level relative to GDP must be selected. Such a measure would show the magnitude of increases in receipts or cuts in non-interest spending that would be needed to achieve that target. However, any specific limit selected may be considered arbitrary. In the United States, there is currently no legislated goal for debt as a share of GDP or a legislated limit on borrowing other than the statutory debt limit, which has been frequently raised.

A61. Since the Board has no objective basis for selecting a debt-to-GDP limit or goal, the requirements for information about the fiscal gap do not include a specific debt-to-GDP limit or goal. Fiscal gap should be explained and reported, either on the face of the financial statement or in the disclosures.

[32] Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest.

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Foreign Holdings of U.S. Treasury Debt

A62. A significant minority of members supported a proposal that the proportion of U.S. Treasury debt held by foreign investors is also important information and should be reported as RSI. They point out that while it is important to report the large and growing gap between receipts and spending, the extent to which deficits are being financed by foreign lenders is also significant information, particularly in light of the large and growing increase in that proportion.

A63. The members supporting this additional requirement pointed out that foreign lenders cannot be counted on to be always willing to finance the government's deficits; that the magnitude of this indebtedness to foreign lenders has national security implications, including threatening our international standing and influence and limiting our foreign policy options; and it results in the interest payments on the debt going abroad instead of providing income to U. S. residents and feeding into our economy.

A64. The members supporting this additional requirement therefore proposed that RSI should include an illustration and/or explanation of the trend in foreign holdings of U.S. Treasury debt for a minimum of 15 years through the most recent date for which data are available.

A65. A majority of members believed that there should not be a requirement to report foreign holdings of U.S. Treasury debt, for reasons that included the following:
   a. It is unclear how the information relates to the fiscal sustainability of current policy without change.
   b. Information on foreign holdings of U.S. Treasury debt is based upon unaudited, unverifiable surveys rather than transaction records and is not available on a timely basis.
   c. A reporting requirement for existing foreign holdings would repeat information readily available in other places.

A66. A majority of respondents agreed with the minority proposal to require reporting of foreign holdings of U.S. Treasury debt. Among the reasons given were:
   a. This information would show the reader the impact foreign countries could have on the U.S. economy.

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b. Trends in the proportion of U.S. Treasury debt held by foreign investors are a fundamental user consideration.
c. This is a very important financial issue that can have significant economic, fiscal, foreign relations and even national security implications over time.
d. Graphic information (like the pie chart in #10, Appendix B of the ED) regarding trends in the proportion of U.S. Treasury debt held by foreign investors (especially foreign countries) should be made part of RSI *and* be subject to the phased-in implementation. The respondent feels strongly about this because of our increasing reliance on foreign countries to fund our operating deficits at a time when the global economy is under great strain and these funds may not be available to us in the future as countries like China, Japan, and Germany are forced to shore up their own economies, especially with further global economic deterioration.

A67. The Board decided not to include a requirement to report on foreign holdings of U.S. Treasury debt for reasons described in paragraph A65.

Alternative Policy Proposals

A68. A minority of members supported a proposal for additional RSI (not subject to the phased-in implementation in paragraph 45) that they believed would increase the likelihood that the financial statement and disclosures will result in important and necessary decisions. These members proposed that if the Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant imbalance, the basic financial statement should be accompanied by an identification of one or more policy alternatives that would close the fiscal gap. The identification, explanation, and fiscal impact of the policy alternative(s) would be presented as RSI.

A69. A majority of members believed that there should not be a requirement to describe policy alternatives because a statement of accounting standards is not the proper venue for requiring policy proposals.

A70. A majority of respondents agreed with the Board majority view.

Inter-period or Inter-generational Equity

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A71. The Board also considered information that may be helpful to readers in assessing whether financial burdens without related benefits were passed on by current year taxpayers to future year taxpayers (sometimes referred to as "inter-generational equity" or "inter-period equity").

A72. In addition to measuring whether projected future receipts are sufficient to support projected future spending, it is important to understand how the financing of future spending affects current and future-year taxpayers. For example, even if projected receipts equal projected spending over the time horizon of the projections, policy may be such that future-year taxpayers assume a higher burden of taxes or lesser public services than current-year taxpayers.

A73. To present such information, a narrative could explain how measures such as debt to GDP over the time horizon of the projection indicate the extent that current deficits are left to be financed by future-year taxpayers either through increased taxes or decreased benefits.

A74. While a minority of the Board believed that such disclosures should be required, the majority of the Board decided to provide that such information is an optional way to meet the disclosure requirement to provide information that puts the data into context (see paragraph 42).

A75. A majority of respondents agreed with the Board majority view.

Other comments

A76. Several respondents raised fundamental questions regarding the project. One respondent said that unlike private entities, the government is sovereign; it has the power to tax and issue money; accordingly, the federal government is unlikely to lack sufficient budgetary resources to sustain public services and to meet obligations as they come due. However, even that respondent noted that government spending can indeed become excessive.

A77. Another respondent said that the concept of sustainability should not require assumptions about what the American people want to do. For example, if 40 years from now citizens decide that 30 percent of GDP may be appropriate to address a large elderly and/or disabled population, the Board should not assume that this would be impossible or unsustainable. That respondent also said that to show income

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taxes as a flat percentage of GDP while we show the cost of entitlements rising with the law is inconsistent and shows an unintended bias. That respondent indicated that even a very small adjustment would put Social Security into balance.

A78. The Board decided that the proposed standard may not have made it sufficiently clear that the reporting consists of projections and not predictions and that the final Statement of Federal Financial Accounting Standards (SFFAS) should explicitly explain the difference between projections and predictions. The following language was added to paragraph 39.c:

> [39] Disclosures should include an explanation of the following limitations:
>
> > [c] Projections are not forecasts or predictions; they are designed to answer the question "what if?" – for example, what would be the impact on federal borrowing if current policies without change were continued for a long period of time?

Board Approval

A79. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB office.

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Appendix B: Example Formats and Illustrations

The examples in this Appendix are illustrative only; they do not represent authoritative guidance.

Basic Financial Statement
Long-Term Fiscal Projections for the U.S. Government

Amounts projected to 75 years

	As of XXXX XX , 20XX (Current Year)		As of XXXX XX, 20XX (Prior Year)		Change from Prior Year	
	PV Dollars *in trillions*	% of the PV of GDP*	PV Dollars *in trillions*	% of the PV of GDP*	PV Dollars *in trillions*	% of the PV of GDP*
Receipts						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
All Other Receipts	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Receipts	$ XXX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Non-Interest Spending						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Medicaid	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program A	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program B	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Non-Interest Spending	$ XXX.X	X.X.%	$ XX.X	X.X%	$ X.X	X.X%
Non-Interest Spending in Excess of Receipts	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%

To maintain the current [or date] level of U.S. Treasury debt held by the public to GDP, actions would need to be taken to increase receipts or decrease non-interest spending by a net present value of $XX.X trillion or X% of GDP. To accomplish this reduction, annual receipts would need to increase by XX.X% or annual non-interest spending would have to decrease by XX.X% (or some combination of these two options).

Note: Amounts are estimated based upon guidance for selecting assumptions provided in this Statement. Receipts and non-interest spending include repayment of borrowings from the trust fund accounts for Social Security and Medicare (estimated as 0.X percent of GDP).

***** GDP (Gross domestic product) can be roughly defined as all of the nation's income or everything the country produces.
** Rest of government: The repayment of borrowings by the general fund from the trust fund accounts for Social Security and Medicare are included in Receipts for Social Security and Medicare, and Non-Interest Spending for Rest of government.

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Examples of Selected Narrative and Graphics

The following examples display and/or describe narrative and graphics that might supplement the basic financial statement in a manner consistent with the standard.

These illustrations are illustrative only and do not represent authoritative guidance. Illustrations are not provided for all requirements.

Examples are provided in this appendix for the following:

1. Rising Cost of Health Care *39*
2. Demographic Trends *42*
3. Relationship of Projected Receipts and Spending *44*
4. Trends in Deficit Spending *45*
5. Trends in Treasury Debt Held by the Public *46*
6. Impact of Delaying Action *47*
7. Alternative Scenarios (Range Information) *48*
8. Fiscal Gap *48*
9. Disclosure on Funding Mechanisms *49*
10. Other Required Information *49*

1. Rising Cost of Health Care

Paragraph 41.b provides that RSI should explain and illustrate major factors that are expected to have a significant impact upon future receipts and spending. For example, if rising federal spending on health care is a major factor in the long-term spending projections, the disclosure might include the following:

a. If the growth in health care spending exceeds the growth in GDP, a narrative might explain that the growth in any spending program cannot continue indefinitely to exceed the growth in the economy, because at some point, the spending would exceed the resources that can be extracted from the economy.

b. A range encompassing projections for major factors affecting future spending such as the rising cost of health care might be presented in a graphic as a percentage of GDP. The graphic could use the example format in Illustration 1a or other formats

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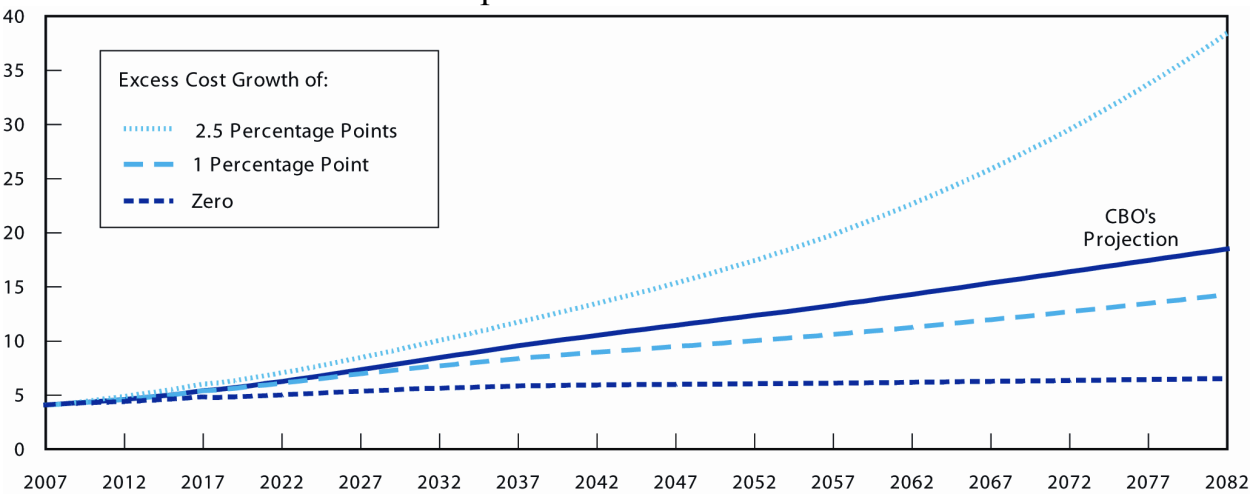
Illustration 1a: Major Cost Drivers for Federal Spending

Federal Spending for Medicare and Medicaid as a Percentage of Gross Domestic Product Under Different Assumptions About Excess Cost Growth



Source: Congressional Budget Office, *The Long-Term Outlook for Health Care Spending* (November 2007) Figure 5, page 15. Available at: http://www.cbo.gov/ (accessed May 7, 2009)

"Excess Cost Growth" refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

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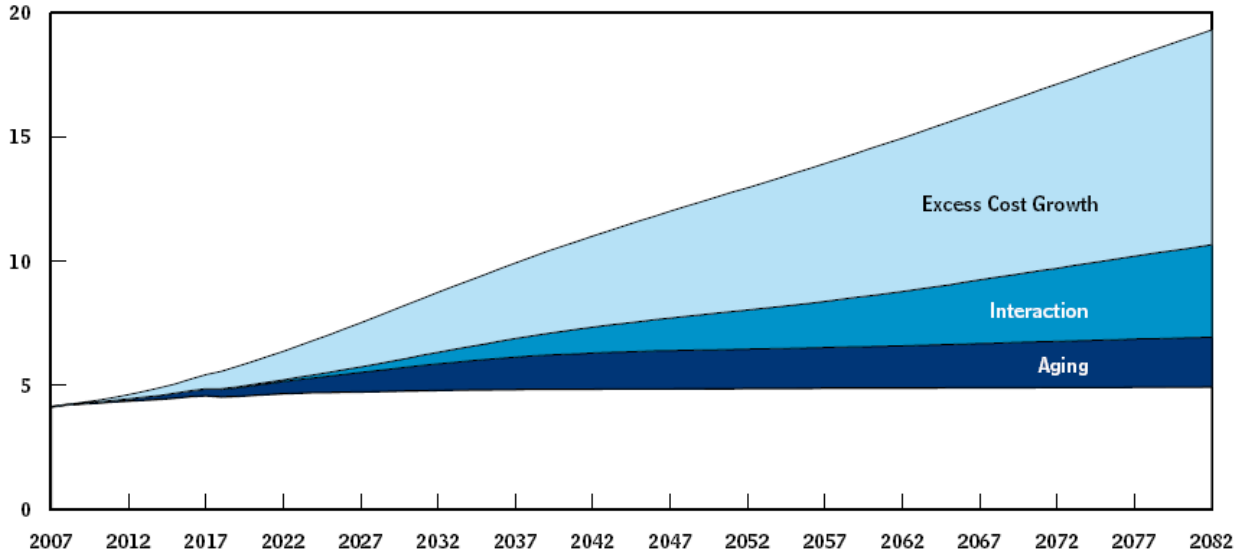
In addition, a graphic might display the relative contribution of two or more major cost drivers. For example, Illustration 1b displays the effect of the aging of the population, excess cost growth, and the interaction of those two factors on federal spending on Medicare and Medicaid.

Illustration 1b: Relative Contribution of Two Major Cost Drivers

Allocation of Projected Growth in Federal Spending on Medicare and Medicaid, by Source
(Percentage of gross domestic product)



"Excess Cost Growth" refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

"Interaction" is the interaction of the aging of the population combined with projected excess cost growth. In other words, both conditions (excess cost growth and aging of the population) are necessary for the cost growth labeled "Interaction" to occur.

"Aging" is the projected increase in federal spending on Medicare and Medicaid that is attributable solely to the aging of the population.

Source: Adapted from Figure 1 of "Accounting for Sources of Projected Growth in Federal Spending on Medicare and Medicaid," Economic and Policy Issue Brief, May 28, 2008. Available at: http://www.cbo.gov (accessed June 1, 2009).

2. Demographic Trends

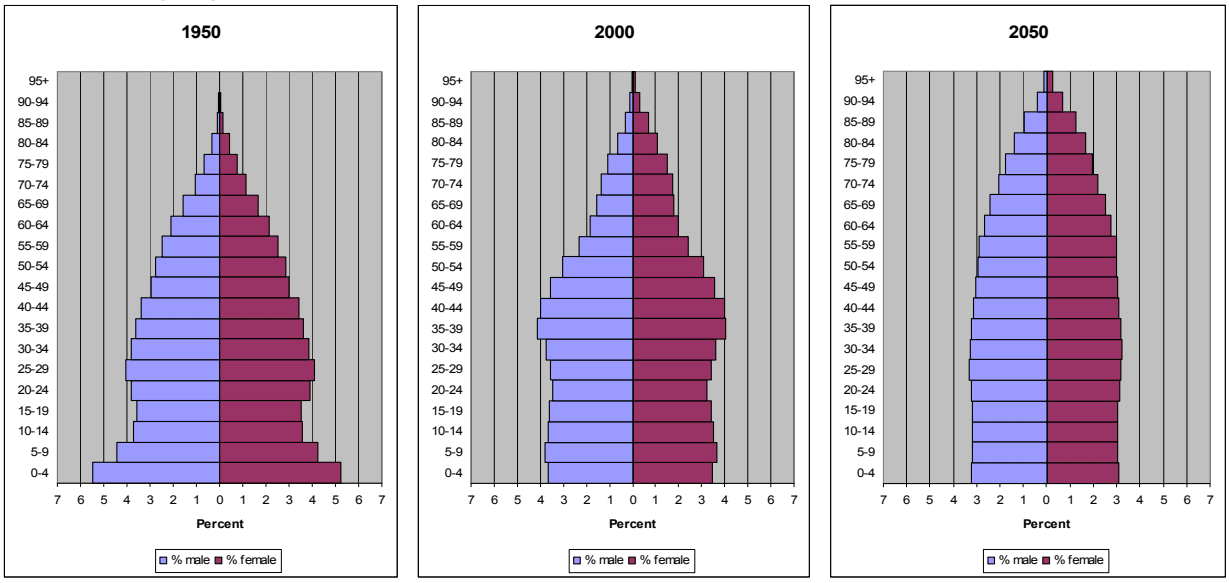
Paragraph 41.b requires that RSI explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government, one example of which may be demographic trends. The narrative might describe demographic trends and briefly explain the major drivers of change in demographic trends, for example, trends in longevity and birth rates, and refer the reader to more extensive coverage of the topic in other existing reports, for example, the Social Security and Medicare Trustees Reports. The narrative could describe the change in the ratio of workers to retirees and how this change relates to long-term fiscal outlook for social insurance programs. Alternatively, simple age demographics rather than workforce participation could be used (in other words, "over 64" instead of "retired") provided that they are used consistently.

A simple graphic to accompany and illustrate the narrative may follow the format of the example shown below. The illustrative sample format below is called an "age/gender pyramid." The graphic could display two or three age/gender pyramids side-by-side, for example:

1 the current (or other baseline) year minus 50 years;
2 the current year (or other baseline year, for example, 2000); and
3 a projection of the current (or other baseline) year plus 50 years.

Illustration 2: Age-Gender Pyramid

The Changing Shape of the United States' Population



Source: *Social Security Administration, Area Population Statistics.*

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The narrative could also discuss the "total dependency" ratio (dependent children plus retirees per worker) for each "worker-to-retiree" ratio that is provided in the narrative.[33]

The narrative also could provide perspective by explaining that similar demographic trends are occurring in other developed countries, and provide examples of developed nation(s) projected to have a greater number of retirees per worker than the United States, and developed nation(s) projected to have fewer retirees per worker.

[33] The European Commission defines the total dependency ratio as the "Population under 15 and over 64 as a percentage of the population aged 15-64." *European Economy: Special Report 1/2006*, page 313.

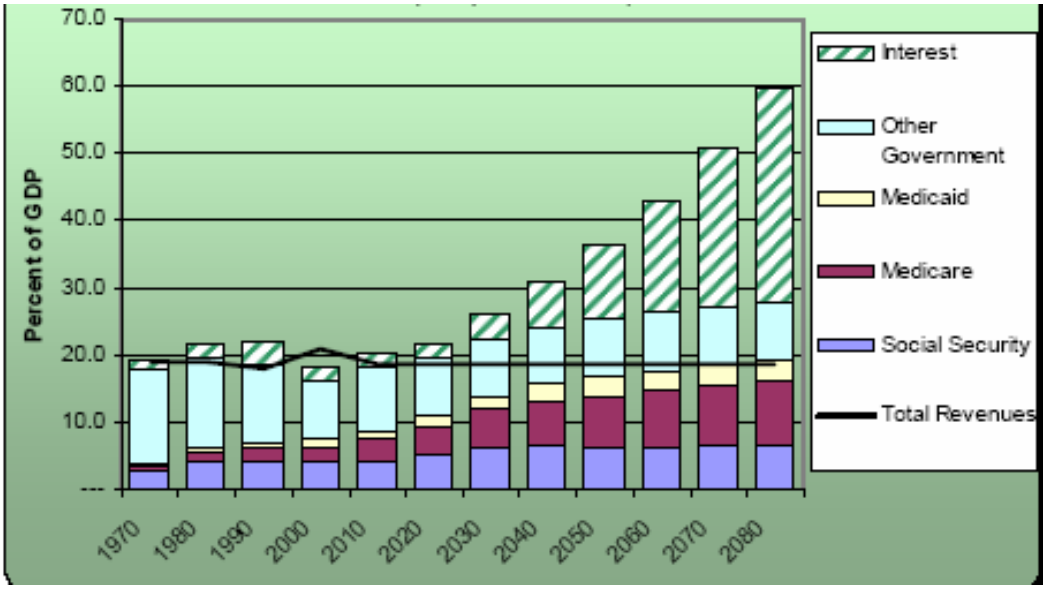
Paragraph 41.a requires that RSI explain and illustrate the historical and projected trends for a progression of years. Illustrations 3, 4 and 5 display how this might be accomplished.

3. Relationship of Projected Receipts and Spending

The RSI section could include a graphic of the relationship between projected receipts and spending for a progression of years, for example beginning 20 years before the current year and extending to all future years projected in the basic financial statements. Below is an example.

Illustration 3: Projected U.S. Government Receipts and Spending

Projected U.S. Government Receipts and Spending
(As a percent of GDP)



Source: FY 2007 *Financial Report of the U.S. Government*, Chart H, page 18. Available at http://fms.treas.gov/fr/index.html (accessed May 7, 2009).

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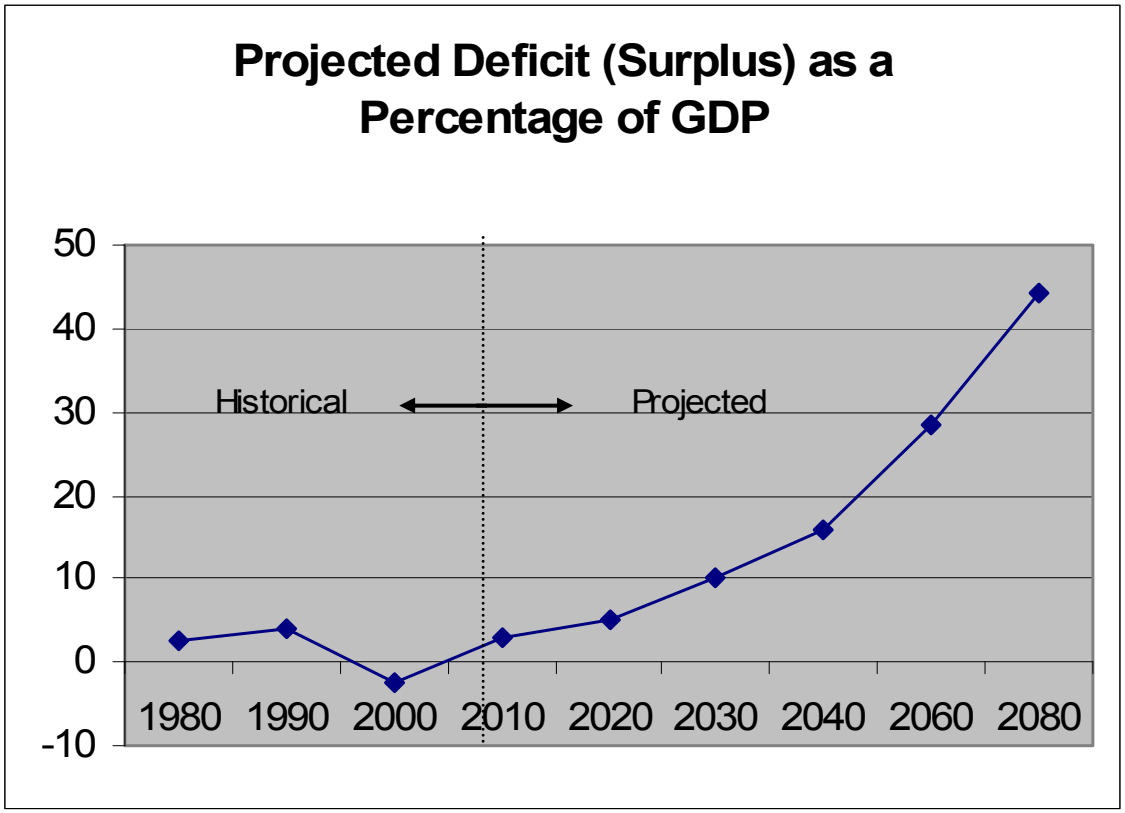
4. Trends in Deficit Spending

The trends in deficit spending could be graphically displayed as a percentage of GDP for a progression of years, for example beginning at least 20 years before the current year and extending to all future years projected in the basic financial statement.

Illustration 4: Projected Deficit/Surplus as a Percentage of GDP

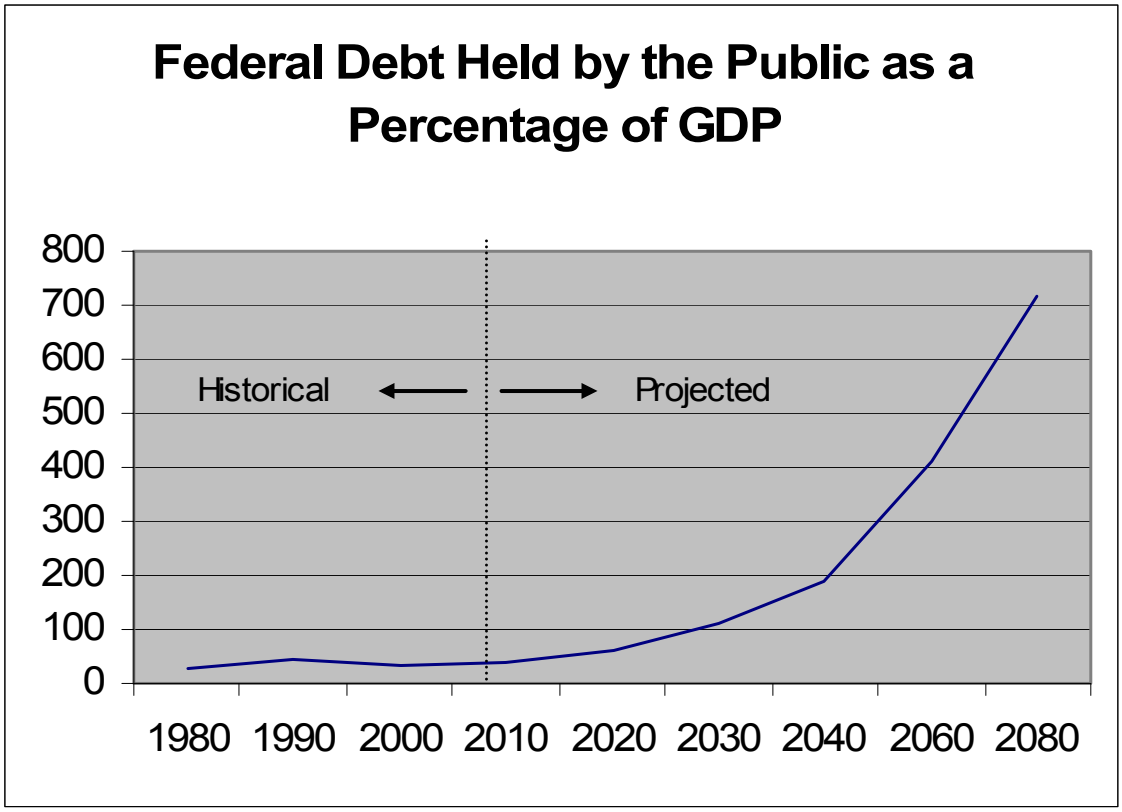


Data sources:
Historical: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget
Projections: Government Accountability Office, Long-Term Fiscal Simulation Data, Alternative Scenario. Available at: http://www.gao.gov/special.pubs/longterm/data.html (accessed May 7, 2009)

5. Trends in Treasury Debt Held by the Public

A graphic could display the projected trends in Treasury debt held by the public as a percentage of GDP, for a progression of years beginning at least 20 years before the current year and extending to all future years projected in the basic financial statement. This graphic could illustrate the assumption that increased borrowing would occur to finance the difference between projected receipts and spending.

Illustration 5: Increase in Federal Debt Held by the Public



Data sources:
Historical: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget
Projections: Government Accountability Office, Long-Term Fiscal Simulation Data, Alternative Scenario. Available at: http://www.gao.gov/special.pubs/longterm/data.html (accessed May 7, 2009).

6. Impact of Delaying Action

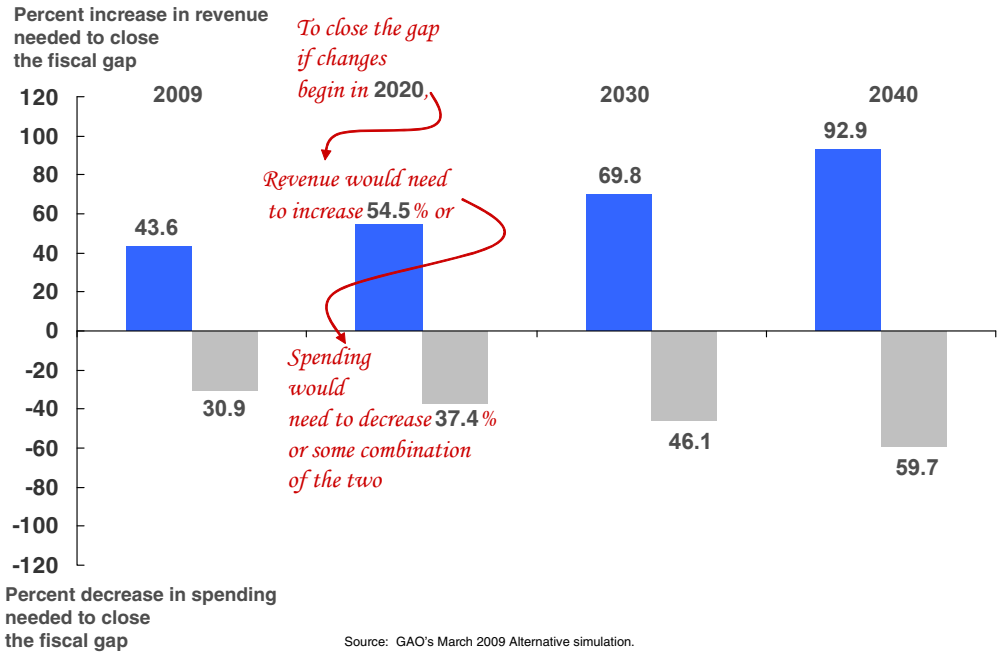
Paragraph 41.c provides that if the projections indicate an excess of projected non-interest spending over projected receipts, RSI should explain and illustrate the likely impact of delaying action. A graphic could display the progressive increase in the change that would be needed to close the fiscal gap by (a) reducing non-interest spending or alternatively (b) by increasing taxes.

Illustration 6: Impact of Delaying Action

What are the Costs of Delaying Action?

How soon action is taken will affect how much the government would have available to spend on various priorities. The measures below show, for each of the years presented, how much the government would have to immediately and permanently either raise receipts or cut non-interest spending – or some combination of the two – to close the fiscal gap* if action begins in that year. For example, if action does not begin until 2040, non-interest spending would have to be permanently reduced by 59.7% or receipts increased by 92.9% (or some combination of the two) relative to 2009 levels of spending and receipts.

*In this projection, "closing the fiscal gap" means to maintain the government's debt at the same size (in relation to the economy) as it was at the beginning of the projection period.



Source: GAO's March 2009 Alternative simulation.

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7. Alternative Scenarios (Range Information)

Paragraph 41.d provides for the explanation and illustration of alternative scenarios consistent with current policy without change. It indicates that a table may be used to display alternative scenarios. The following illustration is an example of how such a table might be displayed.

Illustration 7: Alternative Scenarios

	Statement	Alternative 1	Alternative 2
Receipts:			
Medicare			
Social Security			
All Other			
Total Receipts			
Spending:			
Medicare			
Medicaid			
Social Security			
Major Program A			
Major Program B			
Rest of Government			
Total Non-Interest Spending			
Non-Interest Spending in Excess of Receipts			

8. Fiscal Gap

Paragraph 38 requires that information about fiscal gap be included on the face of the basic financial statement or in the disclosures. The fiscal gap is the change in non-interest spending or receipts that would be necessary to maintain public debt at or below a target percentage of GDP. An illustrative narrative disclosure on the face of the basic financial statement for the change in non-interest spending or receipts necessary is shown on page 38.

The following is an example of an explanation of the concept of fiscal gap that may be useful in putting the information required by paragraph 38 into context:

> How much public debt is sustainable? While many experts agree that some level of public debt is reasonable and acceptable, there is no universally agreed-upon “sustainable” percentage of debt to GDP. However, all experts agree that a continually increasing level of debt to

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GDP is not sustainable. The chart in Note X[34] displays how the debt as a percentage of GDP has varied over time. Debt was 36.8% of GDP as of September 30, 2007, but has risen as high as 109% of GDP (during World War II). Many economists believe that persistent debt-to-GDP levels over 100% are unhealthy.

9. Disclosure on Funding Mechanisms

Paragraph 40.f requires a discussion of the different funding mechanisms for major programs that are not primarily funded by the government's general revenues. Below is an illustrative disclosure.

> Of the $XX of the net excess of non-interest spending over receipts, $YY relates to programs funded by the government's general revenues and $ZZ relates to Social Security (OASDI) and Medicare Part A programs, which are funded by payroll taxes and which are not funded in any material respects by the government's general revenues. If payroll and self-employment taxes and related assets in the Federal Old-Age and Survivors and Disability Insurance (OASDI) Trust Funds or Federal Hospital Insurance Trust Fund (Medicare Part A) become insufficient to cover related benefits, as indicated by projections, additional funding for each of these two programs would be necessary or scheduled benefits would need to be reduced. If the government's general revenues are insufficient to cover both mandated transfers to Medicare Parts B and D and spending for other general government programs funded by the government's general revenues, as indicated by the projections, either the government's general revenues or Medicare Parts B and D revenues (premiums and state transfers) would need to be increased, spending for Medicare Parts B and D and/or other general government spending would need to be reduced, and/or additional amounts borrowed from the public.

10. Other Required Information

The illustrations in the appendix are not all-inclusive. Additional information is required by paragraphs 39 - 42 but is not explicitly described or illustrated in this appendix. For example, paragraph 39 requires an explanation of the nature and limitations of projections. Paragraph 42 requires that the narrative should explain the significance of the data presented and put the information into context.

[34] See *Illustration 5: Trends in Treasury Debt Held by the Public* on page 46.

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Appendix C: Frequently Asked Questions (FAQs)

These FAQs were included in the exposure draft to aid respondents. They are not required in the CFR.

FAQ 1. What is "Fiscal Sustainability Reporting"?
"Fiscal Sustainability Reporting" is the short term for "Comprehensive Long-Term Fiscal Projections and Accompanying Narrative and Graphics in the Financial Report of the U.S. Government."

FAQ 2. What is GDP?
A nation's gross domestic product, or GDP, is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:
GDP = consumption + investment + government spending + (exports − imports)

FAQ 3. a. What is the debt-to-GDP ratio? b. Why does the debt-to-GDP ratio matter?

a. The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by GDP. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]

b. The debt-to-GDP ratio provides an indication of a nation's ability to repay its public debt by comparing the size of its debt to the size of its economy. For example, during the formation of the European Union (EU), one of the conditions for initial membership in the EU, which included eligibility to convert its currency to the Euro, was that each nation had to meet certain conditions, including debt-to-GDP ratio. Generally, higher debt-to-GDP ratios are believed to result in lower economic growth and private investment as well as higher interest costs. Many economists believe that persistent debt-to-GDP levels over 100% are unhealthy. In addition, the debt-to-GDP ratio cannot continue to rise indefinitely, because at some point (although the precise point at which this would occur is unknown) the world's financial markets would likely cease lending to the U.S. government.

FAQ 4. What is present value?
Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the "time value of money" into consideration. The "time value of money" is illustrated by a question such as: "At ten percent interest (compounded annually), how much do I need to put into the bank today in order to have $110 one year from today?" The

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amount you would need today would be $100. Therefore, the present value of $110 in this example would be $100.

In present value calculations, the further out in the future the needed amount, the smaller the amount you would need today. In the first year, you earn interest on the amount that you deposit (the "principal" amount). In the second year, you earn interest on both the original principal amount and the amount of interest that was earned in year one. In year three, you would earn interest on:

- the original principal amount, plus
- the interest earned in year one on the principal amount,
- the interest earned in year two on the principal amount, and
- the interest earned in year two on year one's interest earnings.

This is colloquially called "the magic of compounding." If inflation is less than the rate of interest earned (in this example, ten percent per year), the "magic of compounding" is an advantage to the party that is earning the interest.

FAQ 5. What are projections?

A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions–for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

FAQ 6. What factors affect projections?

Projections are affected by three kinds of assumptions: policy assumptions, economic assumptions, and demographic assumptions.

- Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address projected spending rules for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.
- Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).
- Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Projections are also affected by uncertainty. The uncertainty may be demonstrated by providing alternative scenarios consistent with current policy without change.

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FAQ 7. What is the nature of accounts designated as **"**trust funds" in the budget of the federal government?

A trust fund account, as the term is used in the budget of the federal government, is a type of account designated by law as a trust fund, for receipts earmarked for specific purposes and the expenditure of those receipts. Hence the meaning of the term differs significantly from its meaning in the private sector. For example, a trust in the private sector necessarily involves a fiduciary relationship. In the Federal government, despite the legislative requirement that the funds be earmarked, earmarked funds (often titled "trust funds" in the federal budget) are distinct from fiduciary activities.[35]

Moreover, in order to reduce confusion between accounts designated as "trust funds" in the budget of the federal government (such as the trust fund accounts for Social Security and Medicare) and private-sector trust funds, FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term "trust fund" for earmarked funds (federal "trust funds") except when referring to the legal title of the fund. SFFAS 27 also requires the following note disclosure when accounts designated as "trust funds" in the budget of the federal government use their excess funds to buy Treasury securities:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures. (For some funds, the drawdown is subject to future appropriation).
- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. government-wide financial statements.
- When the earmarked fund's Treasury securities are redeemed to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.[36]

[35] Fiduciary Activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*.
[36] See SFFAS 27, *Identifying and Reporting Earmarked Funds*, paragraphs 16 and 27.

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Appendix D: Abbreviations

CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FAQ	Frequently Asked Question
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office (formerly, General Accounting Office)
GDP	Gross Domestic Product
IPSASB	International Public Sector Accounting Standards Board
OASDI	Old Age, Survivors and Disability Insurance (Social Security)
OECD	Organisation for Economic Co-Operation and Development
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOSI	Statement of Social Insurance
U.S.	United States

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Appendix E: Fiscal Sustainability Reporting Task Force

The FASAB acknowledges with gratitude the invaluable expertise and support of the Fiscal Sustainability Reporting Task Force participants.

The views expressed in this standard represent the views of the FASAB members and should not be attributed to the Task Force participants or to their organizations.

Members of Congress

The Honorable James Cooper, D-TN

The Honorable K. Michael Conaway, R-TX

Federal Government Participants

James Duggan, PhD, Senior Economic Advisor for Social Security, Office of Economic Policy, Department of the Treasury

Patrick Locke, Chief, Budget Analysis Branch, Office of Management and Budget

Robert B. Anderson, Senior Economist, Office of Management and Budget

Stephen Goss, Chief Actuary, Social Security Administration

Richard Foster, Chief Actuary, Centers for Medicare and Medicaid Services

Thomas McCool, PhD, Director, Center for Economics, Government Accountability Office

Benjamin R. Page, PhD, Principal Analyst, Macroeconomic Analysis Division, Congressional Budget Office

Non-Government Participants

Joseph Antos, PhD, Wilson H. Taylor Scholar in Health Care and Retirement Policy, American Enterprise Institute

Allen Schick, PhD, Visiting Fellow in Governance Studies, Brookings Institution

Jagadeesh Gokhale, PhD, Senior Fellow, Cato Institute

Robert Bixby, JD, Executive Director, Concord Coalition

Paul Posner, PhD, Director, Master's in Public Administration Program, George Mason University

Gary Kreps, PhD, Chair, Department of Communication, George Mason University

Sheila Weinberg, CEO and Founder, Institute for Truth in Accounting

C. Eugene Steuerle, PhD, Senior Fellow, Urban Institute

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Appendix F: Glossary

Current Policy Without Change – In federal financial reporting, "current policy without change" refers to the continuation of policies in place as of the valuation date (in other words, no policy change).

Debt-to-GDP Ratio – The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by gross domestic product. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]

Demographic Assumptions – Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Discretionary Spending – In the federal budget process, "discretionary spending" refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not "mandatory." For additional information, see *A Glossary of Terms Used in the Federal Budget Process,* GAO-05-734SP.

Earmarked Revenue (or Earmarked Funding) – Earmarked revenue is revenue that comes from a source that is distinct from general tax revenues and may be used only for the purpose for which it is collected. Examples of earmarked revenue are: Social Security taxes, Medicare taxes, Federal Unemployment taxes, and federal excise taxes on gasoline.

Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as "special funds" or "trust funds." The distinction of whether an earmarked fund is categorized in the budget as a "special fund" or a "trust fund" is determined by the applicable legislation. In order to reduce confusion between accounts designated as "trust funds" in the budget and private-sector trust funds, FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds,* prohibits the term "trust fund" for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure for investments in Treasury securities for earmarked funds to explain the nature of funds that are designated as "trust funds" in the budget of the federal government:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).

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- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.
- When the earmarked fund's Treasury securities are redeemed to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.[37]

Economic Assumptions – Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

Fiscal Gap – The fiscal gap is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of GDP. The fiscal gap is the net present value of projected non-interest spending[38] minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at the target level for the stated projection period. The fiscal gap may be expressed as:

(a) a summary amount in present value dollars,
(b) a share of the present value of the GDP[39] for the projection period, and/or
(c) a share of the present value of projected receipts or projected non-interest spending.

Fiscal Sustainability Reporting – In federal financial reporting, "Fiscal Sustainability Reporting" is the short term for the basic financial statement, disclosures and Required Supplementary Information required in the Financial Report of the U.S. Government.

Gross Domestic Product (GDP) – A nation's gross domestic product is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are:
GDP = private sector consumption and investment + government consumption and investment + net exports (exports − imports).

Mandatory Spending – "Mandatory spending" includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation acts. For additional

[37] SFFAS 27, paragraph 27.
[38] Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest.
[39] GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

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information, see *A Glossary of Terms Used in the Federal Budget Process,* GAO-05-734SP.

Policy Assumptions – Policy assumptions address the factors under the direct control of the federal government concerning the taxes and other receipts to be received by the federal government and the public services to be provided by the federal government. Policy assumptions address projected spending rules for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.

Present Value – Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the "time value of money" into consideration. The "time value of money" is illustrated by a question such as: "At ten percent interest (compounded annually), how much do I need to put into the bank today in order to have $110 one year from today?" The amount you would need today would be $100. Therefore, the present value of $110 in this example would be $100

Projections – A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions–for example, what if current policy without change regarding federal government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

Public Services – In federal financial reporting, "public services" refers to all goods, benefits and services provided by the government. Federal public services include but are not limited to the provision of goods, cash (such as Social Security benefits) or other financial benefits (such as loan guarantees), as well as national defense, national security, transportation safety and the operation of national parks.

Required Supplementary Information (RSI) – Information that a body that establishes generally accepted accounting principles (GAAP) requires to accompany basic information. When an auditor is engaged to audit an entity's financial statements, basic information is subject to testing for fair presentation in conformity with GAAP. However, RSI for federal entities is unaudited but subject to certain procedures.

Trust Fund Accounts – In the federal government, trust fund accounts are accounts that are designated by law as "trust funds," for receipts earmarked for specific purposes and the associated expenditure of those receipts. Collections may come from the public (e.g., earmarked taxes or user charges) or from intra-

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budgetary transfers. More than 150 federal government trust fund accounts exist, of which the largest and best known finance several major benefit programs (including Social Security and Medicare) and certain infrastructure spending (the Highway and the Airport and Airway Trust Funds).

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FASAB Board Members

Tom L. Allen, Chair

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In Memory of Robert Paul Murphy

Robert Paul Murphy, who passed away on August 12, 2008, was the Congressional Budget Office's General Counsel and served as the CBO's representative on FASAB.

Mr. Murphy was an active participant in the FASAB's deliberations during his tenure on the Board. He provided helpful insight regarding the CBO's long-term projections that advanced the Board's work on this Statement. Even more importantly, Mr. Murphy exhibited a quality of leadership that brought people together, a spirit of caring for others, and a commitment to the service rendered by the Board to the American people. He is greatly missed by the members and staff of the Board.

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Eileen W. Parlow

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements

Statement of Federal Financial Accounting Standards 37

April 5, 2010

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or the Board) was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, and academe), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- *"Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*

- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Summary

For federal financial reporting, social Insurance comprises five programs – Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance. However, two programs, Social Security and Medicare, are of special significance because of the high rate of participation among citizens, the fiscal challenges related to the programs, and the challenges associated with incorporating estimates of future cash flows of this magnitude in financial statements. Therefore, the Federal Accounting Standards Advisory Board (FASAB or "the Board") has devoted substantial resources to considering how fundamental questions about social insurance programs should be addressed through federal financial reporting. These questions include whether the government can sustain these programs as currently constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and how long these programs will be able to provide benefits at current levels.

From the outset of this project, members have agreed on the objectives of financial reporting for social insurance programs and yet have had different views about how best to achieve the objectives. For example, all members have agreed that it is extremely important to provide useful financial information about the sustainability of social insurance programs, and that such information should be presented for the government as a whole in the consolidated *Financial Report of the United States Government*.[1] Members have agreed that social insurance information should be included in the basic financial statements and should be "transparent" – that is, readily understandable to an interested, non expert reader. Members also have agreed that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. All members have supported several innovations, including a new basic financial statement presenting changes in the amounts presented on the statement of social insurance. However, members have had different views about what should be reported on certain financial statements.

The key difference among members is in regard to the timing of the recognition of expense and liability for social insurance programs. Some members believe that an expense is incurred and a liability arises for social insurance programs during the working lives of participants, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability. Other members agree with Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, that an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the amount is "due and payable."

[1] To that end the Board recently issued Statement of Federal Financial Accounting Standards 36,

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This Statement of Federal Financial Accounting Standards represents a compromise. It provides enhanced reporting but does not resolve the two strongly held views regarding when the obligating event occurs for social insurance programs and, thus, when the liability and expense definitions are met within those programs. Therefore, this Statement does not change the liability and expense recognition and measurement from that required in SFFAS 17.[2]

SFFAS 17 requires certain information about social insurance programs, and this Statement requires the following:

1. Critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the long-term fiscal projections together in one section in management's discussion and analysis (MD&A).[3]
2. A table or other singular presentation of key measures in MD&A.
3. A new summary section for the statement of social insurance.
4. A new basic financial statement to present the reasons for changes during the reporting period in the open group measure reported on the statement of social insurance.

Although opinions continue to differ regarding when the obligating event occurs for social insurance programs, and thus the question of when the liability and expense occur within those programs continues to be discussed, this Statement fulfills a desire held by all the members to present other information that will significantly improve readers' understanding of the status and results of the government's social insurance programs.

Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government.

[2] SFFAS 17 established a "due and payable" liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims incurred but not reported.

[3] This Statement applies only to the government-wide entity and to component entities that prepare a statement of social insurance.

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Table of Contents

Introduction 4
Purpose 4
Background 5
Materiality 6
Effective Date 6
Accounting Standard 7
Scope 7
Definitions 8
Management's Discussion and Analysis 9
Statement of Social Insurance 10
Statement of Changes in Social Insurance Amounts 11
Required Supplementary Information other than MD&A 11
Valuation Date 11
Sensitivity Analysis 12
Government-wide Entity Accounting and Reporting 13
Effect on SFFAS 17 13
Effective Date 16
Appendix A: Basis for Conclusions 17
Background 17
What the *Preliminary Views* Document Proposed 18
Different Views Regarding the Obligating Event 19
Fiscal Sustainability Reporting 20
Social Insurance Revisited: The Exposure Draft of November 2008 21
History of the Closed Group Measure 22
Respondents Comments on the Exposure Draft 26
Board Approval 39
Appendix B: Illustrative Table of Key Measures 40
Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI 41
Appendix D: Illustrative Statement of Changes in Social Insurance Amounts 46
Appendix E: Glossary 48
Appendix F: List of Abbreviations 50

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_37.pdf.

Introduction

Purpose

1. Federal financial reporting should provide accurate and transparent information to citizens so that they can make well-informed decisions for themselves and their government. In this regard, such reporting must include information on the government's long-term commitments for social insurance as well as all other government programs. This Statement of Federal Financial Accounting Standards (SFFAS or Statement) supports that objective.

2. This Statement amends sections of SFFAS 17, *Accounting for Social Insurance*. In addition to the current requirements in SFFAS 17, the standard requires the government-wide entity as well as entities that present a statement of social insurance (SOSI) to:

    a. include in one section of management's discussion and analysis (MD&A) information[4] about costs, assets and liabilities, social insurance commitments, budget flows, and long-term fiscal **projections**; [5]

    b. include in MD&A a table or other singular presentation of key measures drawn from the basic financial statements;

    c. add a section within the SOSI that summarizes the net **present values** of cash flows and presents certain subtotals and totals (see Appendix C: Illustrative Statement of Social Insurance); and

    d. present a statement of changes in social insurance amounts (SCSIA) that indicates the reasons for changes in the open group measure from the end of the previous reporting period (see Appendix D: Illustrative Statement of Changes in Social Insurance Amounts).

3. The federal financial reporting model is unique. The model includes, in addition to a balance sheet and statements of net cost and changes in net position, unique financial statements designed specifically for the federal government, including a statement of budgetary resources, a SOSI, and a statement of long-term fiscal projections for the U.S. government. In addition, MD&A is a required component in federal financial reports. This Statement provides for additional reporting within this model.

[4] This Statement applies only to the government-wide entity and to component entities that prepare a statement of social insurance.
[5] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

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Background

4. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, the federal government is unique when compared with any other entity in the country. In SFFAC 1, the Board established four major reporting objectives for federal accounting standards. The objectives deal with (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control.

5. Although all four of the objectives are equally important, Objectives 2 and 3 guided the development of the social insurance standard. Objective 2 states that federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

6. Objective 3 states that federal financial reporting should assist users in assessing the impact of the government's operations and investments for the period and how the government's and the nation's financial condition has changed and may change in the future. This objective is based on the government's responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services, but on the requirement that the government report the broad outcomes of its actions.

7. In light of Objective 3, fundamental questions about social insurance programs should be addressed by accounting standards, including whether the government can sustain these programs as currently constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and how long these programs will be able to provide benefits at current levels. The information that is proposed will help users address these questions.

8. The SOSI was a first step in the process of developing information for an assessment of sustainability of specific programs in government-wide financial reports and in the financial reports of component entities that administer social insurance programs. The SOSI is based on long-range actuarial estimates of future costs. SFFAS 17 requires certain supplementary information as well, including presentations of future cash flow as a percentage of taxable payroll and Gross Domestic Product (GDP). The SOSI and required supplementary information (RSI) provide information that helps users analyze the effect of benefit payments to different participants under current law, as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

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9. Social insurance involves major programs. They are not only a component of federal operations, but an essential part of the national economy. This Statement requires information that is not currently provided. Specifically, it requires management to discuss and analyze in MD&A measures of social insurance in the context of other measures presented in the basic financial statements. In addition, it requires a table or other singular presentation of measures in MD&A; a new summary section for the SOSI; and a new statement of changes in social insurance amounts.

Materiality

10. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

11. The provisions of this Statement will be effective beginning in fiscal year 2011.

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Accounting Standard

Scope

12. This Statement of Federal Financial Accounting Standards (SFFAS or Statement) is applicable to the consolidated financial report of the U.S. government as well as to the financial reports of component entities that present a Statement of Social Insurance (SOSI). Social insurance standards for these entities are provided in SFFAS 17.

13. This Statement amends sections of SFFAS17. It does not affect provisions of SFFAS 17 that are not explicitly described and illustrated in paragraph 40 of this standard. For the government-wide entity and entities that present a SOSI, the Statement supplements SFFAS 15, *Management's Discussion and Analysis*; it does not affect the MD&A requirements of other entities.

14. The following five programs are the sole programs subject to social insurance amendments adopted through this Statement:

    a. Old-age, Survivors, and Disability Insurance (OASDI or Social Security);
    b. Medicare Hospital Insurance (Medicare HI) (Part A) and Medicare Supplementary Medical Insurance (Medicare SMI) (Part B and Part D);[6]
    c. Railroad Retirement benefits (RRB);[7]
    d. Unemployment Insurance for the general public (UI);[8] and
    e. Black Lung benefits.

[6] Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) created the Medicare Advantage (MA) program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to beneficiaries, and must provide all Medicare-covered services. Many MA plans offer additional Medicare services such as prescription drugs and vision and dental benefits to beneficiaries. The federal government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and would be accounted for accordingly.

[7] Legislation enacted in 1974 restructured railroad retirement benefits into two tiers, so as to coordinate them more fully with Social Security benefits. The first tier is based on combined railroad retirement and Social Security credits, using Social Security benefit formulas. The second tier is based on railroad service only and is comparable to the pensions paid over and above Social Security benefits in other industries.

[8] Pursuant to SFFAS 17, a statement of social insurance is not prepared for the UI program; SFFAS 17 specifies other reporting for the UI program. Thus, for the purposes of this Statement, the UI program is not a "component entity that presents a SOSI."

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Definitions

15. Closed group population

Those persons who, as of a **valuation date**, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

16. Closed group measure

The closed group measure is the net present value of all expenditures to or on behalf of the closed group population (see above) participating in a social insurance program and all contributions or other income from or on behalf of those participants over a given projection period.

17. Closed group unfunded obligation

The closed group unfunded obligation is the closed group measure (see above) minus the value of the assets held by the program at the beginning of the reporting period.

18. Current participants

All individuals currently participating in a social insurance program, e.g., for Social Security, those who are 15 years and older and are working or have worked in covered employment and retirees as of the valuation date. An entry age for work in covered employment of 15 years is assumed.

19. Future participants

Individuals who are not currently participating in a social insurance program but who are projected to participate in the future over a given projection period as contributors or beneficiaries or both. For example, for Social Security, future workers and beneficiaries who are under age 15, not yet born, or not yet immigrated as of the valuation date.

20. Open group population

Those persons who, as of a valuation date, are or will be during the projection period participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

21. Open group measure

The open group measure is the net present value of all expenditures to or on behalf of the open group population (see above) and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years.

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22. Open group unfunded obligation

The open group measure (see above) minus the value of assets held by the program at the beginning of the reporting period.

Management's Discussion and Analysis

23. Component entities that present a SOSI and the government-wide entity should discuss critical measures from their basic statements in a separate section of their management's discussion and analysis (MD&A). They should explain the significance of key amounts, the major changes in those amounts during the reporting period, and the causes thereof. In particular, the entity should explain why the changes occurred and what they imply for the program's operation. The entity should explain how costs and commitments incurred during the period were or will be financed. The entity should describe important existing and currently-known demands, risks, uncertainties, events, and conditions—both favorable and unfavorable—that affect the amounts reported in the basic financial statements. The discussion should go beyond a mere description of existing conditions and should encompass the possible future effects of anticipated future events, conditions, and trends regarding social insurance programs. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

24. At a minimum, component entities that present a SOSI and the government-wide entity should present and explain, as described in paragraph 23, the following measures except as noted:

    a. From the statement of net cost and the statement of changes in net position (component entities) or statement of operations and changes in net position (government-wide entity):

        i. Net costs
        ii. Total financing sources and net change of cumulative results of operations (for component entities only) and
        iii. Total revenue and net operating costs (for the government-wide entity only)

    b. From the statement of financial position (balance sheet):

        i. Total assets
        ii. Total liabilities
        iii. Net position

    c. From the statement of social insurance and the statement of changes in social insurance amounts (SCSIA):

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i. The open group measure; the entity should discuss the closed group measure in the narrative and explain how it differs from the open group measure[9] and the significance of the difference
ii. The change in the open group measure during the reporting period(s)

d. From the reconciliation of net operating cost and unified budget deficit (for the government-wide entity only): total unified budget deficit or surplus

e. From the statement of long-term fiscal projections (for the government-wide entity only): the net present value of the excess of spending over receipts.

25. In addition, MD&A should present the above measures in a table or other singular presentation (see the illustration for the government-wide entity at Appendix B: Illustrative Table of Key Measures). The closed group measure is not required to be presented in the table or other singular presentation. The table in Appendix B is for purposes of illustration only. The preparer should determine the most effective format for communicating the critical financial information and the reasons for changes during the prior period.

26. Each critical measure above (costs, net position, etc., see paragraph 24) may be disaggregated into sub-measures. For example, regarding assets, component entities may separately present Treasury securities held, and liabilities may be disaggregated into major items, i.e., into line items for employee pension liabilities and other liabilities.

27. The amounts discussed in MD&A for the open group measure should be the same as the amount in the summary section of the SOSI (discussed below and in Appendix C: Illustrative Statement of Social Insurance), and the SCSIA (discussed below and in Appendix D: Illustrative Statement of Changes in Social Insurance Amounts).

Statement of Social Insurance

[*See* Appendix C: Illustrative Statement of Social Insurance*. There are two illustrations, one for the government-wide entity (Part I) and another for the component entity (Part II)*.]

28. The government-wide entity and component entities that present a SOSI pursuant to SFFAS 17[10] should conclude the SOSI with a summary section that presents the closed group measure and open group measure (see Appendix C). The open group

[9] See the definitions of "closed group" and "open group" in pars. 15—22. The Black Lung benefits program serves a population that is closed to new entrants; therefore, for that program, the open and closed groups would be the same.
[10] Currently, these component entities are the Social Security Administration, the Department of Health and Human Services, the Centers for Medicare and Medicaid Services, the Railroad Retirement Board,

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measure line item should be the same as lines on the beginning-of-year and end-of-year amounts on the SCSIA (see below and Appendix D).

29. The summary section of the component entity SOSI should include the assets held by the programs, if any, and totals for the open group unfunded obligation (see Appendix C, Part II, summary section for component entities).

30. This Statement should not be construed to preclude presenting subtotals by age cohort.

Statement of Changes in Social Insurance Amounts

[*See* Appendix D: Illustrative Statement of Changes in Social Insurance Amounts.]

31. The government-wide entity and component entities that present a SOSI should present a SCSIA. The SCSIA will reconcile beginning and ending open group measures and present the components of the changes in the open group measure from the end of the previous reporting period. It should present the significant components of the change, e.g., the change due to the change in valuation period; the interest on the obligation due to present valuation; the changes in demographic, economic, and health care assumptions; the changes in law, regulation, and policy; and the amounts associated with each type of change.

32. The SCSIA should disclose in notes on the face of the statement and/or in notes to the financial statements the reasons for the changes. The reasons should be explained as briefly and simply as possible. The most significant changes should be explained in the entity's MD&A as well as in disclosures associated directly with the SCSIA.

Required Supplementary Information other than MD&A

33. This Statement does not eliminate or otherwise affect the SFFAS 17 requirements for supplementary information[11] except that actuarial projections of annual cash-flow in nominal dollars are no longer required for either component entities that present a SOSI or the government-wide entity.

Valuation Date

34. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("current year") as possible and no more than one year prior to the end of the current year.

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and the Department of Labor.

[11] SFFAS 17, paragraph 27(1) requires certain long-range projections of social insurance cash-flow.

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This valuation date should be consistently followed from year to year. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy reforms had taken place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

35. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from the estimated cost. For example:

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

> The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

Sensitivity Analysis

36. The component entity should provide, as required supplementary information, **sensitivity analysis** of the closed and open group measures appropriate for their circumstances.[12] The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The Social Security Administration (SSA), Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure in the SOSI summary. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.

37. When choosing an approach for sensitivity analysis, the entity should consider future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report.

[12] See Actuarial Standards of Practice 32, paragraph 3.5.

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38. The government-wide entity should provide a summary of the sensitivity analyses required for component entities.

Government-wide Entity Accounting and Reporting

39. The standard for government-wide accounting and reporting for social insurance programs is the same as that for component entities that present a SOSI unless otherwise indicated. However, the level of detail at the government-wide level should be less than at the component level.

Effect on SFFAS 17

40. The Statement provides additional requirements for presentation, disclosure, and supplementary reporting for social insurance programs. SFFAS 17 is amended as follows to conform to the changes in this Statement:

26. ~~All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.~~

All projections and estimates required by this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the policy change should be disclosed. If policy changes are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy change and, if known, the estimated effect on the projections.

26A. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from the estimated cost. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate. For example:

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

27 (1) *Cash-flow Projections –* …

~~(a)~~ Actuarial projections of the annual cash-flow~~, in nominal dollars,~~ with amounts reported for at least every fifth year in the projection period. The cash-flow information should show

i. total cash inflow from:

a. all sources and
b. excluding net interest on intra governmental borrowing/lending and

ii. total cash outflow

~~b)The actuarial estimate provided in 27(1)(a)(i)2) and 27(1)(a)(ii) immediately above as a percentage of~~
~~(i)~~**~~taxable payroll~~**~~[7] and~~
~~(ii)~~ **~~Gross Domestic Product~~** ~~(GDP).[8]~~

For the OASDI and HI programs, the actuarial projections of the annual cash-flows should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

~~[7] Certain social insurance programs (i. e., SMI, Black Lung benefits, and UI) are either not financed by earmarked payroll taxes or are financed by state-determined payroll taxes on employers that can vary by state and by employer; therefore these programs are not required to provide this estimate.~~
~~[8] This requirement does not apply to the RRB, Black Lung, and UI programs.~~

…

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(4) *Sensitivity Analysis* –

(a) ~~For a~~All programs ~~except UI, illustrate the sensitivity of the projections and present values required by paragraph 27(1) and 27(3) to change in the most significant individual assumptions. For example, using the entity's "best estimates" cost assumptions as a baseline, show the effect of varying several significant assumptions one at a time to show the effect on the projection. At a minimum, the OASDI and Medicare programs should analyze assumptions regarding the birth and death rates, net immigration, the real wage differential, and the real interest rate. The real wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI. The Medicare program should also analyze the health care cost factors and their trend.~~ should provide sensitivity analysis appropriate for their particular circumstances. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The OASDI, Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure presented in the SOSI summary. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. The entity should state that the amounts of the closed and open group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.

~~(b) For UI, illustrate the sensitivity of the projections required by paragraph 27(1) to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).~~

32. … (4) *Sensitivity Analysis* – For all social insurance programs, provide a summary of the sensitivity analysis required ~~under the standard~~ for component entities ~~(see par. 27(4)). At a minimum, the summary should present the OASDI, HI, SMI, and UI separately.~~

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Effective Date

41. This Statement is effective for periods beginning after September 30, 2010.

The provisions of this statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This Appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement of Federal Financial Accounting Standards (SFFAS or "Statement"). It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement – not the material in this Appendix – should govern the accounting for specific transactions, events, or conditions.

Background

A1. Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy. In its 19 years of operation the Board has issued several exposure drafts, a standard, and a preliminary views document related to social insurance reporting as follows:

- A 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*
- A 1998 exposure draft entitled *Accounting for Social Insurance*
- SFFAS 17, *Accounting for Social Insurance*, in August 1999
- A 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which resulted, in 2003, in SFFAS 25 of the same title
- A 2004 exposure draft entitled *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, which resulted, in 2004, in SFFAS 26 of the same title
- A 2006 preliminary views document entitled *Accounting for Social Insurance, Revised and*
- A 2008 exposure draft entitled *Accounting for Social Insurance, Revised*

A2. For SFFAS 17 the Board identified five programs as social insurance programs.

- Old-Age, Survivors, and Disability Insurance (OASDI or Social Security)
- Hospital Insurance (HI) and Supplementary Medical Insurance (SMI); known collectively as "Medicare"
- Railroad Retirement benefits
- Black Lung benefits and
- Unemployment Insurance (UI)

A3. The issue of social insurance accounting was addressed in SFFAS 17 through

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compromise between strongly opposing views. The compromise featured:

a. liability recognition at the point when social insurance benefit payments are due and payable and with revenue and expenses on a cash-flow basis, plus or minus the change in the due and payable liability during the reporting period;
b. a SOSI and accompanying disclosures; and
c. other narrative and trend information, e.g., graphs of long-term cash flow projections using nominal dollars and as percentages of taxable payroll and GDP, the "dependency ratio," and sensitivity analysis.

A4. Through SFFAS 25 and 26, the Board re-classified the SOSI from "required supplementary stewardship information" to basic information. The SOSI became subject to a full audit in fiscal year 2006 and significant assumptions were required to be disclosed.

A5. SFFAS 17, 25, and 26 substantially improved the information presented in general-purpose external financial reports of the U.S. government and its component entities. However, in 2004 the Board decided to reconsider the question of liability and expense recognition. A majority of members serving at that time concluded that the compromise that produced SFFAS 17 did not recognize the accruing cost of social insurance programs in each reporting period and the accumulated liability for benefits payable at a determinable date under current law. Nor did it fully explain the change in the net present value of program-related cash flows. Hence, in 2004, the Board initiated a new social insurance project, and a *Preliminary Views* document was issued in October 2006.

What the *Preliminary Views* Document Proposed

A6. In the *Preliminary Views* document, the Board presented two views – a Primary View and an Alternative View – of proposed changes in the information provided about the effect of social insurance programs. Under the Primary View proposal, social insurance expense would have been recognized on the statement of net cost when participants become **fully insured** and thus substantially meet the eligibility conditions for future benefits and as scheduled benefits increase due to additional work in covered employment by fully insured individuals.

A7. In addition to changing the expense and liability recognition points, the Primary View would have linked the SOSI amounts with amounts reported for social insurance on the balance sheet and statement of net cost. For the Primary View members, such linkage or "articulation" would have illustrated how the amounts reported on other basic financial statements relate to the present values of the cash inflow and outflow over the next 75 years reported on the SOSI.

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A8. The Alternative View in the *Preliminary Views* document proposed to maintain the recognition and measurement of expense and liability for Social Security, Medicare, and Railroad Retirement programs currently required in SFFAS 17. That is, the entity would recognize a liability and a related expense for social insurance benefits when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods, or services), which includes the point when benefit payments are "due and payable." Thus, under the Alternative View the amounts reported on the balance sheet, statement of net cost, and statement of social insurance presentation would not have changed from what is currently reported under SFFAS 17.

A9. The Alternative View in the *Preliminary Views* document would have added a new basic financial statement entitled the "statement of changes in social insurance amounts," that would show the reasons for all changes during the period in the amounts (net benefits less receipts) presented in the statement of social insurance. The Primary View members agreed in principle that such a statement should be required.

A10. In addition, the Alternative View in the *Preliminary Views* proposed to break new ground. It proposed a new statement of "fiscal sustainability"[13] for the consolidated *Financial Report of the United States Government* (*CFR*) that would provide sustainability information on the entire government, including information necessary to assess the sustainability of social insurance programs and information on **intergenerational equity**, as required supplementary information.

A11. The members supporting the Primary View welcomed and encouraged the development of additional supplementary sustainability information. However, they believed it should be the subject of a separate project because it has implications for a wide variety of issues.

A12. The FASAB subsequently undertook a project on sustainability that resulted in SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*.

Different Views Regarding the Obligating Event

A13. Supporters of the Primary and Alternative Views differed as to the event or

[13] SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*, paragraph A3, notes that discussion of long-term fiscal issues has been described in terms of "fiscal sustainability," and that in the exposure draft on that subject the Board's working definition of fiscal sustainability was "the federal government's ability to continue, both now and in the future, current policy without change regarding public services and taxation without causing debt to rise continuously as a share of GDP."

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transaction that would trigger an expense and a liability for social insurance programs. The members supporting the Primary View believed that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities.

A14. Members supporting the Alternative View in the *Preliminary Views* document saw a fundamental distinction in financial reporting of exchange transactions, which are voluntary market exchanges of goods and services for a price, and nonexchange transactions resulting from decisions made collectively by the Congress and the President to levy taxes and to authorize programs. They noted that this distinction is made in FASAB concepts, standards, and financial statements, e.g., the statement of net cost, as well as by other standard setters, including the Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB); and that it is also the difference between offsetting collections or offsetting receipts, on the one hand, and governmental receipts on the other hand.

A15. Members who supported the Alternative View in the *Preliminary Views* document believed that although the basis for recognition of a liability and cost for social insurance established in SFFAS 17 (e.g., due and payable) remains appropriate, the set of information required by SFFAS 17 was inadequate. They argued that SFFAS 17 does not (1) recognize important information concerning the fiscal sustainability of social insurance programs, or (2) fully explain the change in the net present value of program related cash flows. They believed that the fundamental nature of social insurance is more complex than the federal government's current accounting model could accommodate.

A16. It is extremely important to note that both the Primary View and the Alternative View in the *Preliminary Views* document called for sustainability reporting. Those members who supported the Primary View believed that the Board should consider additional sustainability reporting in a future project. As noted above, the FASAB subsequently undertook a project on the subject that resulted in SFFAS 36.

Fiscal Sustainability Reporting

A17. After the public hearing on the *Preliminary Views* on social insurance on May 23, 2007 and initial discussions in the summer of 2007, the Board decided to suspend work on the social insurance standard briefly while it developed fiscal sustainability reporting further. The *Preliminary Views* document mentioned the Board's unanimous interest in fiscal sustainability reporting and the Alternative View presented examples of what it might look like.

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A18. The Board issued an exposure draft on fiscal sustainability[14] in August 2008, and subsequently a final standard, SFFAS 36, in September 2009.[15] SFFAS 36 requires that the CFR present information that will help readers assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, including social insurance. The Board concluded that this requires presenting current and projected levels of all federal spending, federal receipts, and federal debt in relation to the economy.

A19. The fiscal sustainability standard is comprehensive. It requires:

a. A statement of long-term fiscal projections for the U.S. government, a basic financial statement, in the CFR presenting the present value of projected receipts and non-interest spending under current policy without change for all activities of the federal government, including social insurance; how those amounts relate to projected GDP; and changes in the present value of projected receipts and non-interest spending from the prior year.
b. Supplementary information explaining and illustrating the projected trends in:
    i. The relationship between all federal government receipts and spending,
    ii. Deficits or surpluses, and
    iii. Treasury debt as a share of GDP.
c. Disclosures explaining and illustrating:
    i. The assumptions underlying the projections,
    ii. Factors influencing trends, and
    iii. Significant changes in the projections from period to period.

A20. The Board believes that these projections will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, including social insurance obligations.

Social Insurance Revisited: The Exposure Draft of November 2008

A21. Having developed the proposed fiscal sustainability standard, the Board returned to social insurance. In November 2008, the Board issued the exposure draft *Accounting for Social Insurance, Revised* (SI ED). The Board noted in the SI ED that the fundamental difference of opinion on the question of liability and expense recognition for social insurance was reflected in the views of the respondents to the *Preliminary Views* document itself. Indeed, the difference of opinion has persisted since the Board's initial consideration of the social insurance liability question during the development of SFFAS 5 and especially during the development of SFFAS 17.

[14] *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government,* Issued August 29, 2008.
[15] September 28, 2009.

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A22. SFFAS 17 presented a compromise between two strongly held views regarding liability and expense recognition for social insurance programs. For SFFAS 17, the Board concluded that the best approach was to recognize the annual cash flow effects of the social insurance programs in the basic financial statements; that is, revenue is the cash inflow during the reporting period from payroll tax contributions and income tax on social insurance benefits and expenses are the cash outflow during the year plus or minus the change in a "due and payable" liability. However, the Board also required a package of information that it characterized as required supplementary stewardship information (RSSI).

A23. For the RSSI section, the Board required an array of present values by age cohort in what became the statement of social insurance (SOSI). In addition, the Board required other information, e.g., projections of cash flows over long-term projection periods using nominal dollars and as percentages of taxable payroll and GDP.

A24. The Board decided that the "bottom line" of the SOSI should be an open group measure. That bottom line represents the total excess of actuarial present values of future benefit payments over future contributions and tax income for current and future participants over a period sufficient to illustrate long-term sustainability. There had been much debate during the development of the standard over whether to present the open group measure or the closed group measure.

History of the Closed Group Measure

A25. The term "group" simply refers to the participants included in a measure. The "closed group" includes current participants only, e.g., for Social Security, current retirees and covered workers. It does not include future participants; those projected to become participants during the projection period but after the valuation date. It contrasts with the "open group" that does include those who are currently participating and those who will participate in the future during the projection period. The open and closed group measures include all future flows related to the specified group. These measures contrast with an accrued benefit obligation measure which includes only future benefits attributed to past work in covered employment by current participants as of the reporting date.

A26. The closed group measure has been an option for federal financial reporting for a long time. From 1985 through 1994, the closed group measure was disclosed in a footnote in the "prototype" *Consolidated Financial Statements of the United States* (prototype CFS). Before that, from 1976 to 1985, a liability had been recognized for Social Security in the prototype CFS, using a calculation similar to that called for by private sector accounting standards.

A27. Ultimately, for SFFAS 17, the Board decided to develop the SOSI to provide

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actuarial present values of future contributions and benefits for the open group of participants but not the closed group per se. The Board concluded that the SOSI as constituted would be useful for analysis of sustainability and financial position of social insurance programs.

A28. The vote for SFFAS 17 was not unanimous. Three members dissented. Their dissents focused primarily on the switch from the closed to the open group bottom line. One of the dissenting members said the closed group deficit was a very important measure in evaluating alternative proposals for social insurance financing. Even though SFFAS 17 required instructions in a footnote on how to calculate the closed group measure, the member felt that, if the Board truly wished to establish standards that meet the information needs of citizens, elected officials, and program managers, the standard should require the prominent presentation and explanation of the closed group measure rather than a footnote explaining how to calculate the closed group measure. The member did not see how that could possibly be interpreted as satisfying the mission of the Board.

A29. Another member dissented because he felt SFFAS 17 did not require a clear unambiguous disclosure of a reasonable estimate of the government's social insurance liability/obligation. That member argued that the due and payable liability would result in a reported financial position that would appear to many as significantly misleading, at best, and clearly not commensurate with the significant financial implications of this critical national issue. The member noted that SFFAS 17 required the net present value of future benefits related to the open group but not the closed group, and that the absence of the specified closed group measure was significant because some suggest that the closed group measure represents an appropriate estimate of the social insurance liability.

A30. Lastly, a third dissenter argued that the removal of the closed group number from the published financial statements removed any forthright indication of the existence of any obligations to participants. He asked what the government's repeated promises meant if there is no obligation to the participating public. He argued that the closed group number is an important indicator of financial stress to be faced by the next generation of Americans, and is a proxy for an economic liability or an "implicit" liability. He mentioned that proposals to add social insurance benefits or increase social insurance taxes or to make other changes in the program should be evaluated by Congress and the public against these absolute numbers and the strength of the government's commitment to honor the indicated obligations. Finally, he argued that the SOSI should be a basic financial statement, which it later became with SFFAS 25 and SFFAS 26.

A31. Some current Board members believe that the closed group measure is the best measure of the social insurance obligation and that the effect of the change in this measure during the reporting period is an economic cost that should be reported on

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the statement of net cost. However, other members agree that the closed group measure is the best measure of the obligation but do not believe the effect of the change in this measure during the reporting period is appropriate for the statement of net cost. They view future revenues that are included in the measure as contingent revenues, and they believe all other future inflows and/or revenues included in the balance sheet and the statement of net cost relate to earned revenues.

A32. The Board notes that federal credit accounting, insurance accounting, and accounting for which fair value measures are utilized currently incorporate future inflows and outflows in the measure of liability and expense, and that the basis for including future revenue in current year cost and liability measures depends on the obligating event to which they relate. If they relate to a past event, e.g., an insured event, then they are appropriate measures of cost. If they relate solely to a future event, e.g., future insurance policies in the program, then they should be excluded from current costs and from liability measurement. The key is the event not the fact that the cash flow is in the future. They cite current FASAB insurance standards in SFFAS 5[16] that include future revenue when calculating the net liability.

A33. Since the two views regarding liability and expense recognition persisted and the likelihood of achieving a satisfactory majority one way or the other was remote, and since the Board wished to further improve social insurance reporting, the Board concluded that a compromise was necessary. In developing the exposure draft of November 2008 (SI ED), the Board believed that a fair presentation of the financial position, condition, and results of operations requires that the closed group measure be provided as part of a balanced package of information. The Board believed that the closed group measure represents a reasonably good estimate of the net responsibility of future taxpayers, under current laws, to pay benefits to current participants. Although this amount is subject to change due to changing long-range demographics and other factors, it is not as volatile as the computation under the open group measure that includes all current and future participants over a projection period, e.g., the next 75 years. It relates only to individuals who already are participating in the program.

A34. The open group measure represents the net present value of all expenditures to or on behalf of the open group population and all contributions or other income from or

[16] SFFAS 5, par. 113: The liability for life insurance includes both the liability for unpaid claims … and a liability for net future policy benefit outflows…. The [latter] represents the expected present value of future outflows to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders. The liability is estimated using appropriate financial or actuarial methods that include assumptions … applicable at the time the insurance contracts are made and in accordance with existing law and related policy …. Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in which the changes occur. …

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on behalf of the open group population over a given projection period, e.g., 75 years. It is used to estimate the future financing shortfall in social insurance programs. The closed group measure involves only those participating in the social insurance program at the reporting date. It represents the same measurement methodology as for the open group, applied to a closed population; that is, it is the net present value of all expenditures to or on behalf of the current participants and all contributions or other income from or on behalf of the current participants over a given projection period.

A35. The open group measure is inherently more sensitive to assumptions about the distant future than the closed group measure. The greater sensitivity is inevitably true, despite the best efforts of actuaries, economists, and other professionals involved in making these projections. It is mainly caused by the fact that a closed group decreases over time, so that uncertainty about what will happen in the distant future has less impact than is the case for an open group that grows larger during the projection period.

A36. For the SI ED, the Board proposed changes to highlight the closed group number. The SI ED would have required:

a. a discussion and analysis by management of the closed group measure of social insurance along with other critical measures in MD&A;
b. a separate line presenting the closed group measure that would be presented on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications;
c. new summary presentations on the SOSI for closed and open group measures;
d. a new statement of changes in social insurance using the closed group measure;
e. note disclosure of an accrued benefit obligation; and
f. continuation of the projections and other supplementary reporting currently required by SFFAS 17 but with amendments to the display of cash flow information, the valuation date, and the sensitivity analysis.

Again, the SI ED did not propose to change the SFFAS 17 liability and expense recognition standard.[17]

[17] SFFAS 17, paragraphs 22-23 and 30 state that, except for Unemployment Insurance, the government-wide and component entities should recognize a liability (and a related expense) for those social insurance benefits that are due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported. For UI, a liability (and related expense) would be recognized for (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which the states and territories have not withdrawn funds from the federal unemployment trust fund (UTF) as of fiscal year end, and (2) estimated amounts to be withdrawn from UTF and benefits paid by states and territories after fiscal year end for compensable days occurring prior to fiscal year end. A UI expense

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Respondents Comments on the Exposure Draft

A37. The SI ED received 20 responses as follows:

	FEDERAL (Internal)	NONFEDERAL (External)
Users, academics, others		14
Auditors	1	
Preparers and financial managers	5	

What the Exposure Draft Proposed Regarding the Balance Sheet

A38. Balance sheet presentation raised difficult issues for the Board with respect to the SI ED. In the *Preliminary Views* document of October 2006, the Board had discussed its differing views of liability and expense recognition, views which have been and remain divergent.

A39. For the SI ED the Board proposed a compromise. Instead of changing the "due and payable" liability measure of SFFAS 17, the Board proposed new reporting featuring the closed group measure of the social insurance commitment as the link or common thread among MD&A, the balance sheet, the SOSI, and the new statement of changes in social insurance amounts. Thus, the closed group measure would have been presented, among other places, as a line item on the balance sheet below assets, liabilities, and net position. It would not have been included in the totals for these classifications, but would have been part of a package of information.

A40. In the SI ED, the members who supported this proposal stated their belief that the closed group measure is important for analysis of social insurance. The closed group measure represents the net present value as of the reporting date of the commitment of future social insurance participants and future general taxpayers to provide benefits to current participants over the latter's lifetime, based on the current participants' past and future work in covered employment. The closed group measure also provides a perspective on the financing challenges for the program. It would be relevant to those who are assessing options for dealing with those

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will also be recognized for the reporting period for amounts withdrawn from the Federal UTF by states and territories to pay benefits to beneficiaries that pertain solely to the current reporting period. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior reporting period pursuant to this paragraph, items (1) and (2), would not be recognized as an expense of the current reporting period.

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challenges. The measure would not only draw attention to the challenge but would also quantify it in a way that can support further analysis and decision-making.

A41. The proposed balance sheet reporting would have affected the reporting model. Again, the proposal was to present the closed group measure as a line item on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. The line item was not presented formally as a new element of financial statements within the context of the SFFAC 5[18] definitions, e.g., a "commitment." The Board explained that it was not formally proposing a new definition or concepts underlying a new reporting model at that time. In order to offer improvements in a timely manner, the Board left open certain questions regarding the reporting model and the elements of federal financial reporting. However, the Board indicated there were areas where additional conceptual work would be undertaken.

A42. Members believe that the current concepts need to do a better job of explaining unique federal accounting issues. Concepts need to explain, for example, why the power to tax is not an asset but nonetheless is relevant to assessing the sustainability or the financial condition of the federal government; why current deficits are indeed bad but that the problem is actually long-range rather than short-range; why the timing of a cash flow problem is important, and why the point estimates on the balance sheet have limitations for assessing financial condition. Members believe that the fiscal sustainability reporting established in SFFAS 36 substantially improves the information communicated regarding financial condition. The Board plans to continue to consider reporting concepts in the Financial Reporting Model Phase of its Conceptual Framework Project.

A43. The subjects of the balance sheet and the open vs. closed group measures of the social insurance commitment raise fundamental issues. Over the years, some members and others have asked why social insurance should be treated differently than other programs that are funded by annual appropriations, and why social insurance should be selected for the balance sheet but not other programs, e.g., food stamps, school lunches. They do not believe that a strong basis has been established for saying social insurance programs are the ones to highlight through liability recognition and others can be excluded. In this regard some members believed one of the drawbacks of the SOSI is that it does not provide a comprehensive view of government liabilities-commitments-expectations. They note that the information provided pursuant to SFFAS 36 will provide that view.

[18] SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.*

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Respondents' Comments Regarding the Balance Sheet

A44. Respondents opposed a line item on the balance sheet by a margin of more than 2 to 1. Various objections were raised. Some cited the SI ED's Alternative View position that the lack of a clear definition of a "commitment" on the balance sheet makes the line item a source of confusion. Others objected that the closed group measure was misleading regarding the commitment to social insurance participants.

A45. Some objected from the opposite perspective. They objected to the absence of a liability on the balance sheet beyond "due and payable" and found the new line item an unacceptable substitute.

A46. Some respondents who favored a line item on the balance sheet agreed with the Board's argument that it was a compromise between opposing positions.

The Board's Conclusions Regarding the Balance Sheet

A47. The Board was of two views on the question of displaying the closed group measure (or any similar measure) on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. Some members favored the compromise approach and wished to alter the presentation – either through changes to the balance sheet or development of a new basic financial statement. Those who opposed the new line item on the balance sheet argued that readers would not have a basis for understanding the new element on the balance sheet, and/or that the closed group measure is not comparable to amounts reported on the balance sheet, and/or other significant long-term commitments should be presented, and/or the SOSI is adequate. Further, these members were not persuaded that the proposals presented to alter the presentation on the balance sheet by presenting the open group instead of the closed group or to instead create a new basic financial statement were necessary. Thus, since the Board could not establish a clear majority in favor of the new line item, it decided not to go forward with the proposed balance sheet presentation of the closed group measure as a commitment.

A48. The Board then discussed developing a new basic financial statement that would present the key measures from the financial statements in one place. Ultimately, the Board agreed to require the key measures in a table or other singular MD&A presentation, and integrate the work on a new basic financial statement with the Reporting Model Project.

What the Exposure Draft Proposed Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A49. Regarding the statement of social insurance (SOSI), in the SI ED the Board

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proposed to require the closed and open group measures in a new SOSI summary section of the CFR which the FY 2008 and 2007 CFR provided even though SFFAS 17 does not currently require it. The SOSI summary section provides information about all age cohorts and about the components of the closed and open group measures. For example, the open group measure equals the closed group measure plus the contributions and the benefits of future participants over the 75-year (or other) projection period.

A50. The Board also proposed a new basic statement, the SCSIA that would have presented the changes during the reporting period for the closed group measure. Heretofore the social insurance reporting had not required an analysis of the changes in the social insurance present values. The Board decided that a financial statement illustrating the components of the change would greatly enhance the value of the presentation. The examples of line items/components for the SCSIA in the exposure draft were consistent with the Social Security Trustees' Report (see, for example, the 2007 Trustees' Report, Table IV.B9, page 66).

Respondents' Comments Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A51. A majority of respondents supported a summary section for the SOSI as described in the SI ED. Those that did not support it objected mainly to the presence of the closed group measure as a component of that summary. Their objections to the closed group measure are noted above regarding other issues. Some respondents objected to requiring a SOSI summary section, although they did not disapprove of it in concept. They preferred to allow the preparer to decide whether to include it. Most respondents supported the SCSIA.

The Board's Conclusions Regarding the Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts

A52. The Board concludes that the SOSI should have a summary section as described in the SI ED. Although it decided not to go forward with a line item on the balance sheet for the closed group measure, as explained above, the Board is going forward with the MD&A discussion and associated table or other singular presentation of key measures and with the SCSIA. Thus, the closed group measure and the open group measure continue to be fundamental information. The summary section of the SOSI will illustrate the components of these measures and how the closed group measure relates to the open group measure.

A53. The summary will present both the net present value of the commitment to the current participants (the closed group measure) and to all participants (the open group measure) over the projection period. The Board decided that the closed group measure should be presented on the SOSI – and addressed in MD&A – to enrich the

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discussion of the open group measure and to give the reader a better understanding of the generational implications of financing social insurance programs.

A54. The Board concludes that the SCSIA will greatly enhance the value of the presentation and should be required since it has substantial support in the community as well as among Board members.

What the Exposure Draft Proposed Regarding Management's Discussion and Analysis

A55. As stated above, the Board provided MD&A standards and guidance in SFFAC 3, *Concepts for Management's Discussion and Analysis* and SFFAS 15. SFFAC 3 provides concepts and a foundation for the standards presented in SFFAS 15.

A56. The MD&A standards in SFFAS 15 are brief. SFFAS 15 requires the entity's financial report to include MD&A, which it categorizes as RSI. SFFAS 15 requires the entity's MD&A to contain sections that address the entity's mission and organization structure, performance goals and results, financial statements, and systems, controls, and legal compliance.[19] It also requires MD&A to include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions, and trends, while encouraging forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends.[20] SFFAS 15 does not specify the contents for each section. SFFAC 3 provides some concepts in that regard.

A57. For the SI ED, the Board proposed to provide additional specific standards for the financial statement analysis section of MD&A for the government-wide entity and for component entities that present a SOSI. Based on SFFAC 3,[21] the Board proposed that, in the section devoted to financial statement analysis, management should explain critical measures and key amounts and why changes occurred and what the change indicates or implies for the program; and, how the costs and commitments incurred will be financed.

A58. In addition, in the SI ED the Board proposed to require forwarding-looking information about anticipated future demands, events, conditions, and trends related to social insurance. In SFFAC 3, the Board had said management should include information about anticipated future demands and events "to the extent feasible and appropriate."[22] In the SI ED, the Board proposed to require discussion of anticipated events, demands, etc.

[19] SFFAS 15, par. 2.
[20] SFFAS 15, par. 3 and 21.
[21] See SI ED, pars. 23-27.
[22] SFFAC 3, par. 33.

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Respondents' Comments Regarding MD&A

A59. The respondents favored the MD&A requirement by a margin of about to 2 to 1. Those who favored the standard mentioned the benefits of management's analysis of key measures and of greater transparency. Almost all agreed that key or critical measures should be discussed in MD&A.

A60. Some respondents objected to aspects of the MD&A requirement. Some objected to the focus on the closed group measure which, as noted elsewhere, many assert is misleading. Some argue that the open group measure is essential to an assessment of financial sustainability, that the closed group measure does not reflect what they describe as the program's pay-as-you-go financing, and that the Social Security and Medicare Trustees' Reports emphasize almost exclusively the open group measure. Other respondents noted that those who object to the closed group measure on the grounds that it does not reflect social insurance financing misunderstand accrual accounting, which seeks to capture economic events, not necessarily financing.

A61. Some said the proposed MD&A standard would be too prescriptive or that it would require too much detail or repeat information that is already in the notes or RSI. Some objected to a standard on social insurance that would require additional MD&A discussion beyond what SFFAS 15 requires or that, in their view, would be unrelated to social insurance.

The Board's Conclusions Regarding MD&A

A62. The Board concludes that the MD&A provisions of the social insurance standard provide flexibility and are not overly prescriptive; nor will they result in redundancy. The Statement incorporates MD&A concepts from SFFAC 3 that currently are not being adequately addressed. Moreover, the Board believes that the long-term nature of social insurance programs requires that management discuss anticipated future demands, events, conditions, and trends as well as those currently existing.

A63. However, the Board did make significant changes to the proposed standard after considering respondents' comments and the views of Board members. First, the Board decided that MD&A should emphasize the open group measure rather than the closed group measure.

A64. In addition, the Board decided to require a table or other singular presentation of key measures in MD&A rather than make it optional, as proposed in the SI ED (see paragraph 25). In the SI ED, the Board had required – and continues to require – a narrative discussion of key measures in MD&A of the government-wide entity and component entities that present a SOSI, as described in paragraphs 23-27, and provided an option whereby the entity could array the key measures in a table or schedule. The Board decided to require a table or other singular presentation

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because it will significantly enhance the presentation by helping users grasp the relationship between social insurance amounts and other costs, assets and liabilities, budget deficits, and sustainability projections, and therefore the table or other singular presentation should not be optional.

A65. In addition, a table or other singular presentation will relate the basic financial statements to each other. The basic financial statements in the federal reporting model do not all "articulate" with one another. Amounts reported on the balance sheet or statement of net cost, for example, do not tie directly to the present values of the cash flows over the next 75 years that are presented in the SOSI and now the SCSIA, which are also basic statements. A table or other singular presentation will bring all of the pieces of the unique federal reporting model together in a single place. To make this function of the table or other singular presentation explicit, the Board changed the wording of the standard (see paragraph 24) so that the preparer is directed to certain basic financial statements to obtain the key measures.

A66. Lastly, the Board decided not to require the discussion and the table or other singular presentation to be in the section of the MD&A devoted to financial statement analysis. The Board had designated the financial statement analysis section of MD&A, which is one of the sections required by SFFAS 15, because the key measures to be discussed come from the financial statements. Instead, the Board decided to allow it to be wherever in MD&A the preparer thinks will be effective, as long as the specified information is presented together. However, the Board believes that the information should be presented in a single section of MD&A, and that the preparer is best positioned to decide where in MD&A the presentation will be the most effective.

What the Exposure Draft Proposed Regarding the Statement of Net Cost

A67. The proposed standard did not affect the statements of net cost of social insurance entities and the government-wide entity. Some argued that the change in the social insurance closed group measure or other net present value during the reporting period is an economic cost. The economic cost of social insurance programs has been debated by the Board over the years. Some current Board members believed that the change in the closed group measure is an economic cost and were concerned that it is not highlighted on the statement of net cost in the SI ED's compromise proposal.

A68. These members noted that SFFAC 5 defines expense as an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.[23] SFFAC 5 defines liabilities as a present obligation of the federal government to provide

[23] SFFAC 5, par. 53.

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assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[24] A present obligation requires a past transaction or other event.[25] These members believed that a past transaction or other event occurs when social insurance participants work in covered employment and pay payroll taxes, that an economic cost is being incurred.

A69. Some members noted that accrual accounting has a universal definition: expenses are recognized when incurred. They believed that only through accrual accounting can cost or financial position of an entity be measured, which is why generally accepted accounting principles primarily require accrual accounting. They believe the current focus on cash flow – or on "pay-as-you-go" financing with payroll taxes matched against current benefit payments – is misleading. They believe that payroll taxes received from those currently working in covered employment should be matched not against benefits payments to current retirees but against the economic cost being incurred, in order for accrual accounting to provide a decision-useful additional perspective.

A70. As is discussed above and in the *Preliminary Views* document, Board members, respondents to the *Preliminary Views* document, and, historically, all groups who considered the question have disagreed over the past transaction or event that creates a liability and expense for social insurance programs.

A71. Those FASAB members who were concerned that the economic cost of social insurance is not being highlighted note that FASAB expectations regarding objectives of federal financial reporting in general and social insurance in particular are most clearly set forth in SFFAC 1, *Objectives*. The FASAB's *Strategic Directions* report, issued November 2006, focused on the objectives in SFFAC 1, and established Objective 2, "Operating Performance," and Objective 3, "Stewardship," as FASAB's most important focus. With respect to social insurance, these members note especially sub-objectives 2A, 2B, and 3A regarding the need for information about costs.

A72. These three sub-objectives speak most clearly about financial statements showing costs associated with a specific period and the impact these costs have on an entity's financial position.

A73. Other FASAB Objectives speak about financial statements showing other elements of financial position. The members who are concerned about economic costs believed that SOSI and the new SCSIA adequately satisfy SFFAC 1, *Objectives*, Objective 3B, "Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due." These statements

[24] SFFAC 5, par. 39.
[25] SFFAC 5, par. 42.

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would also contribute to meeting Objective 3C, "Whether government operations have contributed to the nation's current and future well being."

A74. In addition, these members noted that information from the SOSI, if combined with other financial statement information, could help meet Objective 3A, which relates to changes in the government's financial position. Moreover, they believed that the proposed SCSIA, which all members support, will help meet Objective 3A.

A75. However, these members believed that the proposed standard can be criticized for failing to address Objective 2A and 2B, noted above, unless something is reported on the operating statement. For the SI ED, they suggested adding a line item to the statement of net cost to show the change in the social insurance commitment during the period in close proximity to other costs, an approach similar to the new line item that was proposed in the SI ED for the balance sheet.

A76. Other members disagreed that the change in the social insurance commitment should be on the statement of net cost. They believed that cost should represent the goods and services provided during the period. They argued that the change in social insurance, although meaningful, is not a good or service provided, and should not be associated with such costs. They argued that presenting the change in the social insurance commitment on the statement of net cost would be misleading, that the SOSI amounts are purporting to represent something entirely different from what is on the balance sheet and statement of net cost, and that people expect customary elements on the operating statement for which SOSI amounts are too uncertain.

A77. They noted that the Board made the SOSI a basic statement and proposed that the SCSIA be a basic statement, and that the SOSI and SCSIA are to be presented in close proximity to the balance sheet and operating statement. They believed that that approach is appropriate. For them, the change in the social insurance commitment during the reporting period should be presented apart from the costs of the period and clearly labeled as, for example, "social insurance exposures." They concluded that associating the change with period costs is inappropriate because it does not represent the complete change in the government's financial condition, and that proposed fiscal sustainability reporting, which is now required pursuant to SFFAS 36, provides context and focuses on the government's financial condition.

A78. The SI ED did not require that the change in the closed group measure be recognized as an operating cost of the government on the statement of net cost and the statement of changes in net position. The Board decided to continue the SFFAS 17 approach with respect to expense recognition for social insurance. However, the Board did ask respondents to comment on the issue raised by members regarding the statement of net cost.

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Respondents' Comments Regarding the Statement of Net Cost

A79. The respondents overwhelmingly favored the Board's decision not to include a line item for the change during the period in the closed group measure on the statement of net cost. Many of these respondents asserted that they agreed with the position that the change in this measure is not a period cost, and that position is consistent with the view that the closed group measure should not be presented on the balance sheet.

The Board's Conclusions Regarding the Statement of Net Cost

A80. The Board concludes that there is substantial support in the community for the majority position not to include a new line item on the statement of net cost regarding the statement of net cost as presented in the SI ED.

What the Exposure Draft Proposed Regarding Note Disclosure

A81. The SI ED required note disclosure of an accrued benefit obligation. The objective of the disclosure was to provide information for the many users who are interested in knowing what such an amount would be and in evaluating the obligation in this way. An accrued benefit obligation is a measure of the present value of future benefits scheduled to be paid to or on behalf of current participants based on past transactions or events as of the valuation date. For example, for Social Security and Medicare Hospital Insurance (Part A), past work in covered employment; or Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in force. Because it is based on past events, the accrued benefit obligation applies only to current participants in the programs as of the valuation date.

A82. Several methods for calculating an accrued benefit obligation were acceptable.[26] For example, the Social Security Administration provides, through its Office of the Actuary, an accrued benefit obligation for Social Security in a periodically updated Actuarial Note.[27]

A83. Other approaches for calculating an accrued benefit obligation were acceptable. For example, the Primary View in the FASAB's *Preliminary View: Accounting for Social Insurance, Revised*, provided methodology for calculating a liability amount for social insurance programs.

A84. The SI ED stated that the accrued benefit obligation would give interested users a generally understood frame of reference. The accrued benefit obligation is

[26] See http://www.ssa.gov/OACT/NOTES/actnote.html.
[27] Actuarial Note: Unfunded Obligation and Transition Cost for OASDI.

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intended to provide a perspective on social insurance programs from the point of view of a deferred benefit or an insurance obligation for those users who value such information. It is equivalent to the measure that the Board members who then held the Primary View believed should be recognized as a liability. The amount thus provided can be compared to the other measures and provide a full array of information. This number is not currently available in federal financial reports.

Respondents' Comments Regarding Note Disclosure

A85. Respondents were nearly evenly dividing regarding the note disclosure. Some said the accrued benefit obligation did not reflect the realities of the program; they argue that it represents a termination valuation and would not be meaningful for social insurance. Some respondents asserted that it would require yet another number and this constitutes "information overload." They and/or others objected to the use of the term "obligation" because they believe it implies the government has an obligation to participants, and they do not think there is any more of an obligation to social insurance participants than to other types of entitlement programs, such as those funded entirely by annual appropriations."

A86. Those supporting the disclosure of the accrued benefit obligation mentioned several rationales. Some noted that comprehensive financial reporting requires the accrued benefit obligation perspective, which they say is the only measure of financial status of social insurance programs that can be thought of as a liability because it only involves past transactions and events. They say the accrued benefit obligation provides valuable information to the public about programs upon which participants depend for retirement income and benefits. Another respondent felt that the disclosure would help the reader relate social insurance obligations to federal employee pensions and other retirement benefits. Others felt that the "due and payable" liability measure was simply not based on the proper accounting theory and concepts.

The Board's Conclusions Regarding Note Disclosure

A87. The Board believes that the accrued benefit obligation would give interested readers a generally understood frame of reference and another perspective on social insurance programs. However, the Board decided not to require it in this standard. The Board is persuaded that, given that several measures of the social insurance obligation are already reported in the financial statements, disclosing another number would likely be overwhelming or confusing, rather than enhancing the reader's understanding of the government's social insurance obligations. In addition, the Board is persuaded that, although the SSA provides the amount for Social Security, the accrued benefit obligation is not calculated for Medicare, and there was significant reluctance among members to apply the concept to Medicare or to develop it further for that purpose.

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What the Exposure Draft Proposed regarding Sensitivity Analysis

A88. The SI ED proposed to amend the SFFAS 17 sensitivity analysis provisions to allow the preparer more flexibility. The objective of sensitivity analysis is to illustrate how much an estimate or projection would change if the assumptions, data, methodologies, or other inputs change. The Board believes that the SFFAS 17 requirements result in too much narrative and graphs and not enough easy-to-use information.

A89. Although they call for illustrations of the sensitivity of projections and present values,[28] the SFFAS 17 requirements for sensitivity analysis have led preparers to focus on projections that usually are depicted graphically rather than on present values. The latter have increased in importance since the Board elevated the statement of social insurance to a basic financial statement in SFFAS 26.[29] The result has been a daunting array of narrative, charts, and graphs. The standard also simplifies the social insurance presentations by eliminating the SFFAS 17 requirement for nominal dollar projections. The projections now will be as percentages of the GDP and taxable payroll.

A90. The Board sought to make the analysis more concise and therefore communicate better with users. The SI ED proposal focused analysis on the sensitivity of the open and closed group measures presented in the basic financial statements – specifically, on the balance sheet, where the closed group measure would have been presented; on the statement of social insurance, where both the closed and open group measures will be presented; and on the proposed new statement of changes in the social insurance amounts, where the closed group measure would have been presented.[30]

A91. Thus, the SI ED proposal was intended to reduce the volume of sensitivity analysis information while increasing its usefulness. It provided flexibility for preparers to develop their own sensitivity analysis and decide what is appropriate based on trends, the utility of the information to the users and policy-makers, and the relative burden of producing it. Entities could continue to vary key assumptions or pursue other methods, including stochastic modeling.

Respondents' Comments Regarding Sensitivity Analysis

A92. A majority of respondents agreed with the proposed new flexibility. However, some respondents asserted that sensitivity analysis should continue to include estimates

[28] SFFAS 17, par. 27(4)(a).
[29] *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, November 1, 2004.
[30] For the final standard, this is now the open group measure.

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of the effects of changes in individual assumptions. In addition, they or others noted that stochastic modeling, which the proposal encouraged, is useful for illustrating uncertainty but was fundamentally different than illustrating the sensitivity of individual assumptions. They discouraged suggesting that the preparer may consider stochastic analysis since it is a science still under development and including it would require much explanatory detail and complexity. Some respondents mentioned that sensitivity analysis should be undertaken only for the open group measure.

The Board's Conclusions Regarding Sensitivity Analysis

A93. The Board continues to believe that a flexible yet focused approach to sensitivity analysis is best. Thus, the standard continues to require sensitivity analysis of the closed and open group measures that in the preparer's best judgment effectively communicates with the users. Thus, the preparer would consider future trends, the utility of the information to the users and policy-makers, and the relative burden on its resources.

A94. The Board decided not to include a statement that preparers may consider stochastic modeling. The Board weighed the cautionary responses in that regard from the American Academy of Actuaries and the Chief Actuary of the Social Security Administration. The Board believes that the flexibility of the standard will allow the preparers and their advisors to illustrate sensitivity of the open and closed group measures by varying individual assumptions or by other means they believe are meaningful and comprehensible.

Valuation Date

A95. The SI ED proposed to amend SFFAS 17's valuation date provision by requiring that projections be adjusted, if feasible, after the valuation date but prior to the end of the fiscal year, if changes in policy or other major factors materially affect it. This provision is identical to that in the Board's recently issued SFFAS 36. It addresses the need for projections to reflect recent data.

A96. One respondent found the term "if feasible" problematic. The respondent asserted that, if information comes to the attention of the preparer that impacts the projection after the valuation date, the feasibility of using it to adjust the projection should not be a consideration. The respondent also thought it would be a problem from an audit perspective.

A97. The Board concludes that the additional requirement to consider changes in major factors occurring after the valuation date will enhance the usefulness of social insurance information. In addition, feasibility is a consideration in the context of

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federal financial reporting. The benefit of financial information must be weighed against its cost.

Board Approval

A98. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB office.

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Appendix B: Illustrative Table of Key Measures

Table of Key Measures	billions of dollars		
	2008	2007	2006
Costs			
Net costs	($3,671)	($2,903)	($2,890)
Total taxes and other revenues	2,661	2,627	2,441
Net operating cost	(1,010)	(276)	(449)
Net Position			
Assets	$1,975	$1,581	$1,497
Less: liabilities, comprising			
Federal debt held by the public	5,836	5,078	4,868
Federal employee & veterans benefits	5,319	4,769	4,679
Other liabilities	1,023	940	866
Total liabilities	12,178	10,787	10, 413
Net position (assets net of liabilities)	($10,203)	($9,206)	($8,916)
Social Insurance Commitments			
Net present value (NPV) of future cash flows for all participants over the next 75 years (open group), end of fiscal year	($42,970)	($40,948)	($38,851)
NPV of future cash flow for all participants over the next 75 years (open group), beginning of fiscal year	(40,948)	($38,851)	($35,689)
Change in NPV	(2,022)	(2,097)	(3,162)
Budget Results			
Unified budget deficit	($455)	($163)	($248)
Spending in Excess of Receipts			
Spending in excess of receipts (see long-term projections statement)	($XX,XXX)	($XX,XXX)	($XX,XXX)

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Appendix C: Illustrative Statement of Social Insurance, Part I, Government-wide SOSI

United States Government
Statement of Social Insurance

********UNAUDITED**********

(In billions of dollars)	2008	2007	2006	2005	2004
Federal Old-Age, Survivors, and Disability Insurance (Social Security):					
Contributions and earmarked taxes from:					
Participants who have attained age 62	$ 542	$ 477	$ 533	$ 464	$ 411
Participants ages 15-61	18,249	17,515	16,568	15,290	14,388
Future participants (under age 15 and births during period)	17,566	16,121	15,006	13,696	12,900
All current and future participants	36,357	34,113	32,107	29,450	27,699
Expenditures for scheduled future benefits for:					
Participants who have attained age 62	(6,958)	(6,329)	(5,866)	(5,395)	(4,933)
Participants ages 15-61	(29,091)	(27,928)	(26,211)	(23,942)	(22,418)
Future participants (under age 15 and births during period)	(6,933)	(6,619)	(6,480)	(5,816)	(5,578)
All current and future participants	(42,911)	(40,876)	(38,557)	(35,153)	(32,929)
Net present value (NPV) of future revenue less future expenditures (open group measure)	$ (6,555)	$ (6,763)	$ (6,450)	$ (5,703)	$ (5,230)

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Federal Hospital Insurance (Medicare Part A):	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 202	$ 178	$ 192	$ 162	$ 148
Participants who have not attained eligibility age	6,320	5,975	5,685	5,064	4,820
Future participants	5,361	4,870	4,767	4,209	4,009
All current and future participants	11,883	11,023	10,644	9,435	8,977
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(2,747)	(2,558)	(2,397)	(2,179)	(2,168)
Participants who have not attained eligibility age	(17,365)	(15,639)	(15,633)	(12,668)	(12,054)
Future participants	(4,506)	(5,118)	(3,904)	(3,417)	(3,246)
All current and future participants	(24,619)	(23,315)	(21,934)	(18,264)	(17,468)
NPV of future revenue less future expenditures (open group measure)	$(12,736)	$(12,292)	$(11,290)	$ (8,829)	$ (8,491)
Federal Hospital Insurance (Medicare Part B):	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 461	$ 433	$ 409	$ 363	$ 332
Participants who have not attained eligibility age	3,859	3,184	3,167	2,900	2,665
Future participants	1,158	1,172	906	924	891
All current and future participants	5,478	4,789	4,482	4,187	3,888
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(1,986)	(1,834)	(1,773)	(1,622)	(1,475)
Participants who have not attained eligibility age	(14,949)	(12,130)	(12,433)	(11,541)	(10,577)
Future participants	(4,262)	(4,257)	(3,407)	(3,408)	(3,277)
All current and future participants	(21,197)	(18,221)	(17,613)	(16,571)	(15,329)
NPV of future revenue less future expenditures (open group measure)	$(15,719)	$(13,432)	$(13,131)	$(12,384)	$(11,441)

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Federal Hospital Insurance (Medicare Part D):	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 123	$ 167	$ 173	$ 185	$ 176
Participants who have not attained eligibility age	1,380	1,627	1,700	1,790	1,857
Future participants	604	611	492	572	618
All current and future participants	2,107	2,405	2,365	2,547	2,651
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(581)	(794)	(792)	(880)	(773)
Participants who have not attained eligibility age	(6,527)	(7,273)	(7,338)	(7,913)	(7,566)
Future participants	(2,856)	(2,699)	(2,121)	(2,440)	(2,431)
All current and future participants	(9,964)	(10,766)	(10,251)	(11,233)	(10,770)
NPV of future revenue less future expenditures (open group measure)	$ (7,857)	$ (8,361)	$ (7,886)	$ (8,686)	$ (8,119)
Railroad Retirement:	**2008**	**2007**	**2006**	**2005**	**2004**
Contributions and earmarked taxes from:					
Participants who have attained eligibility age	$ 5	$ 5	$ 5	$ 4	$ 4
Participants who have not attained eligibility age	43	41	40	37	37
Future participants	54	54	56	41	39
All current and future participants	102	100	101	82	80
Expenditures for scheduled future benefits for:					
Participants who have attained eligibility age	(97)	(93)	(92)	(84)	(81)
Participants who have not attained eligibility age	(88)	(86)	(84)	(73)	(72)
Future participants	(26)	(26)	(25)	(16)	(14)
All current and future participants	(212)	(205)	(201)	(173)	(167)
NPV of future revenue less future expenditures (open group measure)	$ (109)	$ (105)	$ (100)	$ (91)	$ (87)
Black Lung (Part C):	**2008**	**2007**	**2006**	**2005**	**2004**
NPV of future revenue less future expenditures (open group measure)	$ 5	$ 5	$ 4	$ 5	$ 4
Total NPV of future revenue less future expenditures (open group measure)	$(42,970)	$(40,948)	$(38,853)	$(35,688)	$(33,364)

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Social Insurance Summary	2008	2007	2006	2005	2004
Participants who have attained eligibility age:					
Revenue (e.g., contributions and earmarked taxes)	$ 1,333	$ 1,260	$ 1,312	$ 1,178	$ 1,071
Expenditures for scheduled future benefits	(12,369)	(11,608)	(10,920)	(10,160)	(9,430)
Present value of future revenue less future expenditures	(11,036)	(10,348)	(9,608)	(8,982)	(8,359)
Participants who have attained age 15 up to eligibility age:					
Revenue (e.g., contributions and earmarked taxes)	29,851	28,342	27,160	25,081	23,767
Expenditures for scheduled future benefits	(67,950)	(63,056)	(61,699)	(56,137)	(52,687)
Present value of future revenue less future expenditures	(38,099)	(34,714)	(34,539)	(31,056)	(28,920)
Closed group -- Total present value of future revenue less future expenditures for current participants	(49,135)	(45,062)	(44,147)	(40,038)	(37,279)
Future participants (those under age 15, and those to be born and to immigrate during period):					
Revenue (e.g., contributions and earmarked taxes)	24,743	22,828	21,227	19,442	18,457
Expenditures for scheduled future benefits	(18,578)	(18,714)	(15,933)	(15,092)	(14,542)
Present value of future revenue less future expenditures	6,165	4,114	5,294	4,350	3,915
Open group -- Total present value of future revenue less future expenditures for current and future participants	$(42,970)	$(40,948)	$(38,853)	$(35,688)	$(33,364)

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Component Entity Illustrative Statement of Social Insurance
Social Security Administration

(In billions of dollars)	2008	2007	2006	2005	2004
			********UNAUDITED**********		
Federal Old-Age, Survivors, and Disability Insurance (Social Security):					
Participants who have attained eligibility age:					
Contributions and earmarked taxes	$ 542	$ 477	$ 533	$ 464	$ 411
Expenditures for scheduled future benefits	(6,958)	(6,329)	(5,866)	(5,395)	(4,933)
Present value of future expenditures in excess of future revenue	(6,416)	(5,852)	(5,333)	(4,931)	(4,522)
Participants who have attained age 15 up to eligibility age:					
Contributions and earmarked taxes	18,249	17,515	16,568	15,290	14,388
Expenditures for scheduled future benefits	(29,021)	(27,928)	(26,211)	(23,942)	(22,418)
Present value of future revenue less future expenditures	(10,772)	(10,413)	(9,643)	(8,652)	(8,030)
Net present value of future revenue less future expenditures for current participants (closed group measure)	(17,218)	(16,265)	(14,976)	(13,583)	(12,552)
Less: Treasury securities and assets held by the programs	2,238	2,048	1,859	1,687	1,531
Closed group unfunded obligation	$(14,980)	$(14,217)	$(13,117)	$(11,896)	$(11,021)
Future participants (those under age 15 and to be born and to immigrate during period):					
Contributions and earmarked taxes	$ 17,566	$ 16,121	$ 15,006	$ 13,696	$ 12,900
Expenditures for scheduled future benefits	(6,933)	(6,619)	(6,480)	(5,816)	(5,578)
Present value of future revenue less future expenditures	10,633	9,502	8,526	7,880	7,322
Net present value of future revenue less future expenditures for current and future participants (open group measure)	(6,555)	(6,763)	(6,450)	(5,703)	(5,230)
Less: Treasury securities and assets held by the programs	2,238	2,048	1,859	1,687	1,531
Open group unfunded obligation	$(4,317)	$(4,715)	$(4,591)	$(4,016)	$(3,699)

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Appendix D: Illustrative Statement of Changes in Social Insurance Amounts

The following is an illustrative statement of changes in social insurance amounts.

Illustrative Statement of Changes in Social Insurance Amounts
0pen Group Measure
For the Year Ended September 30, 2008
(in billions of dollars)

	Social Insurance, Open Group Measure				
	Social Security	Medicare HI	Medicare SMI	Other (e.g., Railroad Retirement)	Total
Net present value (NPV) of future revenue less future expenditures for current and future participants (the “open group”) over the next 75 years, beginning of the year	$(6,763)	$(12,292)	$(21,793)	$ (100)	$(40,948)
Reasons for changes in the NPV during the year:					
Changes in valuation period	XXX	XXX	XXX	XXX	XXX
Changes in demographic data and assumptions[1]	XXX	XXX	XXX	XXX	XXX
Changes in economic data and assumptions[2]	XXX	XXX	XXX	XXX	XXX
Changes in law or policy[3]	XXX	XXX	XXX	XXX	XXX
Changes in methodology and programmatic data[4]	XXX	XXX	XXX	XXX	XXX
Changes in Medicare healthcare and other healthcare assumptions	XXX	XXX	XXX	XXX	XXX
Other changes	XXX	XXX	XXX	XXX	XXX
Net change in open group measure	208	(443)	(1,783)	(4)	(2,022)
Open group measure, end of year	$(6,555)	$(12,735)	$(23,576)	$(104)	$(42,970)

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The following note examples are adapted from the Social Security Trustees' Report. The explanations of the changes will depend on the social insurance program in question.

1. Changes in demographic assumptions affect the open group measure. Final mortality data for 2008 result in slightly lower starting death rates and faster near-term declines in death rates than in last year's report. Also, slightly faster rates of decline in death rates are assumed ultimately for ages 15-64 in this year's report. These changes in ultimate rates are based on the continuing strong declines in mortality recently experienced by men at these ages and a belief that the lower rates of decline experienced by women since 1982 will not continue in the future. All of the mortality changes result in a decrease (worsening) in the open group measure of about $200 billion.

2. Ultimate economic assumptions are unchanged from last year's report. Changes in starting values for the economic assumptions and in the near-term transition to the ultimate economic assumptions have a negligible effect on the social insurance closed group measure.

3. There were no legislative changes since the last report that are projected to have a significant effect on the long-range OASDI actuarial balance.

4. Several methodological improvements and updates of program-specific data are included in the 2008 measures. These changes to programmatic data and methods result in a combined increase (improvement) in the open group measure of about $171 billion.

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Appendix E: Glossary

Fiscal Sustainability Reporting

In federal financial reporting, "Fiscal Sustainability Reporting" is the short term for information designed to assist readers of the consolidated Financial Report of the U.S. Government in assessing whether future budgetary resources of the U. S. government will likely be sufficient to sustain public services and meet obligations as they come due.

Fully Insured

"Fully insured" status means that a social insurance participant is eligible for benefits. Social insurance benefits include pensions and health care for retirees and the disabled. For example, Social Security and Medicare participants become permanently fully insured when they attain at least 40 quarters of work in covered employment (QC). Social Security and Medicare participants may be fully insured without being permanently fully insured. This is important with respect to disability benefits, which include subsistence payments and medical care. Disability benefits may be needed well before the participants attained retirement age. A participant who receives disability benefits for 24 consecutive months is eligible for Medicare and, if he or she continues receiving disability benefits until attaining retirement age, he or she is converted to Social Security retirement benefits. To be fully insured, participants generally need a minimum of 6 QC. Once a worker has accumulated 40 QCs, he or she remains permanently fully insured, that is, no further QCs are required.[31]

Intergenerational Equity

Intergenerational equity refers to the extent that different age groups are required to assume the financial burdens for services provided to other age groups.

Present value

Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the "time value of money" into consideration. The "time value of money" is illustrated by a question such as: "At ten percent annual interest, how much do I need to put into the bank to have $100 one year from today?" Clearly, the amount you would need today would be less than $100.

Projections

A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to

[31] 2003 OASDI Trustees' Report, page 111.

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depict results that may occur under various conditions–for example, what if current policy without change regarding federal government public services and taxation is continued in the future? Projections are useful in order to present alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

Valuation date

A date as close to the end of the fiscal year being reported upon as possible and no more than one year prior to the end of the reporting year.

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Appendix F: List of Abbreviations

CFR	Consolidated financial report
CFS	Consolidated financial statements
CPI	Consumer Price Index
DI	Disability Insurance (Social Security)
DOL	U.S. Department of Labor
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
HHS	Department of Health and Human Services
IPSASB	International Public Sector Accounting Standards Board
MA	Medicare Advantage
MD&A	Management's Discussion and Analysis
Medicare HI	Hospital Insurance (Medicare)
Medicare SMI	Supplementary Medical Insurance (Medicare)
OASDI	Old-Age, Survivors, and Disability Insurance (Social Security)
OASI	Old-Age and Survivors Insurance (Social Security)
OMB	Office of Management and Budget
RRB	Railroad Retirement Board
RSI	Required supplementary information
SCNP	Statement of Changes in Net Position
SCSIA	Statement of Changes in Social Insurance Amounts
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SI ED	Social Insurance Exposure Draft dated November 2008
SMI	Supplementary Medical Insurance
SNC	Statement of Net Cost
SOSI	Statement of Social Insurance
SSA	Social Security Administration
UI	Unemployment Insurance
UTF	Unemployment Trust Fund

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FASAB Board Members

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Debra J. Bond (beginning December 18, 2009)

Robert F. Dacey

Nancy Fleetwood

Michael H. Granof

Norwood J. Jackson

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

Danny Werfel (through December 17, 2009)

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Richard Fontenrose

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Accounting for

Federal Oil and Gas Resources

Statement of Federal Financial Accounting Standards 38

April 13, 2010

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Summary

This standard requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves to be reported in a schedule of estimated federal oil and gas petroleum royalties. In addition, this standard requires the value of estimated petroleum royalty revenue designated for others to be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented in required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity.

This Statement is effective as RSI for periods beginning after September 30, 2011. Earlier implementation is encouraged. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. This Statement will remain in effect until such time a determination is made.

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Table of Contents

Summary i

Introduction 1

Purpose 1
Materiality 1
Effective Date 1

Standards 3

Scope 3
Definitions 3
Accounting and Reporting of Federal Oil and Gas Resources by Component Entities 4
Schedule of Estimated Federal Oil and Gas Petroleum Royalties 4
Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others 6
Annual Valuation of Estimated Petroleum Royalties and Petroleum Royalties to be Distributed to Others 6
Component Entity Reporting Requirements 7
Consolidated Financial Report (CFR) of the United States Government Reporting Requirements 8
Effective Date 9

Appendix A: Basis for Conclusions 10

Project History 10
Accounting for Other Types of Natural Resources 12
Fiduciary Oil and Gas Resources 12
Overview of Federal Oil and Gas Resources 13
Undiscovered Resources 13
Reserves 15
Figure 1 – Components of Federal Oil and Gas Resources 17
Conceptual Aspects of Federal Oil and Gas Resources as an Asset for Estimated Petroleum Royalties and a Liability for the Portion of Revenue to be Distributed to Non-Federal Entities 18
Recognition Criteria 18
Consideration of Asset Recognition or Disclosure 18
Consideration of Liability Recognition or Disclosure 24

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_38.pdf.

Future Rights to Royalty Streams Identified for Sale 25
Original Exposure Draft 25
Comment Letters 25
Field Testing 26
Discussion with DOI Representatives 28
Revised Exposure Draft 29
Comment Letters 30
Board Approval 32

Appendix B: Illustrations 33

Appendix C: Abbreviations 45

Appendix D: Technical Terms 46

Appendix E: Glossary 56

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_38.pdf.

Introduction

Purpose

1. Statements of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*; 8, *Supplementary Stewardship Reporting*; and 29, *Heritage Assets and Stewardship Land*, establish standards related to federal lands, but specifically exclude natural resources from the scope of those standards. Extensive **federal oil and gas resources**[1] exist on public lands throughout the country and on the **Outer Continental Shelf** (OCS). Currently, federal financial reporting does not provide information about the quantity or value of these assets.

2. The Board believes that federal oil and gas resources represent federal assets and accounting for and reporting information about these assets would enhance accountability for and stewardship over assets of the federal government.

3. This Statement provides for a more complete accounting for oil and gas resources available to the federal government. Accounting for the federal government's **royalty** share of **proved reserves** as an asset and reporting information on that asset as required supplementary information (RSI) would provide transparency regarding the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

5. The standards are effective as RSI for periods beginning after September 30, 2011. Earlier implementation is encouraged.

6. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic

[1] Terms defined in Appendix D: Technical Terms or the Glossary are shown in **bold-face** the first time they appear.

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information as financial statement **recognition** or note disclosure. This Statement will remain in effect until such time a determination is made.

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Standards

Scope

7. This Statement applies to federal entities that report information about federal oil and gas resources in general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board* (FASB).

8. This Statement articulates a general principle that should guide preparers of general purpose federal financial reports in accounting for federal oil and gas resources.

9. Federal lands contain a variety of natural resources other than oil and gas proved reserves that are not specifically addressed by this Statement. This Statement does not require or preclude entities from reporting information about other types of federally-owned natural resources; however, this Statement should be considered in conjunction with SFFAS 7, *Accounting for Revenue and Other Financing Sources,* when applying SFFAS 34 to other types of federally-owned natural resources.[2]

Definitions

10. Definitions in paragraphs 11 and 12 are presented first in the accounting standards because they are new technical terms not previously defined in federal accounting standards.

11. **Federal oil and gas resources**: **Oil** and **gas** resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

12. **Regional estimated petroleum royalties**: Regional **estimated petroleum royalties** means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources in each **region**.

[2] SFFAS 7, par. 45, requires, in instances where there are virtually no costs incurred in earning exchange revenue, that federal entities recognize the revenue as a financing source on the statement of changes in net position, rather than the statement of net cost.

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Accounting and Reporting of Federal Oil and Gas Resources by Component Entities

Schedule of Estimated Federal Oil and Gas Petroleum Royalties

13. Extensive federal oil and gas resources exist on public lands throughout the country and on the Outer Continental Shelf (OCS). These resources will provide economic benefits to the federal government through revenue from leasing activities and the collection of royalties on production. The federal government controls access to these resources.

14. Federal oil and gas resources are made up of two primary components – reserves and **undiscovered resources**. Reserves can be further defined as either proved or unproved while undiscovered resources can be further defined as either recoverable or non-recoverable. See *Figure 1 – Components of Federal Oil and Gas Resources* in the basis for conclusions for an illustration of the universe of federal oil and gas resources and a further breakdown of its components.

15. The value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves should be reported in a schedule of estimated federal oil and gas petroleum royalties by the component entity that is responsible for collecting royalties. This schedule should be presented in RSI as part of a discussion of all significant federal oil and gas resources under management by the entity.

16. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect these changing conditions.

17. The estimates that are developed should approximate the **present value** of future federal royalty receipts on proved reserves known to exist as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible.

18. Discount rates as of the reporting date for present value measurements of federal oil and gas resources should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted.

19. The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates

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should reflect what is reasonable to assume under the circumstances. While the entity's own assumptions about future cash flows may be used, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and Product Accounts. If the entity's own assumptions do not reflect data that are consistent with sources independent of the reporting entity, an explanation of why the entity's own assumptions are preferred should be provided.

20. The value of the federal government's estimated petroleum royalties should be computed based on the calculation of federal oil and gas proved reserves on a regional basis. For purposes of these standards, the regions used in determining and reporting regional amounts or factors should be collaboratively developed by all the component entities involved in federal oil and gas resource activities. Regions used in calculating regional estimated petroleum royalties and in applying these standards should be consistent and aligned with regions used internally by the component entities in administering federal oil and gas resource activities.

21. The estimates of future federal royalty receipts on proved reserves known to exist as of the reporting date should be divided further by commodity and type (e.g., wet gas, **dry gas**, oil and **lease condensate**, onshore, offshore, etc.) and calculated separately if material differences would otherwise result. Each of the individual calculations should be reported separately and summed together to arrive at the federal government's total estimated petroleum royalties.

22. The preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves using a risk-free discount rate as described in paragraph 17; however, alternative methods for measuring **fair value** or current price may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 17 through 19.[3]

[3] Calculating the present value of future federal royalty receipts employs the use of a number of estimates including estimating when the proved reserves will be produced over time, future oil and gas prices, and the possibility and extent of royalty-free production. Unforeseen circumstances may result in situations where it is not possible for the entity to reasonably estimate the present value of future federal royalty receipts. In these situations, it may be possible to estimate current price. Current price, sometimes referred to as a "fresh-start" or "remeasured" price, is a general term for various attributes measured as of a financial statement date subsequent to the period of initial recognition, including replacement price, market price, and settlement price.

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23. Once established, the estimation methodology should be consistently followed and explained in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be explained.

Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others

24. The majority of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves are distributed to state governments, other federal agencies, and the general fund of the U.S. Treasury in accordance with legislated allocation formulas. The legislated allocation formulas constitute a present obligation[4] of the component entity that is responsible for collecting royalties to provide assets to another entity, and the underlying legislation identifies the conditions under which these distributions will be made.

25. The value of estimated federal oil and gas petroleum royalty revenue designated for others should be reported in a schedule of estimated petroleum royalties to be distributed to others by the component entity that is responsible for collecting royalties. This schedule should be presented in RSI by type of entity as part of a discussion of all significant federal oil and gas resources under management by the entity.

26. The value of the revenue to be distributed to others should be estimated based on the portion of the royalty share of the federal proved oil and gas reserves designated to be distributed to others. For example, the average annual share of the revenue distributed to others over the preceding twelve (12) months may be an acceptable basis for estimating petroleum royalties to be distributed. Other methodologies may also be acceptable.

Annual Valuation of Estimated Petroleum Royalties and Petroleum Royalties to be Distributed to Others

27. The estimated petroleum royalties asset value and petroleum royalties to be distributed to others should be valued at the end of each fiscal year.

[4] The term obligation is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

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Component Entity Reporting Requirements

28. The component entity responsible for collecting royalties should provide the following as narrative to the schedules presented as RSI:

    a. A concise statement explaining how the management of federal oil and gas resources is important to the overall mission of the entity.

    b. A brief description of the entity's stewardship policies for federal oil and gas resources. The stewardship policies for federal oil and gas resources should describe the guiding principles established to: assess the oil and gas resource areas; offer those resources to interested developers; sell and assign **leases** to winning bidders; administer the leases; collect bonuses, **rents**, royalties, and **royalty-in-kind**; and distribute the collections consistent with statutory requirements, prohibitions, and limitations governing the entity.

    c. A narrative describing future royalty rights identified for sale, if applicable. The narrative should provide the value of the rights identified for future sale, the location of the **field**(s) involved in the future sale, and the best estimate of when the rights would be sold. The calculated value reported for future royalty rights identified for sale should be based on the specific field to be sold and consistent with the valuation requirements of paragraph 22.

    d. A narrative describing and a display showing revenue reported by category for the reporting period should be presented for offshore and onshore revenues for the following categories: royalty revenue for oil and gas; rent revenue; **bonus bid** revenue for leases; and total revenue from all the above categories.

    e. A narrative describing and a display showing:

        (1) the quantity of oil and gas proved reserves at the end of the reporting period;

        (2) the average of the Regional Average **First Purchase Prices** for oil and the average of the Regional Average **Wellhead Prices** for gas for the reporting period; and,

        (3) the average **royalty rate** for oil and gas for the reporting period.

    f. A narrative describing the estimation methodology used to calculate the value of the federal government's estimated petroleum royalties. At a minimum, the narrative explanation should include a "plain

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English" explanation of the measurement method (e.g., present value), the significant assumptions incorporated into the estimate (e.g., discount rates used to calculate present value, production decline curve, portion of proved reserves under federal lands, future oil and gas prices, inflation rates, etc), and any significant changes in the estimation methodology, including the underlying assumptions, from the prior year. As required by paragraph 23, the nature and reason for any changes, as well as the effect of the changes, should be explained.

g. A reference to the source reports used to calculate the value of the federal government's estimated petroleum royalties.

h. A narrative describing and a display showing the **sales volume**, the **sales value**, the royalty revenue, and the **estimated value for royalty relief** produced from federal oil and gas resources for the reporting period. To the extent that regional information is available and would contribute to understanding, the information for each region should be provided.

i. A narrative describing other significant federal oil and gas resources under management by the entity that are not addressed by this Statement because they are not currently under lease (e.g., coastal plain of the Arctic National Wildlife Refuge). The narrative should be sufficient to enable the financial statement reader to gain an understanding of the full extent of federal oil and gas resources under management by the entity.

Consolidated Financial Report (CFR) of the United States Government Reporting Requirements

29. The governmentwide entity should provide the following information related to federal oil and gas resources in RSI as part of a discussion of all significant federal oil and gas resources under management by the federal government:

a. A concise statement explaining the nature and valuation of federal oil and gas resources.

b. A narrative describing and a display showing:

(1) the quantity of oil and gas proved reserves at the end of the reporting period;

(2) the average of the Regional Average First Purchase Prices for oil and the average of the Regional Average First Wellhead

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Prices for gas for the reporting period;

(3) the average royalty rate for oil and gas for the reporting period;

(4) the asset value for oil and gas by the commodities and types identified for use in calculating the federal government's total estimated petroleum royalties for the reporting period (see paragraph 21); and,

(5) the value of estimated petroleum royalties at the end of the reporting period.

c. A reference to specific agency reports for additional information about federal oil and gas resources.

Effective Date

30. The standards are effective as RSI for periods beginning after September 30, 2011. Earlier implementation is encouraged.

31. It is the Board's intent that the information required by this Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. This Statement will remain in effect until such time a determination is made.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. The project began with the formation of a task force to conduct research. The task force produced a discussion paper in June 2000 entitled *Accounting for the Natural Resources of the Federal Government* (see http://www.fasab.gov/pdffiles/natresrpt.pdf to access the report). In 2002, the Board resumed active consideration of the issues raised by the task force after a deferral to address other issues.

A2. The Board was interested in determining whether values for federal natural resources, or some surrogate, should be capitalized and reported on the balance sheet. The Board members believed that capitalizing federal natural resources could increase accountability for their management and improve the comprehensiveness, relevance, and consistency of federal financial statements. The Board members agreed to address each type of natural resource (e.g., fluid leasable minerals such as oil and gas, solid leasable minerals such as coal and timber, etc.) in separate phases. Federal oil and gas resources were addressed first because of the literature available in other domains, the extensive historical information on federal lease programs and royalty collections, and the large amount of revenue received in exchange for federal oil and gas resources.

A3. The Board indicated that the pertinent questions were (1) what, if anything, should be recognized as an asset; and, (2) what is the source and reliability of quantity information. They believed the source and the reliability of the information would have a bearing on where information should be reported.

A4. The extractive industries' activities for oil and gas can be divided into two categories—upstream activities (exploration and production activities) and downstream activities (transportation, refining, and marketing activities). Upstream activities can be divided into the following phases:

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a. Prospecting[5]

b. Acquisition of mineral rights

c. Exploration

d. Appraisal and evaluation

e. Development

f. Production

A5. Downstream activities take place after the production phase of the upstream activities through to the point of sale and can be divided into the following phases:

a. Supply and trading

b. Shipping

c. Refining

d. Storage and distribution

e. Marketing and retail

A6. The national assessment of federal oil and gas resources performed by the federal government is similar to the prospecting phase of the extractive industries' upstream activities. It is the only activity performed by the federal government that is similar to the extractive industries' activities.

A7. The Board noted that, based on discussions about oil and gas lease activities in the private sector, new models for accounting and reporting on the federal government's oil and gas activities would be needed because the current federal model is incomplete and federal activities are not similar to private sector activities.

A8. The Board released two exposure drafts (EDs) to solicit comments on its proposed requirements for accounting for federal oil and gas resources. The original ED, *Accounting for Federal Oil and Gas Resources,* was released on May 21, 2007. A revised ED by the same name was released on July 6, 2009. The board considered the comments received on the two EDs and

[5] Prospecting usually involves researching and analyzing an area's historic geologic data and carrying out topographical, geological, and geophysical studies.

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related field testing in reaching its current position.

Accounting for Other Types of Natural Resources

A9. Federal lands contain a variety of natural resources that are not specifically addressed by this Statement, including coal, gold, and silver, as well as timber and grazing rights. Originally, the Board intended to address each category of resources in separate phases as noted in paragraph A2. Although in principle a broader application was desirable to several Board members, the majority believes that the Board has already devoted a substantial amount of time to the oil and gas standard and developing additional guidance for the other types of resources would significantly delay implementation of a broad standard. Therefore, because federal oil and gas resources represent the most significant portion of all federal natural resources, the majority of members felt it was important to begin recognizing them as soon as possible.

A10. Nonetheless, the majority of the members believe that the substance of the standards developed for federal oil and gas resources may serve as a good analogy for other categories of federal natural resources.[6] Therefore, while this Statement does not specifically address other types of federal natural resources, the Board believes that this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 9 to explicitly state that this Statement does not require or preclude entities from reporting information about other types of federally-owned natural resources; however, members believe this Statement should be considered in conjunction with SFFAS 7, *Accounting for Revenue and Other Financing Sources*, when applying SFFAS 34 to other types of federally-owned natural resources.

A11. The Board directed staff to apply the requirements of this Statement to other types of natural resources through the issuance in the future of a technical bulletin.

Fiduciary Oil and Gas Resources

A12. SFFAS 31, *Accounting for Fiduciary Activities*, par. 12, states that "Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending disposition, or held long-term in a fiduciary

[6] SFFAS 34, Paragraph 7.

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capacity." Both the original and revised EDs included a paragraph on fiduciary oil and gas resources that required similar reporting for fiduciary proved oil and gas reserves. However, one of the respondents to the revised ED raised a question of whether fiduciaries are required to value non-monetary assets. In addition, the Board discussed whether there are currently any oil and gas reserve activities that would meet the definition of fiduciary activity.[7] Since this Statement requires RSI reporting for federal oil and gas proved reserves and would not trigger reporting under SFFAS 31, the Board is deferring the issue of whether reporting should be required for fiduciary proved oil and gas reserves. No reporting on fiduciary oil and gas resources is required as a result of this Statement. The Board will revisit the issue of reporting on fiduciary oil and gas resources either through the issuance of the technical bulletin mentioned in paragraph A11 or when the Board revisits accounting and reporting for federal oil and gas resources in three years as discussed in paragraph A38.

Overview of Federal Oil and Gas Resources

A13. *Figure 1*, *Components of Federal Oil and Gas Resources*, presented after paragraph A27 identifies the universe of federal oil and gas resources (total resources). Total resources incorporate "original in-place" resources, that is, resources in the earth before human intervention. The components are those used in the industry. Information is available in varying degrees and with varying reliability for each component. The components are first separated into "undiscovered resources" and "reserves." Generally, undiscovered resources are not under lease, while reserves are under lease.

Undiscovered Resources

A14. The first major component of total resources is undiscovered resources. The undiscovered resources component is divided into the following subcomponents:

a. **undiscovered non-recoverable resources**

b. **undiscovered recoverable resources**

(1) **undiscovered conventionally recoverable resources**

(2) **undiscovered economically recoverable resources**.

[7] Members questioned whether the federal government currently assumes any fiduciary responsibility for non-federal oil and gas leases beyond the collection of royalties.

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A15. Each component and subcomponent can be further divided between onshore and offshore resources. Onshore resources consist of resources on federal lands. Offshore resources consist of resources on the Outer Continental Shelf (OCS). This division between onshore and offshore resources is important operationally because the source and volume of information varies.

A16. There is no information available on undiscovered non-recoverable resources. These resources are not addressed or included in any type of assessment. Undiscovered non-recoverable resources are referred to as resources that are beyond conventional technologies to be estimated and are not assessed. However, in the realm of "original in-place" resources they may exist.

A17. Information on the two subcomponents of undiscovered recoverable resources is available for offshore oil and gas resources. This information is based on national assessments performed by the Minerals Management Service (MMS) approximately every five years, with updates on a yearly basis for certain geographic locations. The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic **play** analysis approach for resource appraisal. Information on undiscovered conventionally recoverable resources and undiscovered economically recoverable resources is provided in the MMS assessment.

A18. For the onshore portion of undiscovered recoverable resources, the U.S. Geological Survey (USGS) formerly conducted national assessments. The last comprehensive national assessment was completed by the USGS in 1995, and since 2000 the USGS has been re-assessing **basins** of the U.S. that are considered to be priorities for the new assessment rather than assessing all of the basins of the U.S. As each basin is re-assessed, the assessment results are added to the assessment tables, and these new values replace the assessment results from 1995. The USGS assessment provides information on undiscovered conventionally recoverable resources but not on undiscovered economically recoverable resources like the MMS does.

A19. Under existing Federal Accounting Standards Advisory Board (FASAB) accounting standards, there are no requirements to provide or present information about the undiscovered resource components in the financial statements. Information about **technically recoverable resources** was gathered and maintained by the Energy Information Administration (EIA) in the past. However, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is no reliable source for this type of information, federal reporting on onshore and offshore undiscovered recoverable resources is not required.

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Reserves

A20. The second major component of total resources is **reserves**. The reserves component is divided into the following subcomponents as follows:

a. **unproved reserves**

(1) **unproved possible reserves**

(2) **unproved probable reserves**

b. proved reserves

(1) **proved undeveloped reserves**

(2) **proved developed reserves**

(a) **proved developed non-producing reserves**

(b) **proved developed producing reserves**

A21. Under existing FASAB accounting standards, there are no requirements to provide or present information about the unproved reserves components in the financial statements.

A22. Under the accounting standards proposed in the original ED, information about onshore and offshore unproved reserves would be included in the technically recoverable resources and reported as RSI. However, as noted in par. A19, although information about technically recoverable resources was gathered and maintained by the EIA in the past, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is no reliable source for this type of information, federal reporting on unproved reserves is not required.

A23. Quantitative information in relation to onshore and offshore proved reserves, including new discoveries, production, and **adjustments** is submitted to the EIA by oil and gas well operators once a year. The due date for operators to submit the information is April 15 for activities from the preceding calendar year.

A24. Under existing accounting standards, the bonus bid, rent (collected on the lease until oil and gas production begins), and royalty revenue (collected on production) are accounted for as a custodial activity (i.e., an amount collected for others) by MMS, the collecting entity. The collections and their distribution are reported on MMS's statement of custodial activities. Component entities

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receiving a distribution and the CFR of the United States government recognize the revenue as a financing source in their respective statement of changes in net position or statement of operations and changes in net position.

A25. In addition to the above existing accounting standards, this Statement requires that the estimated federal royalty share of proved reserves be reported in RSI as estimated petroleum royalties by the component entity that is responsible for collecting royalties. The portion of the estimated petroleum royalty revenue designated to be distributed to others should also be reported in RSI.

A26. This Statement also requires that information on the quantity and consumption of proved reserves, including the sales volume, the sales value, the amount of royalty revenue, and the estimated value for royalty relief be provided as RSI.

A27. On the following page, *Figure 1 – Components of Federal Oil and Gas Resources* provides a summary of the information presented in the preceding paragraphs. The shaded boxes in the figure represent the availability of information as follows:

No quantity information available	
Technically recoverable resources quantity information provided by EIA at the national level[8]	
Proved reserves quantity information provided by EIA at the national level[9]	

The terms in Figure 1 are defined in Appendix D: Technical Terms under the subheading Definitions of Resource and Reserve Components and Subcomponents.

[8] Quantity information is currently only published at the national level; segregated information on the quantity of oil and gas resources under federal lands is not available.
[9] See footnote 8.

Figure 1 – Components of Federal Oil and Gas Resources

<table>
<tr><td>Accounting Standards</td><td colspan="8">Components of Federal Oil and Gas Resources</td></tr>
<tr><td rowspan="4"></td><td colspan="3">Undiscovered Resources</td><td colspan="5">Reserves</td></tr>
<tr><td rowspan="2">Undiscovered Non-Recoverable Resources</td><td colspan="2">Technically Recoverable Resources</td><td colspan="2" rowspan="2">Unproved Reserves</td><td colspan="3" rowspan="2">Proved Reserves</td></tr>
<tr><td colspan="2">Undiscovered Recoverable Resources</td></tr>
<tr><td>Undiscovered Conventionally Recoverable Resources</td><td>Undiscovered Economically Recoverable Resources</td><td>Unproved Possible Reserves</td><td>Unproved Probable Reserves</td><td>Proved Undeveloped Reserves</td><td colspan="2">Proved Developed Reserves</td></tr>
<tr><td colspan="4"></td><td>Proved Developed Non-Producing Reserves</td><td>Proved Developed Producing Reserves</td></tr>
<tr><td>Existing Accounting Standards</td><td colspan="8">Bonus bid, rent, royalty revenue accounted for as custodial activity by the component entity and recognized as a financing source on the CFR and component entity statement of operations and changes in net position</td></tr>
<tr><td>New Accounting Standards</td><td colspan="8">• Bonus bid, rent, royalty revenue accounted for as custodial activity by the component entity and recognized as a financing source on the CFR and component entity statement of operations and changes in net position
• Asset value and revenue designated to be distributed to others reported as required supplementary information (RSI)
• Information on the quantity and consumption of proved reserves, including the sales volume, sales value, the amount of royalty revenue, and the estimated value for royalty relief reported as RSI</td></tr>
</table>

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Conceptual Aspects of Federal Oil and Gas Resources as an Asset for Estimated Petroleum Royalties and a Liability for the Portion of Revenue to be Distributed to Non-Federal Entities

Recognition Criteria

A28. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, states that to be recognized as an element of the financial statements, an item must (a) meet the definition of an element of the financial statements and (b) be measurable. The term measurable means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.[10]

A29. Measurement may require the use of estimates and approximations as well as an assessment, in a manner consistent with the attribute being measured, of the probability that future inflows or outflows of economic benefits or services will result from the item. Recognition decisions also incorporate the results of assessments of the materiality and benefit versus cost of recognizing the item measured. Thus, it is possible that an item that meets the basic recognition criteria would not be recognized due to measurement, materiality, or cost-benefit considerations.[11]

Consideration of Asset Recognition or Disclosure

A30. Recognition of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves as an asset was considered by the Board based on SFFAC 5, paragraphs 18 through 35.

A31. An asset for federal accounting purposes is a resource that embodies economic benefits or services that the federal government controls.[12]

A32. To meet the definition of an asset of the federal government, a resource must possess two characteristics. First, it must embody economic benefits or services that can be used in the future. Second, the government must control access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.[13]

[10] SFFAC 5, par. 5.
[11] SFFAC 5, par. 7.
[12] SFFAC 5, par. 18.
[13] SFFAC 5, par. 22.

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A33. First, the Board established which federal oil and gas resources were being considered. *Figure 1 – Components of Federal Oil and Gas Resources* presents the federal oil and gas resources that were considered. The two major components are "undiscovered resources" and "reserves." All of the federal oil and gas resources qualify as federal government assets because the government can obtain economic benefits and regulate the access of other entities as provided under federal law.

A34. Since all federal oil and gas resources controlled by the federal government are assets, the Board's next step was to decide whether the federal oil and gas resources "asset" should be recognized on a federal component entity balance sheet. As noted in paragraph A28 above, the second criterion for recognition is that the asset "…be measurable."

A35. Estimates of the quantity of technically recoverable oil and gas resources were available through EIA in the past. With this quantity information, a monetary measure was technically feasible and, therefore, the asset qualified for consideration for recognition. However, the Board does not believe that the information is sufficiently reliable to be recognized in a cost-beneficial manner.

A36. The EIA information on other than proved reserves is derived from sporadic and incomplete national assessments and annual submissions by oil and gas producers. This makes it particularly uncertain. In addition, since these reserves are not currently under lease, determining the royalty share may be misleading since it is a current value measure but the underlying asset may be restricted and production may never occur. For those resources that are not restricted, production may occur but the timing and amount of royalties are very uncertain. Thus, applying the same measurement technique to other than proved reserves may not result in a value that represents what it purports to represent. Therefore, federal oil and gas resources not yet in the "proved reserves" category would not be recognized on the federal balance sheet due to concerns regarding reliability of the proposed measure.

A37. SFFAC 1, *Objectives of Federal Financial Reporting*, provides the following with respect to reliability:

> 160. Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions, nor should anything be

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included that would likely cause the information to be misleading to the intended report user. Reliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.

A38. Concerning the proved oil and gas reserves from federal oil and gas resources, the Board believes that both the quantity and the estimated federal royalty share would be reliable. Thus, in this case, since the quantity of the estimated federal proved oil and gas reserves can be reliably estimated and converted to monetary terms (estimated federal royalty share), the Board believes the estimated federal royalty share of proved oil and gas reserves should be presented as basic information. However, members would like to have more information on the reliability of the valuation methodology before it makes a final decision on whether the information should be recognized on the face of the financial statements or disclosed in the notes to the financial statements. Therefore, the Board has decided to require the information to be reported in a schedule of estimated federal oil and gas petroleum royalties in RSI for three years. Before the end of the three-year period, the Board will make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure.

A39. The Board acknowledges that royalties received from federal oil and gas leases will continue to be recognized on the statement of changes in net position with non-exchange revenue rather than on the statement of net cost with other exchange revenue as long as the asset value is reported as RSI and not recognized in the financial statements with a corresponding depletion expense. However, as noted above, the Board would like to have more information before it makes a final decision regarding changes to revenue recognition.

A40. While the Board intends to require that the information transition to basic information as financial statement recognition or note disclosure, the Board acknowledges that new information might become available that would warrant continued reporting as RSI. The Board will consider its reporting options after additional information becomes available.

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Measurement Attributes and Methods Considered

A41. The FASAB's projects to reexamine and expand its conceptual framework include a project on measurement attributes (i.e., the aspect of an item that is measured, such as, for example, its historical cost or replacement cost) for reporting purposes. This project follows logically from SFFAC 5, which states that an item's being measurable is a criterion for recognition in the financial statements but does not address measurement attributes or measurement methods.

A42. As is true of other components of an expanded conceptual framework, the project on measurement attributes is expected to result in a concepts statement for the future guidance of, primarily, the Board itself. The statement may include definitions and a discussion of the features of different measurement attributes and methods as well as other concepts that should assist the Board in developing future standards. While the project on measurement attributes is underway, the Board will select the measurement attributes for each standard under deliberation based on available definitions.

A43. Concerning the dollar amount to be reported for the estimated federal royalty share of proved reserves, the Board considered various measurement attributes and methods, including the following:

a. Historical cost (historical proceeds) – The amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations.

b. Fair value –The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

c. Net realizable (settlement) value – The total non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion. The net realizable value requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash.

d. Present (or discounted) value of future cash flows – The present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows.

A44. After deliberating on the above attributes and methods, the Board decided that defining a measurement attribute in terms that are common to the oil and

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gas industry would be the best approach. Therefore, the Board proposed to use a regional average first purchase price for oil and lease condensate, a regional average first purchase price for **natural gas plant liquids** (NGPLs), and a regional average wellhead price for gas to value federal estimated petroleum royalties. This measurement approach was included in the May 2007 ED.

A45. Also included in the May 2007 ED was an alternative view from the Board member representing the Congressional Budget Office, expressing the view that fair value is the appropriate basis for valuing federal oil and gas resources. At the time, the other Board members had rejected fair value because of the lack of current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves.

A46. In conjunction with the comment period on the May 2007 ED, the Board requested that the proposal be field tested by the U.S. Department of the Interior (DOI). After reviewing the results of the field testing performed by DOI (see paragraphs A61 through A68) and talking with DOI representatives (see paragraphs A69 and A70) about the alternative methodology that it developed, the Board determined that the estimates that are developed should approximate the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible. In addition, discount rates as of the reporting date for present value measurements of federal oil and gas assets and liabilities should be based on interest rates on marketable Treasury securities with maturities consistent with the cash flows being discounted.

A47. While present value is typically considered to be a method for measuring fair value, the present value measurement approach required by this standard is based on an entity-specific discount rate, specifically the interest rates on marketable Treasury securities, and does not consider the price that market participants demand for bearing the uncertainty inherent in the cash flows (i.e., neither the cash flows nor the discount rate is adjusted for a market risk premium). A typical fair value measurement (e.g., Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements*[14]) is determined based on the assumptions that market participants would use in pricing the asset. A measurement that does not include an adjustment for the market risk premium would not represent a fair value measurement since market participants would include one in pricing the petroleum royalties. Therefore, the present value measurement approach required by this standard is not a market-based fair value measure.

[14] FASB Accounting Standards Codification™ (ASC) 820-10.

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A48. There is some concern that DOI may not be able to implement and/or obtain a favorable audit opinion on the present value methodology that it proposed as a result of its field testing. To permit additional flexibility in the measurement methods for valuing federal estimated petroleum royalties, the Board has also determined that market-based methods for measuring fair value or other methods for measuring current price will be acceptable. Fair value incorporates the effects of uncertainty that are inherent in the cash flows expected in the future from oil and gas activities, including the effects of the additional return demanded by market participants to assume the risk of that uncertainty. Therefore, the standard provides for a measurement method that is based on either (1) the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date using a risk-free discount rate without incorporating market risk, (2) market-based methods for measuring fair value, or (3) other methods for measuring current price.

Asset Valuation Methodology

A49. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect these changing conditions. Sources of information that were once available to preparers may be replaced or become obsolete. On the other hand, new and more reliable data sources may become available. Permitting the preparers flexibility in developing an estimation methodology that keeps pace with the environment will prevent the accounting standards from becoming outdated.

A50. EIA has been used as the source of information on proved reserves data in the past and may prove to continue to be the appropriate source for such information in the future. However, the Board has chosen not to explicitly designate EIA as the source of information; an explicit designation of the source of information would prevent the preparer from fully complying with the standards if the source were no longer available at some point in the future.

Use of Regional Data to Value the Federal Asset "Estimated Petroleum Royalties"

A51. The Board believes that the most relevant, reliable, and cost-beneficial measurement of "estimated petroleum royalties" would be obtained by using regional information. The Board believes this approach would provide conservative, representative regional values of estimated petroleum royalties without having to calculate the value on a field-by-field basis. The Board believes it would not be practicable to make calculations on a field-by-field

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basis. There are more than 60,000 leases maintained by DOI with approximately 115,000 producing wells.

Consideration of Liability Recognition or Disclosure

A52. Recognition of royalty distributions to non-federal entities as a liability was considered by the Board based on SFFAC 5 paragraphs 36 through 48.

A53. A liability is a present obligation[15] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[16]

A54. A liability of the federal government has two essential characteristics. First, a liability constitutes a present obligation to provide assets or services to another entity. Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled.[17]

A55. Paragraph 15 requires that the component entity responsible for collecting royalties report the value of the federal government's estimated petroleum royalties in a schedule of estimated federal oil and gas petroleum royalties. The value of the estimated petroleum royalties would be based on the royalty share of the federal oil and gas resources classified as "proved reserves." In addition to the royalties that the component entity collects on proved reserves that are produced, it also collects lease sale and rent revenue from federal government oil and gas leases. The component entity distributes nearly all of these proceeds to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments) in accordance with legislated allocation formulas. The component entity also receives a very small portion of the revenue collected to fund its operations. The amount used to fund its operations is legislated by Congress as part of the component entity's annual appropriation. For example, the amount received by the component entity was approximately one percent (1%) of annual revenues collected in 2006.[18]

A56. The Board believes that in addition to presenting a schedule of the estimated petroleum royalties to be received, the component entity responsible for

[15] The term obligation is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.
[16] SFFAC 5, par. 39.
[17] SFFAC 5, pars. 41 through 48.
[18] The one percent was derived by dividing [Note 23. Custodial Distributions to MMS, Revenues to Fund Operations] by [Total Revenue on the Statement of Custodial Activity] for 2006.

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collecting royalties should also present a schedule of the estimated petroleum royalties to be distributed to others because nearly all of the revenue from royalties, lease sales, and rent are ultimately distributed to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments).

Future Rights to Royalty Streams Identified for Sale

A57. When rights to a future royalty stream are identified to be sold, the value of those rights should be reported in RSI as "future royalty rights identified for sale." Reporting the approximate value at the balance sheet date alerts the reader to the pending sale and the potential value of the asset to be sold.

A58. The value of the future royalty rights identified for sale is based on the specific field identified for sale. Because the fields are known, this provides a more field specific value for the rights identified to be sold.

Original Exposure Draft

A59. The original ED, *Accounting for Federal Oil and Gas Resources*, was issued May 21, 2007 with comments requested by September 21, 2007. However, because the Board received a request for the comment period to be extended and because few responses had been received, the Board agreed to extend the comment period until January 11, 2008.

Comment Letters

A60. Eight comment letters were received on the original ED. The following points present a high-level summary of the comments received:

a. The majority of respondents agreed with the overall concept of recognizing an asset for the federal government's natural resources and a liability for the related royalty revenues designated to be distributed to others.

b. Two of the eight respondents stated that standards on federal natural resources should include all federal natural resources and not be limited to only oil and gas resources.

c. One of the eight respondents commented on the complex nature of the original ED.

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d. No respondents supported the use of the probabilistic method of estimation as proposed in the alternative view of the original ED.

e. Two respondents supported the use of present value or fair value with discounting (similar to the alternative view proposal) instead of the valuation method as proposed in the original ED that utilizes the average first purchase or wellhead price.

f. The majority of respondents agreed that the numerous disclosures proposed in the original ED appeared excessive and might not pass a cost/benefit test.

g. There was general support for royalty relief disclosures.

h. Of the five respondents that directly addressed the question on fiduciary disclosures, four stated that the cost of such disclosures would outweigh any perceived benefits.

i. The majority of respondents supported the recommendation for more limited disclosures in the CFR. However, one respondent stated that because natural resources are sovereign assets, the major disclosures would more appropriately appear in the CFR and not agency financial statements.

Field Testing

A61. In addition to the comment letters received on the original ED, the Board also considered the results of a field test of the proposed standards performed by a DOI field test team. The field test team consisted of MMS Offshore Minerals Management Economics and Resource Evaluation experts and petroleum engineers; Bureau of Land Management petroleum engineers and resource evaluation experts; and MMS Custodial Reporting Branch senior accountants with expertise in financial reporting.

A62. Field tests are part of FASAB's due process and help FASAB to establish effective standards. Participating federal entities volunteer to go through the exercise of "implementing" the proposed standards as if they were in place and then provide feedback to FASAB regarding the process. Field tests can proactively identify potential problems related to the implementation of proposed standards and allow FASAB to gather valuable information about implementation costs.

A63. The field test team presented the Board with a number of significant considerations, including the lack of availability of quantity information on proved reserves under federal lands. The original ED had proposed that the

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valuation of federal oil and gas resources be based on information to be provided by EIA on quantity of proved reserves under federal lands. However, this information has not been made available as of the date of the revised ED, and does not appear to be forthcoming.

A64. In addition to the reliance on proved reserves data required to be provided by EIA, the field test team noted a number of other concerns, including:

a. the desire to divide proved reserves by type of commodity (e.g., **crude oil**, lease condensate, and natural gas) and compute the asset value separately;

b. the need to develop a methodology for determining what portion of all proved reserves fall under federal domain;

c. the need to exclude royalty relief volumes and estimate the value of commodities received in kind and delivered to the Department of Energy to fill the Strategic Petroleum Reserve;

d. the effect of intermediate production between the effective date of the reserves estimate and the effective date of the booked value;

e. the effect of estimates such as the royalty accrual and prior year production adjustments made in the current year;

f. how to distinguish between long and short-term liabilities for the associated liability for revenue distributions to others;

g. appropriate treatment of interest payments related to oil and gas or commodities other than oil and gas once the custodial provisions are deleted from SFFAS 7 (paragraphs 45, 275, and 277);

h. the impact of material intragovernmental transactions and eliminations on the year-end reporting process; and,

i. the need to revise all, or almost all, of the existing posting models in the accounting system.

A65. The field test team also completed a field test questionnaire using a present value approach. This questionnaire included many of the same concerns as noted in paragraphs A63 and A64 above. In addition, the present value approach also incorporated present value calculations for factors such as the present value of royalties received over time, estimates of future gas prices, transportation allowances, and discount and inflation rates.

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A66. In both estimates (the ED view as well as the present value view), the field test team used share of production as a proxy for share of proved reserves. One of the members expressed concerns about the use of production as a proxy for underlying reserves because it assumes (1) the same percentage of reserves are brought to market each year from all locations (or at least, on average between federal and non-federal) and (2) too much year to year variance in production patterns makes underlying reserve estimates fluctuate by an equal amount.

A67. Staff asked an oil and gas analyst at the Congressional Budget Office for his thoughts on the methodology. He responded that he understands the concern with the first assumption because it is likely that not the same fraction of reserves will be accessed in each year. However, he stated that averaging between federal and non-federal would control for some of that variance, though it is not possible to know just how much. He stated that this simplifying assumption is fairly reasonable given the approximate nature of the analysis. The analyst noted that with the second assumption, the variance might be eliminated or reduced by using a moving average rather than a year-to-year measure. For example, a 5-year or 10-year moving average of total federal production over total production would control some of the yearly differences between federal and non-federal.

A68. The field test questionnaires were extremely useful in helping the Board develop the standards proposed in the revised ED.

Discussion with DOI Representatives

A69. In addition to the Board's consideration of the comment letters received and the field test questionnaires, three members of the field test team and two representatives from DOI's Office of the Secretary met with the Board at the October 23, 2008, meeting to discuss issues raised in its comment letter on the original ED and the related field test questionnaires.

A70. At that meeting, DOI representatives indicated that they would be open to having less detailed implementation guidance in the standards if they were given a longer implementation period (two to three years) with a phase-in from RSI to basic information, and the ability to return to FASAB for implementation guidance if a reasonable methodology could not be agreed to by the auditors.

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Revised Exposure Draft

A71. The revised ED, *Accounting for Federal Oil and Gas Resources*, was issued July 6, 2009, with comments requested by September 8, 2009.

A72. Upon release of the revised ED, notices and press releases were provided to The Federal Register, *FASAB News, The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past.

A73. This broad announcement was followed by direct mailings or e-mails of the revised ED to:

a. Relevant congressional committees: Senate Committee on Energy and Natural Resources, Senate Committee on Finance, Senate Committee on Indian Affairs, House Committee on Financial Services, and House Committee on Natural Resources;

b. Public interest groups and think tanks: National Congress of American Indians (NCAI), national and regional; Alliance to Save Energy; Brookings Institution; Cato Institute; Center on Budget and Policy Priorities; Citizens Against Government Waste; The Concord Coalition; The Heritage Foundation; National Parks Conservation Association (NPCA); Natural Resources Defense Council (NRDC); OMB Watch; Resources for the Future (RFF); Sierra Club; Urban Institute; and World Resources Institute (WRI);

c. Respondents to the prior ED (or their successors);

d. Agencies that manage and/or account for federal natural resources: DOI; Department of Agriculture (USDA), Deputy CFO; USDA Forest Service; and DOI Bureau of Land Management;

e. The Oil and Gas Industry: World Petroleum Council (WPC), American Petroleum Institute (API), Society of Petroleum Engineers (SPE), and Ryder Scott Company; and,

f. Other: DOI, Office of the Special Trustee (OST); Energy Information Administration (EIA); Department of Energy, Deputy CFO; Securities and Exchange Commission; U.S. Geological Service (USGS); and KPMG (DOI's financial statement audit partner).

A74. In addition, the ED was publicized during the FASAB Update session at the Financial Statement Audit Network monthly meeting on July 21, 2009, and at the Department of the Treasury's 19th Annual Government Financial Management Conference on August 5, 2009.

A75. To encourage responses, reminder notices were sent to the FASAB Listserv and each of the above individuals/organizations on August 20, 2009.

Comment Letters

A76. Nine comment letters were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	1	
Preparers and financial managers	6	

A77. The following provides a high-level summary of the comments received on the revised ED:

a. The majority of respondents agreed that federal entities should be provided with flexibility in developing the asset valuation estimation methodology. DOI also agreed with the provision of flexibility with the caveat that a more detailed implementation guide be developed.

b. The majority of respondents agreed with the board's selection of present value of future federal royalty receipts on proved reserves known to exist as of the reporting date as the preferred measurement method. DOI also agreed with the preferred measurement method but noted that the proposed valuation from their field test questionnaire was based upon OMB's economic assumptions about future Treasury marketable security rates.

c. Half of the respondents agreed with the board's proposal to permit an alternative market-based fair value measurement consistent with FASB SFAS 157, *Fair Value Measurement*, if it is not reasonably possible to estimate using present value. One of the respondents disagreed with the use of fair value based on SFAS 157 because the oil and gas market is so volatile. DOI also agreed with the provision of an alternative measurement method but disagreed with the use of fair value based on SFAS 157 because they do not think the asset should be measured at a market exit price[19] since it is extremely unlikely that the asset would ever be sold.

[19] Exit price is the price that would be received to sell an asset or paid to transfer a liability (FASB ASC 820-10-20).

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d. The majority of respondents agreed that federal entities should be permitted to change their methodology for valuing the federal government's estimated petroleum royalties if environmental or other changes would provide for the development of an improved methodology. One respondent disagreed on the basis that it could impair the government's ability to prepare consolidated financial statements for the federal government.

e. The majority of respondents agreed that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided in SFFAS 33. DOI also agreed with the provision of guidance on reporting gains and losses with the caveat that a more detailed implementation guide be developed.

f. Half of the respondents agreed with the disclosure requirements for oil and gas fiduciary activities. Two respondents disagreed because they have cost/benefit concerns. One respondent disagreed partly because of cost/benefit concerns and partly because fiduciaries are generally not required by other standards-setters to value non-cash assets. DOI agreed with the disclosures and indicated that the information could be fairly readily reported.

g. All of the respondents agreed with the three-year phase-in of information from RSI to basic information. However, as discussed more in number A77i below, the majority of respondents would prefer that, following the three-year phase-in period, the information be presented as basic information in the notes rather than recognized on the face of the financial statements.

h. There was not a consistent view among respondents regarding application of the standard to other types of natural resources. Two of the respondents agreed with the inclusion of paragraph 9 relating to other types of natural resources. One respondent did not believe that the ED provided enough detail to form a response. Another respondent preferred that FASAB explicitly require agencies to use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard for all types of natural resources. Another respondent—DOI—provided some clarifying language that they believed would help fill a void in guidance that could lead to potentially inaccurate or inconsistent reporting.

i. The majority of respondents agreed with the alternative view contained in the July 2009 revised ED, which proposed that, following the three-year

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transition period as RSI, the value of federal oil and gas resources and annual changes be disclosed as basic information in the notes, rather than recognized on the face of the financial statements. One respondent disagreed with the alternative view in the revised ED because they supported the eventual presentation of all natural resources on the face of federal financial statements. Another respondent disagreed with the alternative view in the revised ED on the basis that the quantity and value of oil and gas resources and related revenues and depletion expenses would be material to the financial statements of the entities reporting those items; therefore, the omission or misstatement of that information makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced.

A78. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised.

A79. After deliberating the comments received on the revised exposure draft, the majority of the Board voted to require the information as RSI for three years and then put the project back on the agenda after two years to decide whether the asset would be recognized in the financial statements or disclosed in the notes. The Board plans to utilize the experience gained by DOI and others during the RSI period to inform their decision regarding financial statement recognition versus note disclosure.

A80. After considering respondents' views on applying the standard on accounting for federal oil and gas resources to other types of natural resources, the Board directed staff to apply the requirements of this Statement to other types of natural resources through the issuance of a technical bulletin. A technical bulletin will provide another opportunity for respondents to directly comment on the standards as they relate to other types of natural resources.

A81. After debating the advantages and disadvantages of limiting the alternative measurement method to SFAS 157 fair value, as had been proposed in the revised ED, the Board unanimously agreed to broaden the acceptable alternative measurement methods during the RSI phase to allow for greater flexibility in development of a valuation methodology.

Board Approval

A82. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Illustrations

PLEASE NOTE: The examples in this Appendix are illustrative only; they are populated with ***hypothetical*** amounts and do not represent authoritative guidance. Illustrations are not provided for all requirements.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Estimated Federal Oil and Gas Petroleum Royalties
Asset Value as of September 30, 20X3
(in thousands)

Offshore	Region 1	Region 2	Region 3	Region 4	Region 5	Total
Dry Gas	$4,500,000	$3,960,000	$2,880,000	$3,240,000	$3,420,000	$18,000,000
Wet Gas	500,000	440,000	320,000	360,000	380,000	2,000,000
NGPLs	500,000	440,000	320,000	360,000	380,000	2,000,000
Oil	5,500,000	4,840,000	3,520,000	3,960,000	4,180,000	22,000,000
Condensate	250,000	220,000	160,000	180,000	190,000	1,000,000
Total Offshore	**$11,250,000**	**$9,900,000**	**$7,200,000**	**$8,100,000**	**$8,550,000**	**$45,000,000**
Onshore	Region 1	Region 2	Region 3	Region 4	Region 5	Total
Dry Gas	$2,625,000	$2,310,000	$1,680,000	$1,890,000	$1,995,000	$10,500,000
Wet Gas	250,000	220,000	160,000	180,000	190,000	1,000,000
NGPLs	250,000	220,000	160,000	180,000	190,000	1,000,000
Oil	3,000,000	2,640,000	1,920,000	2,160,000	2,280,000	12,000,000
Condensate	125,000	110,000	80,000	90,000	95,000	500,000
Total Onshore	**$6,250,000**	**5,500,000**	**$4,000,000**	**$4,500,000**	**$4,750,000**	**$25,000,000**
Total Offshore and Onshore	**$17,500,000**	**$15,400,000**	**$11,200,000**	**$12,600,000**	**$13,300,000**	**$70,000,000**

Schedule of Estimated Federal Oil and Gas Petroleum Royalties
Asset Value as of September 30, 20X2
(in thousands)

Offshore	Region 1	Region 2	Region 3	Region 4	Region 5	Total
Dry Gas	$5,250,000	$4,620,000	$3,360,000	$3,780,000	$3,990,000	$21,000,000
Wet Gas	1,000,000	880,000	640,000	720,000	760,000	4,000,000
NGPLs	1,000,000	880,000	640,000	720,000	760,000	4,000,000
Oil	7,250,000	6,380,000	4,640,000	5,220,000	5,510,000	29,000,000
Condensate	500,000	440,000	320,000	360,000	380,000	2,000,000
Total Offshore	**$15,000,000**	**$13,200,000**	**$9,600,000**	**$10,800,000**	**$11,400,000**	**$60,000,000**

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Onshore	**Region 1**	**Region 2**	**Region 3**	**Region 4**	**Region 5**	**Total**
Dry Gas	$4,000,000	$3,520,000	$2,560,000	$2,880,000	$3,040,000	$16,000,000
Wet Gas	500,000	440,000	320,000	360,000	380,000	2,000,000
NGPLs	500,000	440,000	320,000	360,000	380,000	2,000,000
Oil	4,750,000	4,180,000	3,040,000	3,420,000	3,610,000	19,000,000
Condensate	250,000	220,000	160,000	180,000	190,000	1,000,000
Total Onshore	**$10,000,000**	**$8,800,000**	**$6,400,000**	**7,200,000**	**$7,600,000**	**$40,000,000**
Total Offshore and Onshore	**$25,000,000**	**$22,000,000**	**$16,000,000**	**$18,000,000**	**$19,000,000**	**$100,000,000**

Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others as of September 30 (in thousands)			
		20X3	**20X2**
Other Federal Agencies			
	Department of the Treasury	$56,000,000	$80,000,000
	Department of Energy	420,000	600,000
	Other[20]	1,330,000	1,900,000
Indian Tribes and Agencies		350,000	500,000
States and Others		10,500,000	15,000,000
Total Estimated Petroleum Royalties to be Distributed to Others		**$68,600,000**	**$98,000,000**

[20] Material distributions should be listed separately by entity.

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Management of Federal Oil and Gas Resources

The Minerals Management Service (MMS) plays an integral part in the implementation of the President's national energy policy (NEP). The NEP is a comprehensive strategy designed to secure America's energy future by reducing dependence on foreign sources, increasing domestic fossil fuel production, improving energy conservation efforts, and developing alternative and renewable energy sources. The MMS is responsible for managing the nation's oil and natural gas resources on the Outer Continental Shelf (OCS) and the mineral revenues from the OCS and federal lands. The MMS management process can be broken down into six essential analysis components: pre-leasing, post-leasing and pre-production, production and post-production, revenue collection, fund disbursement, and revenue compliance.

Stewardship Policies for Federal Oil and Gas Resources

The MMS's responsibilities as stewards of the physical oil and gas resources on the OCS begin when the MMS conducts pre-leasing analysis activities, which include the assessment of oil and gas resources that may be offered for lease. Following the pre-leasing assessment, the MMS develops a plan for offering those resources to developers. In the case of oil and gas development, this planning process is designed to consider both the environmental and economic concerns of the nation by providing opportunities for input from the public, the private sector, states, and Congress. The MMS conducts public planning processes for each individual lease sale.

Once a sale is completed, the MMS evaluates the bids to ensure that the government will receive fair market value. The evaluation determines whether the bid can be accepted and a lease issued. Once a lease is assigned to a winning bidder, the MMS begins post-leasing and pre-production activities. These activities include a permitting and approval process for all exploration, development, and production activities proposed by the lease operators. MMS staff inspects each operation in order to confirm that all activities are conducted in an environmentally and physically safe manner. Similar inspections also occur during the production and post-production activities to help ensure the federal government is receiving accurate royalties from production and facilities are decommissioned in a manner that protects the environment.

Once a lease is in place, the federal government's share of production from both offshore and onshore operations may be recovered as royalty-in-value (RIV) or royalty-in-kind (RIK). Federal oil and gas leasing laws and lease terms provide the government with the option of receiving production royalty payments either in money ("in value") or oil and gas production ("in kind"). Through royalty revenue collection and fund disbursement, the MMS achieves optimal value by ensuring that all revenues from federal oil and gas leases are efficiently, effectively, and accurately collected, accounted for, and disbursed to states, other federal component entities, and the U.S. Treasury. The MMS also performs revenue compliance activities to ensure the federal government has received fair market value and that companies comply with applicable laws, regulations, and lease terms.

Through this mineral asset management process, the MMS serves as a leading mineral asset manager for the federal government, the states, and the American people.

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Future Royalty Streams Identified for Sale

Future royalty streams from two specific oil fields have been identified to be sold.

The estimated value of the future royalty stream identified to be sold from field number one in the Gulf of Mexico is $4.8 million based on the following calculation: The royalty stream from one million barrels are to be sold at a $40.00 sale price per barrel per field number one first purchase price for oil with a 12 percent royalty rate for field number one.

The estimated value of the future royalty stream identified to be sold from field number two in the Gulf of Mexico is $2.7 million based on the following calculation: The royalty stream from 750 thousand barrels are to be sold at a $30.00 sale price per barrel per field number two first purchase price for oil with a 12 percent royalty rate for field number two.

The future royalty streams are expected to be sold sometime during the next fiscal year.

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Revenue Reported by Category
Fiscal year 20X3
(in thousands)

	Federal Offshore	Federal Onshore	Total
Dry Gas Royalty	$900,000	$200,000	$1,100,000
Wet Gas Royalty	600,000	100,000	700,000
NGPLs Royalty	300,000	100,000	400,000
Oil Royalty	1,500,000	300,000	1,800,000
Lease Condensate Royalty	100,000	40,000	140,000
Subtotal	$3,400,000	$740,000	$4,140,000
Rent	$200,000	$40,000	$240,000
Bonus Bid	2,000	0	2,000
Subtotal	$202,000	$40,000	$242,000
Total	**$3,602,000**	**$780,000**	**$4,382,000**

Revenue Reported by Category
Fiscal year 20X2
(in thousands)

	Federal Offshore	Federal Onshore	Total
Dry Gas Royalty	$1,000,000	$225,000	$1,225,000
Wet Gas Royalty	700,000	150,000	850,000
NGPLs Royalty	400,000	150,000	550,000
Oil Royalty	1,600,000	325,000	1,925,000
Lease Condensate Royalty	100,000	60,000	160,000
Subtotal	$3,800,000	$910,000	$4,710,000
Rent	$200,000	$50,000	$250,000
Bonus Bid	3,000	0	3,000
Subtotal	$203,000	$50,000	$253,000
Total	**$4,003,000**	**$960,000**	**$4,963,000**

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The above tables of revenue reported by category presents royalty revenue for dry gas, wet gas, natural gas plant liquids (NGPLs), oil and lease condensate, as well as rent revenue and bonus bid revenue, by offshore leases and by onshore leases for the current and prior reporting periods. In addition, totals for the dry and wet gas royalty revenue categories, NGPLs royalty revenue category, oil and lease condensate royalty revenue categories, the rent revenue category, and the bonus bid revenue category are reported, with a total for all revenue reported.

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Estimated Petroleum Royalties
End of Fiscal Year 20X3

	Quantity (in thousands)	Purchase Price ($)	Royalty Rate (%)
Dry Gas (Mcf)	60,100,000,000	$4.00/Mcf	14.0%
Wet Gas (Mcf)	40,000,000,000	$4.00/Mcf	15.0%
NGPLs (Bbl)	2,000,000	$23.00/Bbl	9.0%
Oil (Bbl)	11,000,000	$40.00/Bbl	13.0%
Lease Condensate (Bbl)	2,100,000	$29.00/Bbl	15.0%

Estimated Petroleum Royalties
End of Fiscal Year 20X2

	Quantity (in thousands)	Purchase Price ($)	Royalty Rate (%)
Dry Gas (Mcf)	58,100,000,000	$5.00/Mcf	12.0%
Wet Gas (Mcf)	36,800,000,000	$5.00/Mcf	13.0%
NGPLs (Bbl)	1,900,000	$24.00/Bbl	8.0%
Oil (Bbl)	10,000,000	$42.00/Bbl	11.0%
Lease Condensate (Bbl)	2,000,000	$30.00/Bbl	13.0%

The tables above provide the quantity, purchase price, and royalty rate by category of estimated petroleum royalties at the end of the current and prior reporting periods.

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Federal Regional Oil and Gas Sales Information

The tables on the following pages reflect sales volume, sales value, royalty revenue earned, and estimated value for royalty relief information for fiscal year 20XX.

Sales volume represents the quantity of a mineral commodity sold during the reporting period. Sales value represents the dollar value of the mineral commodity sold during the reporting period. Royalty revenue earned represents a stated share or percentage of the value of the mineral commodity produced.

Royalty relief is the reduction, modification, or elimination of any royalty payment due to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. The estimated value for royalty relief is an approximated calculation of royalty relief. The estimated value for royalty relief is calculated based on a formula developed by the Department of the Interior.

The sales volume, sales value, royalty revenue earned, and the estimated value for royalty relief are presented on a regional basis. The information is presented on a regional basis to provide users of the financial statements with the regional variances in the prices of oil and gas for decision-making purposes, to reflect the amount of royalty relief granted and to forecast future royalty revenue.

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Federal Regional Oil and Gas Information

FY 20XX Dry Gas Information
(in thousands)

Region	Sales Volume (Mcf)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	2,800,000	$8,100,000	$1,200,000	N/A
[Region 2]	2,900,000	7,300,000	1,100,000	N/A
[Region 3]	3,000,000	7,700,000	1,200,000	4,000,000
[Region 4]	2,800,000	6,200,000	900,000	N/A
[Region 5]	2,700,000	4,500,000	700,000	N/A
Totals	**14,200,000**	**$33,800,000**	**$5,100,000**	**$4,000,000**

FY 20XX Wet Gas Information
(in thousands)

Region	Sales Volume (Mcf)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	1,800,000	$5,400,000	$800,000	N/A
[Region 2]	1,900,000	4,800,000	700,000	N/A
[Region 3]	2,000,000	5,100,000	800,000	N/A
[Region 4]	1,800,000	4,100,000	600,000	N/A
[Region 5]	1,800,000	3,000,000	400,000	N/A
Totals	**9,300,000**	**$22,400,000**	**$3,300,000**	**N/A**

FY 20XX Natural Gas Plant Liquids (NGPLs) Information
(in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	500,000	$7,100,000	$1,000,000	N/A
[Region 2]	400,000	5,700,000	800,000	N/A
[Region 3]	500,000	10,200,000	1,400,000	3,200,000
[Region 4]	400,000	8,900,000	1,300,000	N/A
[Region 5]	300,000	7,200,000	1,100,000	N/A
Totals	**2,100,000**	**$39,100,000**	**$5,600,000**	**$3,200,000**

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FY 20XX Oil Information
(in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	300,000	$4,500,000	$700,000	N/A
[Region 2]	300,000	5,600,000	800,000	N/A
[Region 3]	100,000	1,800,000	100,000	N/A
[Region 4]	4,500,000	11,500,000	1,800,000	N/A
[Region 5]	4,500,000	9,100,000	1,700,000	N/A
Totals	**9,700,000**	**$32,500,000**	**$5,100,000**	**N.A**

FY 20XX Lease Condensate Information
(in thousands)

Region	Sales Volume (Bbl)	Sales Value ($)	Royalty Revenue Earned ($)	Estimated Value for Royalty Relief ($)
[Region 1]	80,000	500,000	70,000	N/A
[Region 2]	70,000	600,000	90,000	N/A
[Region 3]	50,000	200,000	20,000	N/A
[Region 4]	500,000	1,200,000	200,000	N/A
[Region 5]	500,000	1,000,000	190,000	N/A
Totals	**1,200,000**	**$3,500,000**	**$570,000**	**N/A**

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Appendix C: Abbreviations

ASC	FASB Accounting Standards Codification™
Bbl	Barrels
CFR	Consolidated Financial Report
DOI	Department of the Interior
ED	Exposure Draft
EIA	Energy Information Administration
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
Mcf	Thousand Cubic Feet
MMS	Minerals Management Service
OCS	Outer Continental Shelf
NGPLs	Natural Gas Plant Liquids
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States
USGS	U.S. Geological Survey

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Appendix D: Technical Terms

The terms explained in Appendix D have specific technical meanings within the oil and gas industry and may be useful in applying the requirements of this Statement.

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Definitions of Resource and Reserve Components and Subcomponents

Provided below are definitions used by federal entities to describe oil and gas resource and reserve components and subcomponents.[21] This section of Appendix D defines the terms used in Figure 1 – *Components of Federal Oil and Gas Resources*.

Undiscovered Resources

Resources estimated from broad geologic knowledge or theory and existing outside of known fields or known accumulations are undiscovered resources. Undiscovered resources can exist in untested prospects on unleased acreage, or on undrilled lease acreage, or in known fields. In known fields, undiscovered resources occur in undiscovered **pools** that are controlled by distinctly separate structural features or stratigraphic conditions.

The Mineral Management Service (MMS) and the U.S. Geological Survey (USGS) formerly conducted national assessments of undiscovered oil and gas resources together. The former was responsible for the offshore while the latter was responsible for onshore and state waters. The last such assessment was in 1995. MMS updates their assessment approximately every five years in accordance with DOI's five-year leasing program, with the last update in 2006.[22] Since 1995, the USGS has not conducted an overall update for onshore and state waters, but has conducted assessments updates on a basin or area level.

The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic play analysis approach for resource appraisal.

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[21] Unless otherwise noted, the definitions in this section were adapted from (1) the OCS Report, Estimated Oil and Gas Reserves, Gulf of Mexico, December 31, 2000, MMS 2003-050; available online at https://www.gomr.mms.gov/PDFs/2003/2003-050.pdf; last accessed December 2, 2009 and (2) the OCS Report, Estimated Oil and Gas Reserves Pacific Outer Continental Shelf as of December 31, 1997, MMS 99-0023; available online at http://www.mms.gov/omm/pacific/offshore/oil-gaspdfs/99-0023.pdf; last accessed December 2, 2009.

[22] MMS Assessment of Undiscovered Technically Recoverable Oil and Gas Resources of the Nation's Outer Continental Shelf, 2006 (MMS 2006 Assessment); available online at http://www.mms.gov/revaldiv/PDFs/2006NationalAssessmentBrochure.pdf; last accessed December 2, 2009.

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Undiscovered resources are **hydrocarbons** estimated on the basis of geologic knowledge and theory to exist outside of known accumulations. They are presumed to occur in unmapped and unexplored areas. The speculative and hypothetical resource categories comprise undiscovered resources. Undiscovered resources are classified as either undiscovered non-recoverable resources or undiscovered recoverable resources.

- Undiscovered Non-Recoverable Resources

The portion of undiscovered petroleum-initially-in-place quantities not currently considered to be recoverable. A portion of these quantities may become recoverable in the future as commercial circumstances change, technological developments occur, or additional data are acquired.

- Undiscovered Recoverable Resources

An assessment provides estimates of undiscovered recoverable resources in two categories for federal offshore oil and gas resources. However assessments for federal onshore oil and gas resources provide information for only one, the undiscovered, conventionally recoverable resources. Both are described below:

1. Undiscovered, conventionally recoverable resources: The portion of the hydrocarbon potential that is producible, using present or reasonably foreseeable technology, without any consideration of economic feasibility.[23]

2. Undiscovered, economically recoverable resources: The portion of the undiscovered conventionally recoverable resources that is economically recoverable under imposed economic scenarios.

Reserves

In accordance with the Society of Petroleum Engineers (SPE), the World Petroleum Congresses (WPC), and the American Association of Petroleum Geologists (AAPG), the definition for "reserves" and the following explanatory paragraphs are presented as follows:[24]

> Reserves are those quantities of petroleum which are anticipated to be commercially recovered from known accumulations from a given date forward. All reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data.

[23] MMS Assessment of Undiscovered Technically Recoverable Oil and Gas Resources of the Nation's Outer Continental Shelf, 2003 Update; available online at http://www.mms.gov/revaldiv/PDFs/2003NationalAssessmentUpdate.pdf; last accessed December 2, 2009.
[24] WPC/SPE/AAPG Petroleum Reserves Definitions – 1997; available online at http://www.spe.org/spe-site/spe/spe/industry/reserves/Petroleum_Reserves; last accessed December 2, 2009.

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The relative degree of uncertainty may be conveyed by placing reserves into one of two principal classifications, either 1) unproved or 2) proved.

Unproved Reserves

After a lease qualifies under Title 30, Section 250.115/116 of the Code of Federal Regulations, the MMS Field Naming Committee reviews the new producible lease to assign it to an existing field or, if the lease is not associated with an established geologic structure, to a new field. Regardless of where the lease is assigned, the reserves associated with the lease are initially considered to be unproved reserves. Unproved reserves are based on geologic or engineering information similar to that used in estimates of proved reserves, but, technical, contractual, economic, or regulatory uncertainties preclude such reserves from being classified as proved.

Unproved reserves may be divided into two subclassifications, possible and probable, which are similarly based on the level of uncertainty.

> Unproved possible reserves are less certain than unproved probable reserves and can be estimated with a low degree of certainty, which is insufficient to indicate whether they are more likely to be recovered than not. **Reservoir** characteristics are such that a reasonable doubt exists that the project will be commercial. After a lease qualifies under Title 30, Section 250.115/116 of the Code of Federal Regulations, the reserves associated with the lease are initially classified as unproved possible.
>
> Unproved probable reserves are less certain than proved reserves and can be estimated with a degree of certainty sufficient to indicate they are more likely to be recovered than not. Reserves in fields for which a schedule leading to a Development and Production Plan (DPP) has been submitted to the MMS have been classified as unproved probable.

Proved Reserves

Proved reserves can be estimated with reasonable certainty to be recoverable under current economic conditions, such as prices and costs prevailing at the time of the estimate. Proved reserves must either have facilities that are operational at the time of the estimate to process and transport those reserves to market or a commitment or reasonable expectation to install such facilities in the future. Proved reserves can be subdivided into undeveloped and developed.

> Proved undeveloped reserves are classified proved undeveloped when a relatively large expenditure is required to install production and/or transportation facilities, a commitment by the operator is made, and a timeframe to begin production is established. Proved undeveloped reserves are reserves expected to be recovered from (1) yet undrilled wells, (2) deepening existing wells, or (3) existing wells for which a relatively large expenditure is required for recompletion.

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Proved developed reserves are classified as proved developed when the reserves are expected to be recovered from existing wells (including reserves behind pipe). Reserves are considered developed only after necessary production and transportation equipment have been installed or when the installation costs are relatively minor. Proved developed reserves are subcategorized as producing or non-producing. This distinction is made at the reservoir level and not at the field level.

- Any developed reservoir in a developed field that has not produced or has not had sustained production during the past year is considered to contain proved developed non-producing reserves. This category includes reserves contained in non-producing reservoirs, reserves contained behind-pipe, and reservoirs awaiting well workovers or transportation facilities.

- Once the first reservoir in a field begins production, the reservoir is considered to contain proved developed producing reserves, and the field is considered on production. If a reservoir had sustained production during the last year, it is considered to contain proved developed producing reserves.

End of the terms in Figure 1 that are defined under the subheading **Definitions of Resource and Reserve Components and Subcomponents**

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Other Definitions

Adjustments: The quantity which preserves an exact annual reserves balance within each State or State subdivision. These adjustments are the yearly changes in the published reserve estimates that cannot be attributed to the estimates for other reserve change categories because of the survey and statistical estimation methods employed. For example, variations as a result of changes in the operator frame, different random samples or imputations for missing or unreported reserve changes, could contribute to adjustments.[25]

Basin: A depression in the Earth's surface that collects sediment (loose, uncemented pieces of rock or minerals).[26]

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[25] Energy Information Administration, U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves 2007 Annual Report, Glossary (EIA 2007 Annual Report Glossary); available online at http://www.eia.doe.gov/oil_gas/natural_gas/data_publications/crude_oil_natural_gas_reserves/cr.html; last accessed December 2, 2009.

[26] The USGS "Geologic Glossary"; available online at http://www.nature.nps.gov/Geology/usgsnps/misc/glossaryAtoC.html; last accessed December 2, 2009.

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Bonus Bid: Leases issued in areas known to contain minerals are awarded through a competitive bidding process. A bonus bid, as used in this Statement, represents the cash consideration paid to the United States by the successful bidder for a mineral lease. The payment is made in addition to the rent and royalty obligations specified in the lease.[27]

Crude Oil: A mixture of hydrocarbons that exists in the liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities. Crude oil may also include: 1) small amounts of hydrocarbons that exist in the gaseous phase in natural underground reservoirs but are liquid at atmospheric pressure after being recovered from oil well gas in lease separators, and that subsequently are commingled with the crude oil stream[28] without being separately measured; and, 2) small amounts of nonhydrocarbons produced with the oil.[29]

Dry Gas: The actual or calculated volumes of natural gas which remain after: 1. The liquefiable hydrocarbon portion has been removed from the gas stream (i.e., gas after lease, field, and/or plant separation) 2. Any volumes of nonhydrocarbon gases have been removed where they occur in sufficient quantity to render the gas unmarketable.[30]

Estimated Petroleum Royalties: The estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources.

Estimated Production: The volumes of oil and gas that are extracted or withdrawn from reservoirs during the report year.

Estimated Value for Royalty Relief: The estimated value for royalty relief is the calculated approximation of royalty relief based on a formula developed by DOI.

Extensions: The reserves credited to a reservoir because of enlargement of its proved area. Normally the ultimate size of newly discovered fields, or newly discovered reservoirs in old fields, is determined by wells drilled in years subsequent to discovery. When such wells add to the proved area of a previously discovered reservoir, the

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[27] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior (MRM Glossary of Mineral Terms); available online at http://www.mrm.mms.gov/Stats/pdfdocs/glossary.pdf; last accessed December 2, 2009.

[28] A crude oil stream is crude oil produced in a particular field or a collection of crude oils with similar qualities from fields in close proximity, which the petroleum industry usually describes with a specific name, such as West Texas Intermediate (EIA-182 Domestic Crude Oil First Purchase Report Instructions; available online at http://www.eia.doe.gov/pub/oil_gas/petroleum/survey_forms/eia182i.pdf; last accessed December 2, 2009).

[29] EIA 2007 Annual Report Glossary.

[30] EIA Glossary, available at http://www.eia.doe.gov/glossary/; last accessed December 1, 2009.

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increase in proved reserves is classified as an extension.[31]

Federal Oil and Gas Resources: Oil and gas resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

Field: An area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same general geological structural feature and/or stratigraphic trapping condition. There may be two or more reservoirs in a field that are separated vertically by impervious strata, laterally by local geologic barriers, or by both. The area may include one lease, a portion of a lease, or a group of leases with one or more wells that have been approved as producible.[32]

First Purchase Price: The actual amount paid by the first purchaser for crude oil as it leaves the lease on which it was produced.[33] A "first purchase" constitutes a transfer of ownership of crude oil during or immediately after the physical removal of the crude oil from a production property for the first time.

Gas: A mixture of hydrocarbon compounds and small quantities of various nonhydrocarbons existing in the gaseous phase or in solution with crude oil in natural underground reservoirs at reservoir conditions.[34]

Hydrocarbon: An organic chemical compound of hydrogen and carbon in the gaseous, liquid, or solid phase. The molecular structure of hydrocarbon compounds varies from the simplest (methane, a constituent of natural gas) to the very heavy and very complex.[35]

Lease: Any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, extraction of, or removal of oil or gas.[36]

Lease Condensate: A mixture consisting primarily of pentanes and heavier hydrocarbons which is recovered as a liquid from natural gas in lease or field separation facilities. This category excludes natural gas plant liquids, such as butane and propane,

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[31] EIA 2007 Annual Report Glossary.
[32] MMS OCS Estimated Oil and Gas Reserves Gulf of Mexico, December 31, 2005 (MMS 2009-022); available online at http://www.gomr.mms.gov/PDFs/2009/2009-022.pdf; last accessed December 2, 2009.
[33] Adapted from Form EIA-182 Domestic Crude Oil First Purchase Report Instructions.
[34] EIA 2007 Annual Report Glossary.
[35] EIA Glossary.
[36] 30 U.S.C. §1702 (5).

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which are recovered at downstream natural gas processing plants or facilities.[37]

Natural Gas Plant Liquids (NGPLs): Those hydrocarbons in natural gas that are separated as liquids at natural gas processing plants, fractionating and cycling plants, and, in some instances, field facilities. Lease condensate is excluded. Products obtained include ethane; liquefied petroleum gases (propane, butanes, propane-butane mixtures, ethane-propane mixtures); isopentane; and other small quantities of finished products, such as motor gasoline, special naphthas, jet fuel, kerosene, and distillate fuel oil.[38]

Net of Sales and Acquisitions[39]: The net change in the quantity of reserve estimates, either positive or negative, as a result of reserves gained through purchase and deducted through sale during the report year.

New Discoveries in Old Fields: The volumes of proved reserves of crude oil, natural gas, and/or natural gas liquids discovered during the report year in new reservoir(s) located in old fields.[40]

New Field Discoveries: The volumes of proved reserves of crude oil, natural gas and/or natural gas liquids discovered in new fields during the report year.[41]

Oil: See Crude Oil.

Outer Continental Shelf (OCS): All submerged lands seaward and outside the area of lands beneath navigable waters. Lands beneath navigable waters are interpreted as extending from the coastline 3 nautical miles into the Arctic Ocean, the Atlantic Ocean, the Pacific Ocean, and the Gulf of Mexico, excluding the coastal waters off Texas and western Florida. Lands beneath navigable waters are interpreted as extending from the coastline 3 marine leagues into the Gulf of Mexico off Texas and western Florida.[42]

Play: A group of pools that share a common history of hydrocarbon generation, migration, reservoir development, and entrapment.[43]

Pool: A discovered or undiscovered accumulation of hydrocarbons, typically within a single stratigraphic interval.[44]

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[37] EIA 2007 Annual Report Glossary.
[38] EIA Glossary.
[39] Acquisitions are the volume of proved reserves gained by the purchase of existing fields or properties, from the date of purchase or transfer (EIA 2007 Annual Report Glossary).
[40] EIA 2007 Annual Report Glossary.
[41] Ibid.
[42] MRM Glossary of Mineral Terms.
[43] MMS 2006 Assessment.
[44] Ibid.

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Proved Reserves: For crude oil and gas, proved reserves are the estimated quantities that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. For lease condensate and natural gas plant liquids, proved reserves are the estimated quantities demonstrated with reasonable certainty to be recoverable in future years in conjunction with the production of proved gas reserves, under existing economic and operating conditions.[45] The total quantity of proved reserves is calculated by adding the quantity of reserves reported as **revisions and adjustments**, **net of sales and acquisitions**, total recoveries and deducting **estimated production** during the report year.[46]

Region: The term region or regional refers to the geographic area or areas for which estimated petroleum royalties are calculated.[47]

Regional Estimated Petroleum Royalties: Regional estimated petroleum royalties means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources in each region.

Rent: Annual payments, normally a fixed dollar amount per acre, required to preserve the rights to a lease while the lease is not in production. A rent schedule is established

[45] EIA 2007 Annual Report Glossary.
[46] For a more detailed explanation of proved reserves and its components, see the section of Appendix D titled Definitions of Resource and Reserve Components and Subcomponents.
[47] For example, offshore federal oil and gas resources have typically been classified into regions such as: Alaska Region – the Federal Outer Continental Shelf Alaska; Pacific Region – the Federal OCS Pacific (Washington, Oregon, and California); Gulf of Mexico (GOM) Region – the Federal OCS Gulf of Mexico (Texas, Louisiana, Mississippi, Alabama, and GOM portion of Florida); and Atlantic Region – the Federal OCS Atlantic portion of all East Coast States.

For onshore federal oil and gas resources, the U.S. Department of Energy typically divides the United States into regions, which are referred to as Petroleum Administration for Defense Districts (PADD), for planning purposes. The result is a geographic aggregation of the 50 States and the District of Columbia into five Districts, with PADD I further split into three sub-districts, as follows:

- PADD I (East Coast): PADD IA (New England) – Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont; PADD IB (Central Atlantic) – Delaware, District of Columbia, Maryland, New Jersey, New York, and Pennsylvania; and, PADD IC (Lower Atlantic) – Florida, Georgia, North Carolina, South Carolina, Virginia, and West Virginia.
- PADD II (Midwest) – Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, and Wisconsin.
- PADD III (Gulf Coast) – Alabama, Arkansas, Louisiana, Mississippi, New Mexico, and Texas.
- PADD IV (Rocky Mountain) – Colorado, Idaho, Montana, Utah, and Wyoming.
- PADD V (West Coast) – Alaska, Arizona, California, Hawaii, Nevada, Oregon, and Washington.

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at the time a lease is issued.[48]

Reservoir: A porous and permeable underground formation containing an individual and separate natural accumulation of producible hydrocarbons (oil and/or gas) which is confined by impermeable rock or water barriers and is characterized by a single natural pressure system.[49]

Revisions: Changes to prior year-end proved reserves estimates, either positive or negative, resulting from new information other than an increase in proved acreage (extension). Revisions include increases of proved reserves associated with the installation of improved recovery techniques or equipment. They also include correction of prior report year arithmetical or clerical errors and adjustments to prior year-end production volumes to the extent that these alter reported prior year reserves estimates.[50]

Revisions and Adjustments: The net change in the quantity of reserve estimates, either positive or negative, as a result of adding changes reported as revisions and adjustments during the report year.

Royalty: Any payment based on the value or volume of production which is due to the United States on production of oil or gas from the Outer Continental Shelf or federal lands, or any minimum royalty owed to the United States under any provision of a lease.[51]

Royalty-In-Kind: A program operated under the provisions of the Mineral Leasing Act of 1920 and the Outer Continental Shelf Lands Act of 1953. The federal government, as lessor, may take part or all of its oil and gas royalties “in kind” (a volume of the commodity) as opposed to “in value” (money). Under the oil royalty-in-kind program, the government sells oil at fair market value to eligible refiners who do not have access to an adequate supply of crude oil at equitable prices.[52]

Royalty Rate: A proportionate interest in the production value of mineral deposits due the lessor from the lessee in accordance with a lease agreement.[53]

Royalty Relief: Existing statutes authorize MMS to grant royalty relief to operators on the production of oil and gas resources from federal oil and gas leases. Royalty relief is the reduction, modification, or elimination of any royalty to operators to promote

[48] MRM Glossary of Mineral Terms.
[49] EIA 2007 Annual Report Glossary.
[50] Ibid.
[51] Adapted from 30 U.S.C. § 1702 (14).
[52] MRM Glossary of Mineral Terms.
[53] Ibid.

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development, increase production, or encourage production of marginal resources on certain leases or categories of leases.[54]

Sales Value: The proceeds received for the sale of a product. Sales value is calculated by multiplying the sales volume by unit price.

Sales Volume: The volume, or quantity, of the product that is sold. The sales volume is measured in thousand cubic feet (Mcf) for gas and in barrels (Bbl) for oil.

Technically Recoverable Resources: The term used to describe the total quantity of undiscovered recoverable resources and unproved reserves. Proved reserves are not included in the estimated quantity of technically recoverable resources.

Wellhead Price: The value of the purchased natural gas at the mouth of the well. In general, the wellhead price is considered to be the sales price obtainable from a third party in an arm's length transaction. Posted prices, requested prices, or prices as defined by lease agreements, contracts, or tax regulations should be used where applicable.[55]

[54] 43 U.S.C. § 1337(a).
[55] EIA Glossary.

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Appendix E: Glossary

Fair Value: Value determined by bona fide bargain between well-informed buyers and sellers, usually over a period of time; the price for which a property, plant and equipment item can be bought or sold in an arm's length transaction between unrelated parties; value in a sale between a willing buyer and a willing seller, other than in a forced or liquidation sale; an estimate of such value in the absence of sales or quotations.

Marketable Treasury Securities: Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

Present Value: The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest.

Recognition: The terms recognition and recognize refer to the process of formally recording or incorporating an element into the financial statements of an entity. Recognition comprises depiction of an element in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements.

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FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Nancy Fleetwood

Michael H. Granof

Norwood J. Jackson, Jr.

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Julia Ranagan

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards

Statement of Federal Financial Accounting Standards 39

August 4, 2010

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Table of Contents

Summary **4**

Introduction **5**

Purpose 5

Materiality 5

Effective Date 5

Accounting Standards **6**

Scope 6

Definitions 7

Subsequent Events 7

Effect on Current Standards 9

Effective Date 9

Appendix A: Basis for Conclusions **10**

Subsequent Events 10

Going Concern 11

Related Parties 12

Exposure Draft 13

Board Approval 15

Appendix B: Abbreviations **16**

Appendix C: Glossary **17**

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_39.pdf.

Summary

The American Institute of Certified Public Accountants' (AICPA) Statements on Auditing Standards (SAS) AU section 560, *Subsequent Events*, includes accounting and financial reporting guidance that is not discussed in the authoritative literature that establishes accounting principles. The objective of this Statement is to incorporate that guidance into the authoritative literature of the FASAB. Insofar as AU Section 560 established principles pertaining to the preparation of basic information and required supplementary information (RSI)[1] it would be more appropriately included in the accounting and financial reporting standards of the FASAB than in the auditing literature. Accordingly, this Statement does not establish new accounting guidance but rather incorporates the existing guidance (to the extent appropriate in the federal government environment) into the FASAB standards. In developing this Statement, the FASAB also considered incorporating existing AICPA guidance regarding an entity's ability to continue as a going concern and related party transactions. However, for reasons presented in the basis for conclusions (Appendix A), the FASAB does not provide accounting standards in these areas at this time.

The requirements in this Statement will improve financial reporting by incorporating authoritative accounting and financial reporting literature into a single source and thereby better enabling entities to prepare basic information and RSI in conformity with generally accepted accounting principles (GAAP). The Statement addresses the circumstances under which an entity should recognize or disclose events or transactions occurring after the end of the reporting period but before issuance of the financial report.

[1] The FASAB is in the process of reclassifying all items of required supplementary stewardship information (RSSI). Once the Board reclassifies all the items, the RSSI category will be eliminated. Until such time, this Statement also applies to RSSI.

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Introduction

Purpose

1. Accounting and financial reporting guidance regarding **subsequent events**[2] has been included in SASs of the AICPA. The objective of this Statement is to incorporate that guidance into the Statements of Federal Financial Accounting Standards.

Materiality

2. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

3. The requirements in this Statement are effective upon its issuance.

[2] Terms defined in the glossary (Appendix C) are in boldface type the first time they appear in this Statement.

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Accounting Standards

Scope

4. This Statement establishes accounting and financial reporting standards for subsequent events and applies to the accounting for, and disclosure of, subsequent events not addressed in other applicable GAAP.

5. Other applicable GAAP may address the accounting treatment of events or transactions that occur after the end of the reporting period but before the financial statements are issued. If an event or transaction is within the scope of other applicable GAAP, then an entity should follow the guidance in that applicable GAAP, rather than the guidance in this standard. The following are examples of other applicable GAAP that prescribe the accounting and disclosures for specific subsequent events. Note that this is not meant to be an exhaustive list.

    - Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, par. 24.
    - SFFAS 27, *Identifying and Reporting Earmarked Funds*, par. 23.
    - SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, par. 33.

6. Also, this Statement amends SFFAS 5, *Accounting for Liabilities of the Federal Government*, footnote 17.

7. This Statement applies to the basic information and required supplementary information (RSI) [3]of all federal reporting entities that are presented in conformity with GAAP.[4]

[3] Basic information and RSI are required components of a financial report prepared in conformity with GAAP. In the federal government environment, a financial report is known as a Performance and Accountability Report or an Agency Financial Report and may include other components required by legislation or administrative directives.

[4] The FASAB is in the process of reclassifying all items of required supplementary stewardship information (RSSI). Once the Board reclassifies all the items, the RSSI category will be eliminated. Until such time, this Statement also applies to RSSI.

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Definitions

8. **Subsequent events**: Events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.

9. **Recognized events**: Subsequent events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI.

10. **Nonrecognized events**: Subsequent events that provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date.

Subsequent Events

11. Events or transactions that affect the basic information or RSI sometimes occur subsequent to the end of the reporting period but before the financial report is issued. Some of those transactions and events (referred to as recognized events) require adjustments while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI.

12. Recognized events consist of those events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI. In evaluating the conditions on which the estimates were based, all information that becomes available prior to the issuance of the financial report should be used. The basic information or RSI as applicable should be adjusted for any changes in estimates resulting from the use of such evidence.

13. Identifying recognized events calls for the exercise of professional judgment and knowledge of the facts and circumstances. The receipt of information regarding the impairment of an asset or the incurrence of a liability subsequent to the end of the reporting period may be indicative of conditions existing at the end of the reporting period, thereby calling for adjustment of the basic information or RSI before the issuance of the financial report. For

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example, the settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the basic information if the event that gave rise to the litigation, such as a personal injury occurring on government property, had taken place prior to the end of the reporting period. In this example, the resolution of an uncertainty may confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

14. Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities will ordinarily require adjustment of the basic information or RSI because such events typically represent the culmination of conditions that existed over a relatively long period of time.

15. Nonrecognized events consist of those events that provide evidence with respect to conditions that did not exist at the end of the reporting period, but arose subsequent to that date. These events should not result in adjustment of the basic information or RSI. Some of these events, however, may be of such a nature that their disclosure in basic information or RSI is required to keep the basic information or RSI from being misleading. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the basic information or RSI because such changes typically reflect a concurrent evaluation of new conditions.

16. Examples of nonrecognized events that may require disclosure in basic information or RSI, but should not result in adjustment, include the enactment of legislation, after the end of the reporting period, to establish a major federal program or an appropriation to provide benefits or services to protect the public's health and safety during a major disaster that occurred after the end of the reporting period but before the financial report is issued. The disclosures should concern matters that will probably affect the judgments and decisions of those relying on the financial report.

17. When a financial report is reissued, certain events may have occurred subsequent to the original issuance that requires disclosure in the reissued financial report. Events requiring disclosure in the reissued financial report are those that are considered important to a user's understanding of the reissued financial report. These events, occurring between the time of original issuance and reissuance of the financial report, should not result in adjustment of the basic information or RSI unless the adjustment meets the criteria for the correction of an error or the criteria for prior-period adjustments as set forth in SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. This also applies for events occurring subsequent

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to the original issuance when a financial report is reissued in comparative form with a financial report of subsequent periods.

Effect on Current Standards

18. In addition, SFFAS 5, footnote 17 is amended as follows to conform to the above requirements:

> Contingencies are different from "subsequent events." ~~as used in the accounting/audit literature.~~ Subsequent events are events or transactions that affect the basic information or required supplementary information (RSI) and occur subsequent to the end of the reporting period but before the financial report is issued. ~~Balance Sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements.~~ Some of those transactions and events (referred to as recognized events) require adjustments to the basic information or RSI while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI. A subsequent event may affect a contingency by providing information that resolves an uncertainty related to a contingent liability and confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

Effective Date

19. The requirements in this Statement are effective upon its issuance.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by FASAB members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

A1. Representatives of the AICPA requested that the U.S. accounting standards-setters consider adopting certain guidance for accounting and financial reporting issues that now reside in the professional auditing literature. In July 2008, the FASAB joined the Governmental Accounting Standards Board in responding to this request.

A2. The AICPA SASs address certain accounting and financial reporting issues not included in the FASAB's authoritative literature that establishes accounting principles. Those initially-identified issues concerned subsequent events, an entity's ability to continue as a going concern (going concern), and related parties. The FASAB believes that the presentation of principles used in the preparation of a financial report is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

Subsequent Events

A3. AU Section 560, *Subsequent Events*, discusses events or transactions that occur subsequent to the end of the reporting period but prior to the issuance of the financial report. Such events require either adjustment or disclosure in the basic information or RSI and the auditing literature discusses the two types of events for consideration.

A4. The FASAB believes that incorporating the accounting and financial reporting guidance essentially as it exists in the AICPA literature would only change the source of the guidance and not significantly affect practice. Upon evaluating the auditing literature for subsequent events, the FASAB decided that the guidance is readily adaptable to the federal government environment with only minor terminology enhancements.

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Going Concern

A5. AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, identifies certain factors that could indicate that there may be substantial doubt about a non-governmental entity's ability to continue as a going concern and provides examples of information that an entity might disclose if the conditions warrant such disclosures. However, the FASAB considered the nature of the federal government and determined that going-concern as contemplated in the commercial sense is not applicable to federal government financial reporting. Additionally, the FASAB considered that related guidance has been developed as discussed below and, as a result, decided to exclude the going concern standard from the Statement.

A6. On September 28, 2009, the FASAB issued SFFAS 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. This standard concerns the consolidated financial report (CFR) of the federal government and requires the reporting of information to help users determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. It will thereby facilitate assessments of the extent to which financial burdens without related benefits were passed on by current year taxpayers to future year taxpayers.

A7. On the other hand, the FASAB noted that some federal government component units may experience fiscal challenges and may need to seek additional funding from Congress to continue their missions. In such instances and because SFFAS 36 only applies to the CFR, the FASAB expects that the entity would address the matter in the Management's Discussion and Analysis (MD&A) section of its financial report. SFFAS 15, *Management's Discussion and Analysis*, paragraph 3 provides guidance for reporting information in an entity's MD&A.

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Related Parties

A8. AU Section 334, *Related Parties*, attributes the requirement for related party disclosures to the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 850 (Statement of Financial Accounting Standards 57), *Related Party Disclosures*, and provides indicators of related party transactions. The FASAB determined that the related party guidance was not readily adaptable to the federal government and discussed the applicability of related FASAB projects and current federal financial reporting practices to the issue of related party transactions.

A9. The FASAB has an on-going Federal Entity project that is intended to define and characterize federal reporting entities and to establish criteria for including various organizational units in a reporting entity. Also, the project will involve research on the various types of relationships that the federal government has established to carry out its public policy functions. The FASAB believes that it would be premature to incorporate the related party guidance before it completes its Federal Entity project. Consequently, the FASAB decided to conduct research on related parties as part of the Federal Entity project and use the research results to develop related party guidance applicable to the federal government environment.

A10. In addition, the FASAB noted that federal agencies typically purchase goods and services from other federal agencies or organizational units within the same agency and the FASAB has provided guidance to assist in reporting this activity. The guidance includes, but is not limited to:

a. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*;

b. SFFAS 5, *Accounting for Liabilities of the Federal Government*;

c. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*; and

d. SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*.

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A11. The FASAB expects that this statement will not alter current reporting practices. However, some are concerned that reporting practices may change if the auditing guidance changes before the Federal Entity project is completed. If so, the FASAB would issue a Technical Bulletin to assist the federal financial reporting community.

Exposure Draft

A12. The Board published the exposure draft (ED), *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, on October 20, 2009, with comments requested by December 28, 2009. Upon release of the ED, notices and press releases were provided to: the Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, and Government Accounting and Auditing Update, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past.

A13. This broad announcement was followed by direct mailings of the exposure draft to the Subcommittee on Federal Financial Management, Government Information, and International Security, Committee on Homeland Security and Governmental Affairs, United States Senate, and the Subcommittee on Government Management, Organization, and Procurement, Committee on Oversight and Government Reform, House of Representatives.

A14. The Board received 17 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		2
Auditors	3	1
Preparers and financial managers	11	
Totals	14	3

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A15. Respondents agreed that accounting principles regarding subsequent events should be incorporated into the FASAB's authoritative literature and they generally agreed that the going concern and related party guidance were not readily adaptable to the federal government environment. While some respondents believed that it would be helpful to consider providing additional guidance, such as FASB requirements for subsequent events, the objective of the Board's project was to incorporate the guidance presented in the audit literature rather than developing additional guidance or requiring changes in current practices.

A16. In addition, some respondents believed that it would be helpful to clarify aspects of the statement. Particularly, a respondent noted that in federal financial reporting, the term *financial statements* may refer to a *financial report*. A financial report includes basic information, required supplementary information (RSI), and required supplementary stewardship information (RSSI),[5] and may include other accompanying information (OAI). The respondent believed that the Statement should be clarified to state that it applies to *basic statements* and disclosures. However, if the Statement applies to a financial report, it should clarify the components or categories of the report and how it applies to those categories. The Board clarified this concern by clearly indicating that the Statement applies to basic information and RSI. The Board's standards are authoritative for only the basic information and RSI and do not apply to the other portions of a document (e. g., Performance and Accountability Report, Agency Financial Report) in which basic information and RSI are included. Further, auditors of the financial statements have certain responsibilities to read OAI. Any identified material inconsistencies between OAI and the basic information and RSI and any identified material misstatements of fact in OAI would affect the audit and/or the auditor's report.

A17. Another respondent believed that the definition of subsequent events should explicitly state that subsequent events pertain to *material* events and transactions and the term *material* should be used throughout the Statement as applicable. Also, one respondent believed that the term *material* should be included in the definition of

[5] The FASAB has re-categorized all RSSI items except for stewardship investments. Once the FASAB reclassifies the remaining RSSI item, the category will be eliminated. See SFFAC 6, par. A15.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_39.pdf.

subsequent events presented in SFFAS 5, footnote 17. The Forward to the FASAB's *Pronouncements as Amended*, June 30, 2009, discusses the term *materiality*. It states,

> The Board intends that application of authoritative guidance be limited to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them.

Consequently, paragraph 2 of the Statement provides the Board's position on the matter of materiality regarding this Statement.

A18. An additional respondent believed that the examples in paragraph 16 should be clarified to help readers understand what type of events should be considered nonrecognized events. The Board revised the examples of nonrecognized events in paragraph 16 to clarify that such events provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date. The examples include legislative enactments occurring subsequent to the end of the reporting period. Also, additional guidance was added to assist readers in determining nonrecognized events that should be disclosed.

Board Approval

A19. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Abbreviations

AICPA	American Institute of Certified Public Accountants
ASC	Accounting Standards Codification
AU	Auditing Standards codified by the AICPA
CFR	Consolidated Financial Report
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SAS	Statement on Auditing Standards
SFAS	Statement of Financial Accounting Standards
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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Appendix C: Glossary

Nonrecognized events: Subsequent events that provide evidence with respect to conditions that did not exist at the end of the reporting period but arose subsequent to that date.

Recognized events: Subsequent events that provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates inherent in the process of preparing basic information and RSI.

Subsequent events: Events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.

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FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Nancy Fleetwood

Michael H. Granof

Norwood J. Jackson, Jr.

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Ross Simms

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment.

Statement of Federal Financial Accounting Standards 40

May 11, 2011

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Table of Contents

Summary **4**
Introduction **5**
Purpose 5
Materiality 6
Standards **7**
Scope 7
Effect on Existing Standards - SFFAS 6 7
Effective Date 9
Appendix A: Basis for Conclusions **10**
Project History 10
Primary Goals of the Proposed Amendments 10
Summary of Outreach Efforts 12
Responses to the Exposure Draft 13
Board Deliberations 24
Board Approval 24
Appendix B: Abbreviations **25**

Summary

Deferred maintenance and repairs (DM&R) is maintenance and repair activity that was not performed when it should have been or was scheduled to be and which is put off or delayed to a future period. Although DM&R is not sufficiently measurable to support recognition or disclosure as basic information, it is nonetheless a cost and has been reported as required supplementary information (RSI). Information about DM&R has been required because the information is important to help financial statement users assess the efficiency and effectiveness of the federal government's management of property, plant, and equipment. The Board believes reliable government-wide data are needed to assist users in making assessments related to property, plant, and equipment.

This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment* (PP&E). The amendments (1) clarify that "deferred maintenance" reporting includes deferred repairs, (2) revise the examples of maintenance and repair activities to better reflect current practices and encompass activities associated with heritage assets, multi-use heritage assets and stewardship land as well as equipment and other personal property, and (3) address issues related to the distinction between maintenance, repairs, and new capital expenditures.

These amendments represent a first step toward improving reporting on deferred maintenance and repairs. The Board is working, and will continue to work, closely with stakeholders interested in improving management of and reporting on federal PP&E and related deferred maintenance. By addressing definitional issues as a first step, the Board will facilitate continued cooperation with stakeholders toward improved financial reporting especially as it plans to address measurement and reporting issues.

Introduction

Purpose

1. Issues regarding both federal real property management and DM&R are currently being addressed by stakeholders including members of Congress,[1] federal agencies[2] as well as federal and non-federal councils.[3] As part of a coordinated effort among key federal stakeholders, the Board is committed to providing timely guidance on issues currently being addressed. The Board believes clarifying the definition of maintenance and repairs is an important first step in improving the accounting and reporting of DM&R.

2. The objective of this Statement is to incorporate definitional changes in response to concerns raised by the financial and technical[4] communities. The Board also considered the findings of a Federal Facilities Council (FFC) Committee on Operations & Maintenance review of SFFAS 6. The major SFFAS 6 concerns it identified include: (a) different interpretations among agencies and auditors regarding what to report and how to report, (b) introduction of terms not used in the technical community, (c) terms in the maintenance definition loosely defined, and (d) terms in the maintenance definition not reflective of actual practice.

3. Additionally, the Board desires to improve and, where needed, develop accounting and reporting guidance relative to DM&R that best reflects or enhances current federal practices. SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS no. 6, Accounting for Property, Plant, and Equipment and SFFAS 8, Supplementary Stewardship Reporting*,

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[1] Federal Real Property Disposal Enhancement Act of 2009. H.R. 2495, 111th Congress, 1st Session. Federal Real Property Disposal Pilot Program. S. 1667, 110th Congress, 2nd Session.

[2] Presidential Executive Order 13327, Federal Real Property Asset Management signed February 4th, 2004 established the following policy in Section 1*," It is the policy of the United States to promote the efficient and economical use of America's real property assets and to assure management accountability for implementing Federal real property management reforms. Based on this policy, executive branch departments and agencies shall recognize the importance of real property resources through increased management attention, the establishment of clear goals and objectives, improved policies and levels of accountability, and other appropriate action."*

[3] *National Research Council (NRC) Study on Predicting Outcomes of Investments in Maintenance and Repair for Federal Facilities.* This study will be conducted by a panel of experts. The committee plans to finish its report by December 31, 2010.

[4] This Statement uses the phrase "technical community" to refer to agency personnel responsible for the management of property, plant, and equipment including technical issues such as maintenance and repair.

issued in April 1999, reclassified deferred maintenance (DM) to RSI primarily as a result of auditor concerns. Since then, asset assessment methodologies have matured and Administration initiatives[5] have prompted agencies to develop condition assessment, measurement, and reporting systems. However, these methodologies and systems are not uniform throughout government, resulting in a lack of comparability.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[5] Presidential Executive Order 13327.

Standards

Scope

5. This Statement revises maintenance and repair (M&R) terminology in Statement of Federal Financial Accounting Standards (SFFAS) 6, as amended, by modifying the definition of maintenance and by replacing the term "deferred maintenance" with "deferred maintenance and repairs."

Effect on Existing Standards - SFFAS 6

6. SFFAS 6, paragraph 78 is replaced with the following text:

> Maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition.[1] Activities include preventive maintenance; replacement of parts, systems,[1a] or components; and other activities needed to preserve or maintain the asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.
>
> [Footnote 1 – [1] The determination of acceptable condition may vary both between entities and among sites within the same entity. Management shall determine what level of condition is acceptable.]
>
> [Footnote 1a – [1a] The term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property.]

7. The term "maintenance" is replaced with "maintenance and repairs" and conforming grammatical changes are made in the following paragraphs of SFFAS 6:

   a. Paragraph 77 – "Deferred maintenance and repairs" are ~~is~~ maintenance and repairs…

   b. Paragraph 80 – …for deferred maintenance and repairs may…

c. Paragraph 82 – …in a forecast of maintenance and repairs expense, these forecasts may serve as a basis against which to compare actual maintenance and repairs expense and estimate deferred maintenance and repairs.

d. Paragraph 83 –

At a minimum, the following information shall be presented as required supplementary information for all PP&E (each ~~of the four~~ category~~ies~~ established in SFFAS 6 ~~the PP&E standard~~ should be included).

• Identification of each major class [footnote 6 to remain; omitted here for brevity] of asset for which maintenance and repairs have~~s~~ been deferred.

• Method of measuring deferred maintenance and repairs for each major class of PP&E.

• If the condition assessment survey method of measuring deferred maintenance and repairs is used, the following should be presented for each major class of PP&E:

− description of requirements or standards for acceptable operating condition,

− any changes in the condition requirements or standards, and asset condition[footnote 7 to remain; omitted here for brevity] and a range or a point estimate of the dollar amount of maintenance and repairs needed to return assets to their ~~it to its~~ acceptable operating condition.

• If the total life-cycle cost method is used, the following should be presented for each major class of PP&E:

− the original date of the maintenance and repairs forecast and an explanation for any changes to the forecast,

− prior year balance of the cumulative deferred maintenance and repairs amount,

− the dollar amount of maintenance and repairs that was defined by the professionals who designed, built or manage the PP&E as required maintenance and repairs for the reporting period,

− the dollar amount of maintenance and repairs actually performed during the period,

− the difference between the forecast and actual maintenance and repairs,

− any adjustments to the scheduled amounts deemed necessary by the managers of the PP&E, [footnote 8 revised] and

− the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance and repairs.

[Footnote 8 - [8]Adjustments may be necessary because the cost of maintenance and repairs foregone may not be cumulative. For example, if periodic painting is skipped twice it is not necessarily true that the cost would be double the scheduled amount.]

• The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* provides for required supplementary information applicable to the U.S. government-wide financial statements for these activities.

e. Paragraph 84 – …noncritical amounts of maintenance and repairs needed……noncritical amounts of maintenance and repairs needed…

Effective Date

8. This Statement is effective for periods beginning after September 30, 2011. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors. The guidance enunciated in the Statement–not the material in this or other appendices –should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In late 2008 the Board reviewed its technical agenda and initiated a DM project. The DM project was highly ranked by constituents who provided input on the Board's technical agenda. A FASAB task force was convened to study the findings of a past review and recent federal and industry developments. The task force is addressing issues in two phases – (1) definitions and (2) measurement and reporting. This Statement is the result of the definitions phase. It addresses areas the task force identified as needing clarification. The task force developed definitional options for the Board's consideration and the amendments in this Statement are intended to clarify important matters. The Board notes that the minimum required supplementary information currently required at paragraph 83 of SFFAS 6 may be further modified as a result of the outcome of subsequent work related to the measurement and reporting phase of this project.

Primary Goals of the Proposed Amendments

Goal of DM&R Reporting

A2. Concerning the goal of DM&R reporting, the Board believes there is confusion regarding what is required in the financial reports under the current definitions. The Board's ultimate goal for DM&R information is that it serves as a useful tool for all decision makers, including Congress, oversight bodies, management, and citizens. To be useful, it must provide information about needed M&R that has yet to be performed. Therefore, management should present a reasonable estimate(s) of the cost of maintenance and repair activities that it would have performed in support of its mission if resources had been available in the past. In addition, management should provide explanatory material.

A3. Achieving the goal of DM&R reporting requires many judgments regarding what is needed in each situation. These definitional changes are a first step in improving the usefulness of DM&R reporting. Several definitional issues were discussed by the task force. For some issues, changes were proposed and in others they were not. The primary issue for which a change was not proposed in the exposure draft was a definition of acceptable condition. The rationale for that decision is provided below. Issues addressed by the exposure draft and the Board's decisions are discussed following a summary of the exposure draft outreach and responses.

Acceptable Condition and Judgment

A4. M&R planning requires decisions about the level of condition to which an asset should be maintained – for example, "as new" condition or "fair" condition. When management elects to use the condition assessment survey method, SFFAS 6 also requires that information concerning requirements or standards for acceptable condition be reported; assisting users in understanding what condition the agency judges to be "acceptable." The Board acknowledges that a view exists among certain practitioners and users of DM&R information that because SFFAS 6 guidance allows decisions about acceptable levels of condition it is too flexible. Further, it requires agencies to rely heavily on unspecified human judgment in the area of "acceptable" condition.

A5. Preparers and users who hold this view opine that unless FASAB includes guidance defining "acceptable condition" in the DM&R standards, agencies will continue to have disparate goals regarding DM&R. In their opinion, this could lead to (a) inaccurate DM&R reporting because of inconsistent definitions of "acceptable condition," (b) flawed M&R planning, and (c) DM&R reporting that is not informative to readers. After careful consideration of this view, the Board believes that the guidance these preparers/users seek would be management policies. Providing such guidance is not an appropriate role for an accounting standards setting body. The Board believes that the standards provide general guidance to be coupled with managerial judgment based on such factors as agency mission and asset use. In the next phase of the project, the Board will ask the task force to consider factors that management might appropriately consider in determining acceptable condition.

Summary of Outreach Efforts

A6. The Exposure Draft was issued May 4, 2010 with comments requested by June 25, 2010. Upon release of the exposure draft, notices and press releases went to *The Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive,* the CFO Council, the Council of Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network; and members of both the Federal Real Property Council and the Federal Facilities Council and committees of professional associations generally commenting on exposure drafts in the past.

A7. This broad announcement was followed by direct mailings of the exposure draft to the House Committee on Oversight and Government Reform, the Senate Committee on Homeland Security and Governmental Affairs, and the American Association of State Highway and Transportation Officials.

A8. A reminder notice was provided on June 14th and professional associations were contacted via telephone on or about that date.

Responses to the Exposure Draft

A9. Thirty-four responses were received. Table 1.0 summarizes received responses by respondent type.

Table 1.0

Summary of Respondent Types to DM&R Maintenance Definition Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	**28**	**1**	**29**
Users, academics, others	**1**	**2**	**3**
Auditors	**2**	**0**	**2**
Total	**31**	**3**	**34**

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss respondent comments and Board decisions.

Adding "Repairs" to Title and Body of Definition

A11. The task force reported much confusion regarding the proper treatment of repairs. Due to this confusion, some agencies may not be reporting deferred repairs. As a result, the Board proposed that the term "deferred maintenance" should be revised to "deferred maintenance and repairs." The majority of respondents agreed with the Board's proposal to add "repairs" to the title and body of the revised definition

in order to clarify that deferred "repairs" as well as deferred "maintenance" need to be reported.

A12. Two respondents objected based on the assumption that "repairs" cannot be planned. However, this is not always nor usually the case. There are in fact many repairs that can be planned for based on historical and statistical analyses such as a study of failure rates. Also, not all repairs are of an emergency or corrective nature as some repairs are adaptive which lend themselves to planning. Some agencies have programs in-place that attempt to predict repairs and in some cases these predictions can cover over 90% of the repair activity over a two year time horizon. For example, roof maintenance plans include an analysis of the condition assessment which can forecast when a roof (or portion thereof) might fail and require repair.

A13. The remaining respondent who disagreed believes including repairs will cause continued confusion due to the lack of definition for this term. However, based on both the task force's recommendation as well as the majority of respondents who are in favor of this change, it is apparent that the community-at-large believes that including this term helps to clarify conflicting interpretations and divergent practices. Although the Board does not believe that from an accounting point of view, maintenance and repairs should be distinguished from each other, it does recognize that some within the technical community do make a distinction. Accordingly, the original definition[6] by virtue of excluding other than "normal" repairs" contributes to the underreporting of deferred maintenance and repairs as well as the lack of consistency both within and among agencies. While it is the Board's intention that for financial reporting purposes M&R not be treated separately, the Board acknowledges the view that maintenance generally retains an asset's functionality whereas repair generally restores an asset's functionality.

A14. It should be noted that although the Board believes that "repairs" should be added to the definition, it does acknowledge that various

[6]SFFAS 6, paragraph 78.

interpretations surrounding unique circumstances may warrant future guidance.

Illustrative List of Activities

A15. The second sentence of the definition provides an illustrative list of activities which is not meant to be all inclusive. The Board believes that the list of activities contained in the second sentence of the existing definition should be changed to better reflect current federal and industry practices as well as encompass M&R activities related to heritage assets, multi-use heritage assets, stewardship land, equipment and other personal property in addition to buildings.

A16. In reviewing the reasons cited by the minority of respondents who disagreed with the proposed changes to the illustrative list of activities, it is clear that some of the issues raised should be dealt with via implementation guidance while others require Board clarification. Specifically:

a. Systems – One respondent objected to adding "systems" since it appeared confusing to include a term which relates to equipment along with terms associated with buildings. Another respondent objected to adding "systems" since it referenced information technology assets which are already included by virtue of being an asset class within property, plant, and equipment. The Board desires to clarify that the term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) which are in fact covered by SFFAS 6 as amended or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property. Furthermore, depending on an agency's capitalization criteria, systems and/or their replacements may or may not be capitalized. Because the maintenance and repair definition is an umbrella definition covering many categories and classes of assets, it would be both impractical and inappropriate to limit the meaning of terms such as "systems" that cut across such a broad spectrum of assets.

b. Greater Clarity of Terms – Two respondents sought greater clarity in each of the proposed terms. One respondent preferred retaining "normal repairs" since it distinguishes itself from major and extraordinary repairs. The Board believes that standards should be general. If needed, detailed guidance can be provided through

implementation guidance. However, the Board will work with the task force to consider examples in the next phase of the project. In addition, agencies are encouraged to seek implementation guidance as needed before the effective date.

c. Eliminate entire list - One respondent preferred eliminating the entire list or at least excluding preventative maintenance entirely stating that maintenance work is routine, recurring, repetitive, and periodic in nature and as such is never deferred but rather extended. Thus, according to this respondent deferred maintenance is minor in magnitude and too difficult to measure and report. The Board does not subscribe to the notion that deferred maintenance and repair activities are immaterial in nature at all agencies. Furthermore, the Board's research and overall respondent support (from the community-at-large) for the proposed changes reflect that greater clarity and not less is needed in the definition.

d. Audit misapplication - One respondent was concerned that auditors will treat the list as all-inclusive. The Board desires to make it clear that the list is illustrative only and does not purport to identify all activities that an agency might consider to be either maintenance or repair.

e. Accounting for disposal costs - One respondent sought guidance on disposal activities. Disposal activities are beyond the scope of this project.

f. Information technology assets - One respondent sought inclusion of internal use software. As previously stated, this SFFAS 6 as amended in fact applies to all categories and classes of PP&E including internal-use software.

g. Impact on capitalization - One respondent was concerned that systems might be capitalized even though capacity increases or upgrades are not accomplished. The Board notes two points in this matter: (1) depending on an agency's capitalization criteria, systems and/or their replacements may or may not be capitalized and (2) it does not intend at this time making any definitional changes that would require an agency to change its capitalization policies or criteria.

Phrase Elimination:
Acceptable Services and
Expected life

A17. The majority of respondents agreed with the Board's proposal to eliminate the phrase, *"so that it continues to provide acceptable services and achieves its expected life."* Of the three respondents who disagreed, the following issues were raised:

a. One objected to removing the "useful [sic] life" reference since it takes away a key quantitative factor for the evaluation of management's determination of the relative length of time in which an asset's acceptable condition would be expected to be maintained, and undermines the concept of useful life recognition in the basic financial statements and notes.

b. One objected to deleting "acceptable services" since the term "acceptable condition" does not encompass "acceptable services." According to this respondent the term "acceptable services" seems more measurable and indicative of adequate functionality and support of mission than "acceptable condition."

c. One objected to both phrases being removed since the phrase "acceptable services" helps convey the meaning of "acceptable condition" and the phrase "expected life" is also useful as it helps set the boundaries of the FASAB definition - subsequent acquisitions that extend an asset's "useful life" are capitalized and outside the scope of "deferred maintenance."

A18. The Board considered each of the arguments presented and decided eliminating this phrase helps to eliminate ambiguity and reflect actual asset management practices.

a. First, the Board notes that the changes made to the maintenance and repairs definition are limited to the application of this standard in regards to presenting DM&R information in RSI. Therefore, elimination of the "expected life" reference does not infringe on management's determination of an asset's acceptable condition. Furthermore, because the definition is limited to DM&R, the Board does not believe the "expected life" concept used for capitalization and depreciation is impacted in any meaningful way.

b. To help eliminate confusion and clarify the intent regarding DM&R reporting, the Board desires to simplify the definition wherever practicable. Notwithstanding health and/or safety implications, the Board believes that the most basic function for an adequate M&R program is to keep an asset in an acceptable condition consistent with management's expectations. Therefore, management is in the best position to first define and then assess whether or not a nexus exists between asset condition and "acceptable services." Although the term "acceptable condition" may not always encompass "acceptable services," management is responsible for that determination. Accordingly, undefined terms such as "acceptable services" that might have multiple meanings within an agency, let alone among agencies, run counter to the Board's intent of clarification.

c. The Board believes that linking DM&R to an "expected life" estimate is not useful. From an operational perspective, M&R activities may not solely be performed for the purpose of allowing PP&E to achieve its expected life because health and safety considerations may be paramount. Furthermore, estimates of expected life may change over time due to operating conditions, actual maintenance practices, or technical changes. As an asset's expected life changes, the life assigned in the accounting records should be appropriately updated. However, this presents practical problems if M&R is tied to meeting an expected life – for example, which expected life is to be used and what happens when the expected life is exceeded. Therefore, the Board believes that linking M&R to attainment of an expected life is not appropriate.

Originally intended vs. current use.

A19. Two issues were raised by respondents who did not agree with the proposed change from "originally intended" to "current use." First, it was noted that "current use" will be misunderstood and misapplied and instead the Board should adopt the phrase "the use for which it is currently configured." Second, it was noted that "current use" would be a poor benchmark for definitional purposes and that the original intent could in fact be ascertained via reviewing various agency documents. The Board notes that the task force considered the term proposed by the respondent and found it to be problematic because it introduces a new term without a consistent meaning. For example, the term

"configure" raises questions as to definition. Specifically, "configured" when and by whom? Does this imply a purely technical configuration based on schematic drawings or operational configuration based on logistics? The Board does not wish to introduce new terms that could cause further confusion or create any additional ambiguity. Concerning the second issue, the Board notes that the task force found the opposite to be true: current use is the most appropriate benchmark especially when one considers changes in mission or code (i.e., construction, health, and/or safety) requirements over the years and that original intent cannot always be readily ascertained via a review of agency documents.

Other Comments

Capital Improvements

A20. One respondent raised a concern regarding the exclusion of capital improvements from DM&R reporting. Additionally, the Board has been made aware of several other concerns over this matter. The concerns include:

a. failure to include "Total Correction Costs" in the definition would significantly under report all costs to correct existing capitalized assets; e.g., maintenance, repairs and estimated capital improvements

b. some special purpose reports include unfunded capital needs along with DM&R information and this is beneficial to users

c. some repair activities may incidentally improve assets (e.g., damaged lighting fixtures may be replaced with more energy efficient lighting fixtures) and there is uncertainty regarding treatment of such projects

d. there is uncertainty regarding planned M&R activities relating to fully depreciated fixed assets and fixed assets that are not recognized in the accounting records due to capitalization thresholds

A21. The Board believes that the existing goal of differentiating those activities that might be considered capital improvements (or new assets) from M&R should be maintained. DM&R reporting addresses concerns about management of existing assets. While unmet capital needs (i.e., capital improvements and new acquisitions) are relevant to

decision makers, they do not as clearly relate to reporting on past transactions and events as DM&R does. As such, unmet capital needs should not be included in the calculation of DM&R. DM&R arises because an asset exists that is not maintained in accordance with an agency's established M&R policy; DM&R have financial consequences apart from unmet capital needs which are relevant to decision makers.

A22. The Board is mindful that the distinction between M&R activities and improvements to existing assets is often not clear. Some M&R activities that could enhance an asset may not generally be considered by accountants as "capital improvements" and recognized as additions to the agency's assets. In addition, there will be uncertainty regarding the unit of analysis – whether an entire facility is "the asset" or its individual components are "assets." Therefore, depending on the unit of analysis, an activity might be considered M&R or replacement of an old asset with a new one. It is not the Board's intention that a precise distinction be attained in every case. Rather, agencies should not include new asset, capital improvement, and/or enhancement needs in DM&R and should treat like circumstances similarly over time since a consistently followed practice that is well described will assist decision makers.

A23. By reaffirming that M&R excludes capital improvements, the Board is striving to ensure the definition of DM&R for purposes of financial reporting will be one and the same as in the condition index[7] calculation of the Federal Real Property Profile (FRPP). This should result in agencies having to develop only one estimate of DM&R for both purposes.

A24. In the exposure draft, the Board sought not only input on the proposed changes, but also other changes, points, issues and/or considerations which may not have been specifically addressed in the exposure draft.

[7] It should be noted that the revised maintenance and repair definition as contained in this standard is intended to be the basis for the numerator so that a uniform reporting requirement definition exists throughout federal government. ***Condition Index (CI)*** is a general measure of the constructed asset's condition at a specific point in time. *CI* is calculated as the ratio of Repair Needs to Plant Replacement Value (PRV). *Formula: CI = (1 - $repair needs/$PRV) x 100.* Source: 2009 GSA's Guidance For Real Property Inventory Reporting dated July 14, 2009.

Twenty-two respondents provided additional comments that covered a broad array of issues ranging from editorial notes to acknowledging the positive effects of revising the definition as well as the ambitious nature of this project. In summary the comments received include:

a. One respondent suggested that the Board should not be overly prescriptive because one size does not fit all.

b. One respondent said the difficulty will be in transferring accounting requirements into the operations and maintenance arena.

c. One respondent suggested that the Board should consider distinguishing between types of repairs.

d. One respondent recommends that the Federal Real Property Council (FRPC) and the General Services Administration require agencies to report Active and Inactive DM.

e. One respondent suggested that guidance could be enhanced that DM&R applies to all classifications and classes of PP&E (i.e., in addition to real property). The Board notes that SFFAS 6, paragraph 83 requires DM&R information for each category of PP&E by major class.

f. One respondent stated that acceptable condition differs between equipment and facilities. For equipment it may be defined as mission-capable or serviceable.

g. One respondent suggested adding guidance on using GSA's FRPP information for the annual data calls. Replacement costs or ranges of such costs are needed to determine whether or not funding DM&R is economically advantageous compared to asset replacement.

h. One respondent stated that there is a borderline between financial reporting of DM&R and technical or project completion of M&R. In their opinion, M&R should be viewed over an asset's life-cycle and not by a financial reporting period.

DM&R on Non-capitalized General PP&E

A25. While views were sought on this issue, no changes in practice relating to DM&R on non-capitalized general PP&E should result from this Statement. SFFAS 6, paragraph 83, provides minimum reporting requirements. The Board will clarify these requirements during the next phase of this project.

A26. The Board asked if the respondents believed that DM&R reporting should be limited to DM&R related to capitalized general PP&E as well as non-capitalized stewardship PP&E or directed broadly to fixed assets. Sixteen respondents were in favor of reporting DM&R broadly to fixed assets whereas fourteen respondents were in favor of limiting DM&R reporting to capitalized general PP&E as well as stewardship PP&E.

a. Respondents in favor of reporting DM&R broadly to fixed assets provided the following comments:

i. DM&R should apply to all assets because capitalization thresholds are not recognized in asset management practices and should be consistent with GSA's Real Property profile (all assets).

ii. DM&R on all fixed assets is a better indication of risk to the Government's varied missions.

iii. Fixed assets relate better to M&R since all or most assets require maintenance.

iv. Since there is confusion between what a capital asset is versus PP&E, DM&R should be reported under fixed assets.

v. If an agency has a significant number of fully depreciated assets for which DM&R is reported, a reevaluation of useful life estimates is in order.

vi. If an agency has a significant number of assets that do not meet its capitalization threshold for which the agency

believes DM&R should be reported, a reevaluation of the capitalization threshold is in order.

vii. Consideration should be given to allowing a threshold for DM&R reporting purposes that may or may not be different from the threshold used for capitalizing PP&E.

viii. DM&R is more pertinent to users than depreciation or historical cost information inasmuch as it represents future costs to be incurred.

ix. Limitations to DM&R reporting could cause potential data conflicts with other sources of information used by program and congressional offices.

b. Respondents in favor of reporting DM&R limited to capitalized general PP&E and stewardship PP&E provided the following comments:

i. DM&R should retain association to PP&E. Adding DM&R for non-capitalized assets skews any resultant analysis to PP&E. DM&R should trace and be auditable to PP&E.

ii. Capitalization thresholds reflect cost/benefit considerations balancing the cost of precision versus the costs to compile data.

iii. If an asset is expensed, it has been deemed immaterial and DM&R should follow suit.

iv. A (separate) threshold for DM&R on non-capitalized assets should be allowed to encourage such reporting.

v. Apply a uniform DM&R threshold applicable only for government-wide reporting purposes.

vi. Reporting DM&R for fixed assets in essence undervalues the PP&E reflected on the balance sheet.

vii. Establishing limits (definitions) for “fixed assets” will be very difficult in practice adding additional costs.

viii. Agencies should use judgment in determining whether DM&R be limited or applied broadly; user benefits should exceed costs of preparing said information.

Board Deliberations

A27. The Board discussed respondent input but has made a decision only regarding the proposed amendments to SFFAS 6 relating to the definition of DM&R. Input and suggestions regarding other topics will be considered in the next phase of the project – measurement, reporting and asset impairment. The basis for conclusions primarily addresses Board deliberations on definitional issues.

Board Approval

A28. This statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Abbreviations

CFO	Chief Financial Officers (Council)
DM	deferred maintenance
DM&R	deferred maintenance and repair
FASAB	Federal Accounting Standards Advisory Board
FFC	Federal Facilities Council
FRPC	Federal Real Property Council
FRPP	Federal Real Property Profile (GSA Asset Management Database)
GAAP	generally accepted accounting principles
GAO	Government Accountability Office
GSA	General Services Administration
M&R	maintenance and repair
OMB	Office of Management and Budget
PP&E	property, plant and equipment
RSI	required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_40.pdf.

FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Michael H. Granof

Norwood J. Jackson, Jr.

Mark Reger

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Domenic Nicholas Savini

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Deferral of the Effective Date of SFFAS 38, *Accounting for Federal Oil and Gas Resources*

Statement of Federal Financial Accounting Standards 41

July 6, 2011

This is the original Statement; please check for the most recent update in the FASAB Handbook at
www.fasab.gov/pdffiles/handbook_sffas_41.pdf

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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Summary

This Statement defers the effective date of Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, for one year. The standards contained in SFFAS 38 will become effective as required supplementary information for periods beginning after September 30, 2012, with earlier implementation encouraged.

This is the original Statement; please check for the most recent update in the FASAB Handbook at
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Table of Contents

Summary 3

Standards 5

Scope 5
Amendment to SFFAS 38 5
Effective Date 5

Appendix A: Basis for Conclusions 6

Project History 6
Request for Deferral 7
Due Process 7
Comment Letters 8

Appendix B: Abbreviations 10

This is the original Statement; please check for the most recent update in the FASAB Handbook at
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Standards

Scope

1. This Statement applies to federal entities that report information about federal oil and gas resources in general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Amendment to SFFAS 38

2. Paragraphs 5 and 30 of SFFAS 38, *Accounting for Federal Oil and Gas Resources*, are amended as follows:

> The standards are effective as RSI for periods beginning after September 30, ~~2011~~2012. Earlier implementation is encouraged.

Effective Date

3. This standard is effective upon issuance.

> The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. FASAB issued Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, on April 13, 2010. This standard requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves be reported in a schedule of estimated federal oil and gas petroleum royalties. In addition, this standard requires the value of estimated petroleum royalty revenue designated for others be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented as required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity. SFFAS 38 is effective as RSI for periods beginning after September 30, 2011 with earlier implementation encouraged.

A2. It is the Board's intent that the information required by SFFAS 38 transitions to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the Board plans to make a determination as to whether the information will transition to basic information as financial statement recognition or note disclosure. SFFAS 38 will remain in effect until such time as a determination is made.

A3. On September 30, 2010, FASAB staff was informed that the Department of the Interior (DOI) was considering requesting a one-year deferral of the effective date of SFFAS 38 due to the recent reorganization of the Minerals Management Service (MMS) into several different bureaus under the newly created Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE). MMS had been the component entity responsible for collecting royalties and charged with preparing the information to be reported under SFFAS 38.

A4. On October 7, 2010, FASAB staff notified a BOEMRE representative that in order to issue an amendment to the standard by September 2011, staff would need to receive DOI's formal deferral request in time to prepare a draft exposure draft (ED) for the December 2010 board meeting.

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Request for Deferral

A5. The formal request was received from BOEMRE on November 18, 2010. The request explained that MMS's successor organization will be divided into three new entities. First, the BOEMRE and the Bureau of Safety and Environment Enforcement will divide the duties of the former Offshore Energy and Minerals Management organization, with the former managing the development of conventional and renewable resources and minerals on the Outer Continental Shelf, and the latter providing safety and environmental oversight. These new bureaus will report to the Assistant Secretary of Land and Minerals Management. Second, the Office of Natural Resources Revenue (ONRR) will perform the roles of the former Minerals Revenue Management organization and report to the Assistant Secretary for Policy, Management and Budget.

A6. BOEMRE's request stated that many issues and challenges have arisen as a direct result of these organizational changes that will greatly complicate the implementation of SFFAS 38 for fiscal year 2012. Accordingly, a one-year deferral of SFFAS 38 was requested.

A7. While a reorganization in and of itself would not normally be a justification for deferring a standard, the Board members noted that the nature and extent of the MMS reorganization goes above and beyond what would be considered within the normal course of operations. The Board therefore approved the one-year deferral, but emphasized that earlier implementation is encouraged and strongly urged that the standard be implemented for fiscal year 2012 if at all possible.

Due Process

A8. The Exposure Draft (ED), Deferral of the Effective Date of SFFAS 38, *Accounting for Federal Oil and Gas Resources*, was released on January 5, 2011, with comments requested by February 7, 2011.

A9. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A10. This broad announcement was followed by direct e-mailings of the press release to:

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a) Relevant congressional committees: Senate Committee on Energy and Natural Resources, Senate Committee on Finance, House Committee on Financial Services, and House Committee on Natural Resources;

b) Public interest groups and think tanks: Alliance to Save Energy, The Brookings Institution, The Cato Institute, Center on Budget and Policy Priorities, Citizens Against Government Waste, The Concord Coalition, The Heritage Foundation, National Parks Conservation Association (NPCA), Natural Resources Defense Council (NRDC), OMB Watch, Resources for the Future (RFF), Sierra Club, The Urban Institute, and World Resources Institute (WRI);

c) Respondents to SFFAS 38 and related EDs (or their successors);

d) Agencies that manage and / or account for federal natural resources: Department of the Interior (DOI) Office of the Secretary; DOI Bureau of Land Management ; DOI Bureau of Ocean Energy Management, Regulation and Enforcement; DOI U.S. Geological Service (USGS); Department of Agriculture (USDA), Deputy CFO; and USDA Forest Service.

A11. To encourage responses, reminder notices were provided to the FASAB email listserv on January 28, 2011, and February 8, 2011.

Comment Letters

A12. Four comment letters were received from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others	0	2
Auditors	0	0
Preparers and financial managers	2	0

A13. The Board considered responses to the exposure draft at its February 23, 2011, public meeting. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below.

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A14. Three of the four respondents were in favor of deferring the effective date. One respondent disagreed, citing the need for DOI to incorporate the reporting for oil and gas resources into its newly reorganized reporting structure as it is being developed. The Board considered both views and decided to approve the one-year deferral, noting that the additional time provided to DOI to improve upon its estimation process in light of the major reorganization of MMS would be preferable.

A15. This statement was approved for issuance by all members of the Board. Written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Abbreviations

BOEMRE	Bureau of Ocean Energy Management, Regulation and Enforcement
CFR	Consolidated Financial Report of the U.S. Government
DOI	Department of the Interior
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
MMS	Minerals Management Service
ONRR	Office of Natural Resources Revenue
RSI	Required Supplementary Information
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

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FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Michael H. Granof

Mark Reger

Norwood J. Jackson, Jr.

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Julia Ranagan

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Deferred Maintenance and Repairs

Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32

Statement of Federal Financial Accounting Standards 42

April 25, 2012

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Table of Contents

Summary 4

Introduction 5

Purpose 5

Materiality 5

Effective Date 5

Standards 6

Scope and Applicability 6

Appendix A: Basis for Conclusions 15

Appendix B: Sample Illustration 26

Appendix C: Abbreviations 33

Appendix D: Glossary 34

This is the original [Statement]; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_42.pdf

Summary

Deferred Maintenance and Repairs (DM&R) reporting enables the government to be accountable to citizens for the proper administration and stewardship of its assets. Specifically, DM&R reporting assists users by providing an entity's realistic estimate of DM&R amounts and the effectiveness of asset maintenance practices the entities employ in fulfilling their missions.

This Statement amends the required supplementary information (RSI) presentation requirements contained in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment* and also provides conforming amendments as explained within the Scope and Applicability section at paragraph 6. The amendments require entities to: (1) describe their maintenance and repairs (M&R) policies and how they are applied, (2) discuss how they rank and prioritize M&R activities among other activities, (3) identify factors considered in determining acceptable condition standards, (4) state whether DM&R relate solely to capitalized general property, plant and equipment (PP&E) and stewardship PP&E or also to non-capitalized or fully depreciated general PP&E, (5) identify PP&E for which management does not measure and/or report DM&R and the rationale for the exclusion of other than non-capitalized or fully depreciated general PP&E, (6) provide beginning and ending DM&R balances by category of PP&E, and (7) explain significant changes from the prior year.

Other significant amendments contained in this Statement include (1) requiring that condition standards, related assessment methods, and reporting formats be consistently applied unless management determines that changes are necessary, (2) eliminating the requirement to report condition information, and (3) eliminating the (i) optional reporting of low-high DM&R estimates as well as (ii) option to report critical and non-critical DM&R.

Additionally, the amendments note the importance of communication with, and input from, professionals in diverse disciplines in compiling and reporting DM&R information.

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Introduction

Introduction

Purpose

1. The objective of this Statement is to improve the measurement of deferred maintenance and repairs (DM&R) by incorporating changes responsive to concerns raised by the financial and technical[1] communities. The Board also considered, where appropriate, a Government Accountability Office (GAO) study[2] specific to repair and maintenance backlog issues surrounding federal real property.

Materiality

2. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

3. This Statement is effective for periods beginning after September 30, 2014. Earlier implementation is encouraged.

[1] This Statement uses the phrase “technical community” or “technical communities” to refer to entity personnel responsible for the management of property, plant, and equipment (PP&E), including maintenance and repair.
[2] GAO Report No. GAO-09-10 dated October 2008. *Federal Real Property. Government’s Fiscal Exposure from Repair and Maintenance Backlogs is Unclear*.

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Standards

Scope and Applicability

4. This Statement applies to federal entities that present general purpose federal financial reports in conformance with generally accepted accounting principles as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

5. This Statement replaces the definitions, measurement and reporting requirements for deferred maintenance and repairs established in SFFAS 6, as amended by *SFFAS 40, Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*. SFFAS 6, *Chapter 3: Deferred Maintenance and Repairs*, paragraphs 77 through 84, and *Appendix C, Deferred Maintenance and Repairs Illustration* are rescinded.

6. In addition to SFFAS 6, this Statement also provides the following conforming amendments:

   a. SFFAS 14*, Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment, and SFFAS 8, Supplementary Stewardship Reporting,* is rescinded.

   b. SFFAS 29*, Heritage Assets and Stewardship Land,* is amended to adopt the revised terminology and to rescind requirements for reporting **condition**[3] information.

   c. SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government,"* is amended to adopt the revised terminology and to rescind certain requirements.

   d. Technical Release 9*, Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land,* Section III: Assessing and Reporting Condition is amended to explain the status of guidance relating to condition reporting.

[3] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

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Definition

7. Deferred maintenance and repairs (DM&R) are maintenance and repairs that were not performed when they should have been or were scheduled to be and which are put off or delayed for a future period.

8. Maintenance and repairs are activities directed toward keeping fixed assets in an acceptable condition.[4] Activities include preventive maintenance; replacement of parts, systems,[5] or components; and other activities needed to preserve or maintain the asset. Maintenance and repairs, as distinguished from capital improvements, exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use.

Measurement

9. Amounts for DM&R may be measured using:

    a. condition assessment surveys,

    b. life-cycle cost forecasts, or

    c. other methods that are similar to the condition assessment survey or life-cycle costing methods.

10. *Condition assessment surveys* are periodic[6] visual (i.e., physical) inspections of property, plant and equipment (PP&E) to determine their current condition and estimated cost to correct any deficiencies.

11. *Life-cycle costing* is an acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in forecasts of maintenance and repairs expense, these forecasts may serve as a basis against which to compare actual maintenance and repairs expense to arrive at an estimate of deferred maintenance and repairs.

---

[4] The determination of acceptable condition may vary both between entities and among sites within the same entity. Management shall determine what level of condition is acceptable.
[5] The term "systems" can refer to either (1) information technology assets (e.g., hardware, internal use software, data communication devices, etc.) or (2) groupings (assemblages) of component parts belonging to a building, equipment or other personal property.
[6] This Statement does not require an entity's entire portfolio to be inspected each year. It is permissible to schedule condition assessment surveys on a cyclical (i.e., calendar) basis or a frequency based on consideration of risk provided scheduling is done in accordance with established practices.

12. Management should determine which methods to apply and what condition standards are acceptable. Once determined, condition standards, related assessment methods[7], and reporting formats should be consistently applied unless management determines that changes are necessary. Although condition information is essential in developing DM&R amounts, reporting of condition information is not required. Changes to methods or formats that management determines are necessary should be accompanied by an explanation documenting the rationale for the change and any related impact on the DM&R estimate(s). To best meet the goal of DM&R reporting, communication with, and consideration of, input from professionals in diverse disciplines such as engineering, facilities management, finance, budgeting and accounting is necessary.

13. DM&R should be measured and reported for capitalized general PP&E and stewardship PP&E. DM&R also may be measured and reported for non-capitalized or fully depreciated general PP&E. DM&R should include funded maintenance and repairs (M&R) that have been delayed for a future period as well as unfunded M&R. DM&R on inactive and/or excess PP&E should be included to the extent that it is required to maintain inactive or excess PP&E in acceptable condition. For example, inactive PP&E may be maintained or repaired either to comply with existing laws and regulations, or to preserve the value of PP&E pending disposal.

Component Entity Required Supplementary Information

14. DM&R reporting should provide (1) DM&R beginning and ending balances for the reporting period and (2) narrative information related to DM&R activities. Entities are required to present both qualitative and quantitative information.

15. At a minimum, the following information should be presented as required supplementary information (RSI) for all PP&E (each category established in SFFAS 6, as amended, should be included) regardless of the measurement method chosen.

[7] Assessment methods are techniques or procedures used in a process of systematically evaluating an entity's PP&E in order to project M&R, renewal, or replacement needs that will maintain or preserve its ability to support the entity's mission or activities it is assigned to serve.

Qualitative

a. A summary of the entity's M&R policies and brief description of how they are applied; i.e., method of measuring DM&R
b. Policies for ranking and prioritizing M&R activities[8]
c. Factors the entity considers in determining acceptable condition standards
d. Whether DM&R relates solely to capitalized general PP&E and non-capitalized stewardship PP&E or also to amounts relating to non-capitalized or fully depreciated general PP&E
e. Capitalized general PP&E, and non-capitalized heritage assets and stewardship land for which management does not measure and/or report DM&R and the rationale for the exclusion
f. If applicable, explanation of any significant changes[9] to (1) the policies and factors subject to the reporting requirements established in a. through e. above and (2) DM&R amounts from the prior year[10]

Quantitative

g. Estimates of the beginning and ending balances of DM&R for each major category[11] of PP&E for which maintenance and repairs have been deferred

Consolidated Financial Report of the US Government Required Supplementary Information

16. The disclosure requirements listed in paragraphs 14 and 15 above are not applicable to the U.S. government-wide financial statements. The U.S. government-wide financial statements should include the following RSI:

    a. A description of what constitutes DM&R and how it was measured

[8] As an example, entities may report (1) how they will pursue reducing their DM&R backlog and how they will be impacted by budget or funding shortfalls or reductions, and (2) whether or not the entity has used Return on Investment analyses in its ranking and prioritizing of either M&R or DM&R.
[9] The determination of whether or not an item is significant is a matter of professional judgment. This determination is separate and distinct from materiality considerations that include considering the likely influence that such information could have on judgments or decisions of financial statement users.
[10] Consistent with paragraph 12, once determined, condition standards and related assessment methods and reporting formats should be consistently applied.
[11] SFFAS 6 sets forth three categories of PP&E: (1) general PP&E; (2) heritage assets; and (3) stewardship land.

b. Amounts of DM&R for each major category of PP&E (i.e., general PP&E, heritage assets, and stewardship land); and
c. A general reference to specific component entity reports for additional information

Conforming Amendments to Other Statements and Technical Releases

17. This Statement amends requirements in SFFAS 29 and 32 to replace 'deferred maintenance' with 'deferred maintenance and repairs' and to rescind certain requirements in SFFAS 29 and 32, including the requirement to report condition information. The changes to SFFAS 29 and 32 are presented in paragraphs 18 and 19 below.

18. Paragraphs 26, 28, 41 and 42 of SFFAS 29, *Heritage Assets and Stewardship Land*, are amended as follows:

> [26] ~~Entities should report the condition[11] of the heritage assets (which may be reported with the deferred maintenance information[12]) as required supplementary information.~~ Entities should include a reference to ~~the condition and~~ deferred maintenance and repairs information[13] ~~if~~ reported in required supplementary information ~~elsewhere in the report containing the basic financial statements~~.

Paragraph 26 Footnote references:

> [11] ~~Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.~~

~~[12] See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance~~.

[13] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32* for information regarding definition, measurement and required supplementary information. ~~SFFAS 14, Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.~~

[28.c.] A general reference to agency reports for additional information about heritage assets, such as agency stewardship policies for heritage assets, and physical units by major categories of heritage assets~~, and the condition of the heritage assets~~.

[41] ~~Entities should report the condition[22] of the stewardship land (which may be reported with the deferred maintenance information[23]) as required supplementary information.~~ Entities should include a reference to the ~~condition and~~ deferred maintenance and repairs information[24] ~~if~~ reported in required supplementary information ~~elsewhere in the report containing the basic financial statements~~.

Paragraph 41 Footnote references:

~~[22] Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors,~~

~~including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.~~

[23] ~~See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.~~

[24] See SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32,* for information regarding definition, measurement and required supplementary information. ~~SFFAS 14, Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.~~

[42. c.] A general reference to agency reports for additional information about stewardship land, such as agency stewardship policies for stewardship land, and physical units by major categories of stewardship land use~~, and the condition of the stewardship land~~.

19. Paragraphs 12b., 12c., and 24 of *SFFAS 32: Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government" are rescinded.*

~~12. b. The text "The above listed required supplementary information is not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for required supplementary information applicable to the U.S. government-wide financial statements for these activities." is added as a separate bullet following the existing text for par. 83.~~

~~12. c. The text "The U.S. government-wide financial statements need not separately report stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition as well as management's definition of these categories. SFFAS 32 provides for optional information applicable to the U.S. government-wide financial statements for these activities." is added to par. 84 as the final sentences.~~

~~24. The U.S. government-wide financial statements should include the following required supplementary information:~~

~~a. a broad description of deferred maintenance,~~

~~b. amounts or ranges of amounts of deferred maintenance for each major asset category (i.e., general property, plant, and equipment; heritage assets, and stewardship land) for which maintenance has been deferred,~~

~~c. a general reference to component entity reports, and~~

~~d. optional reporting of the stratification between critical and non-critical amounts of maintenance needed to return each major asset category to its acceptable operating condition.~~

20. This Statement amends requirements in Technical Release 9, Section III, to acknowledge the rescission of requirements to report condition information as RSI. The following text is to be inserted before Section III:

> Statement of Federal Financial Accounting Standards 42, *Deferred Maintenance and Repairs*, *Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32,* rescinded the requirement to report condition information regarding heritage assets and stewardship land as RSI. The following guidance offers insights regarding condition assessments and factors that may influence reporting of deferred maintenance and repairs information. The guidance has not been updated to conform to the new standards and should be considered other literature until revised implementation guidance, if any is provided.

Effective Date

21. This Statement is effective for periods beginning after September 30, 2014. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards provided in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. Concerns pertaining to DM&R reporting have arisen since the issuance of SFFAS 6. The two most common concerns related to (1) the lack of comparability in assessing asset condition both within and among entities and (2) measurement and reporting practices and formats that vary greatly among entities. In its most recent real property study (GAO Report No. GAO-09-10 dated October 2008), the GAO noted that entities define and estimate DM&R differently in part due to the degree of flexibility afforded by both SFFAS 6 and the Federal Real Property Profile Reporting Guidelines. As a result, confusion and uncertainty exists among users of DM&R information.

A2. Primarily as a result of auditor concerns, SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, amended SFFAS 6 and SFFAS 8 to reclassify deferred maintenance information as required supplementary information instead of a disclosure in the notes to the financial statements.

A3. At the time, the Board believed that a period of experimentation would be desirable for deferred maintenance information and that classifying it as RSI was appropriate during the experimentation period. As a result, the standards for estimating deferred maintenance were intentionally flexible. However, at a minimum, the Board expected to develop guidance on determining acceptable condition and revise the standards based on experience gained during the experimentation period.

A4. Since completing deliberations on SFFAS 40, *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment*, the Board has continued seeking advice and guidance from stakeholders interested in improving the management of, and reporting on, federal PP&E and related DM&R.

A5. As demonstrated by SFFAS 40, the Board has spent considerable time and effort working with key stakeholders and the community-at-large evaluating much of the experience gained during the experimentation period. As a result, the Board

has both reaffirmed and refined its position regarding DM&R measurement and reporting.

A6. Two external reports served as the initial basis for the scope of the Task Force's work.[12] The first report (Deferred Maintenance Reporting for Federal Facilities, The National Academies, (2001), ISBN 0-309-56339-9) was a critique of the deferred maintenance definition in SFFAS 6*, Accounting for Property, Plant, and Equipment*. This report was prepared by the Federal Facilities Council under the auspices of The National Academies. The report was reviewed by the Task Force and provided a foundation for the proposed amendment(s) contained in SFFAS 40. The second report (GAO Report No. GAO-09-10 dated October 2008) was a GAO study specific to federal real property repair and maintenance backlog issues. In that study, the GAO discussed the need for comparability and realistic estimates of deferred maintenance so that the government's fiscal exposure could be revealed.

A7. The Task Force's work was not constrained by either of these external reports. Task Force members contributed entity specific information which also included input from internal and external audit communities.

Summary of Outreach Efforts

A8. The Exposure Draft was issued June 27, 2011 with comments requested by September 16, 2011. Upon release of the exposure draft, notices and press releases went to *The Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive,* the CFO Council, the Council of Inspectors General on Integrity and Efficiency (CIGIE), the Financial Statement Audit Network; members of both the Federal Real Property Council and the Federal Facilities Council and committees of professional associations generally commenting on exposure drafts in the past.

Responses to the Exposure Draft

A9. Twenty-two responses were received. Table 1.0 summarizes responses by respondent type.

[12] During 2008 FASAB established a Task Force to address deferred maintenance and asset impairment issues. The Task Force consists of government and non-government representatives from various disciplines such as: real property/facilities management, personal property management, appraisal and valuation services, engineering, architecture, accounting, internal auditing, external auditing, finance, and budgeting.

Table 1.0

Summary of Respondents by Type to Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	**11**	**-0-**	**11**
Users, academics, others	**5**	**3**	**8**
Auditors	**3**	**0**	**3**
Total	**19**	**3**	**22**

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

No Longer Requiring Condition Reporting - Refining the Goal of DM&R

A11. The majority of respondents agreed with the Board's proposal to no longer require condition reporting. Respondents who disagreed noted that (1) condition reporting for key infrastructure which directly affects public safety provides a measure of the effectiveness of the allocated budget to maintain those critical assets, (2) condition reporting has become the "standard" to understand the overall condition of facilities, and (3) all federal agencies are required to report condition information and DM&R by the Federal Real Property Council Reporting Requirements.

A12. The goal of DM&R is to provide reliable information on the estimated cost of the PP&E maintenance and repairs that have been deferred. To that end, this

Statement no longer requires that condition information be reported. Although condition reporting is important and is the basis of an entity's DM&R estimate, the Board determined that it is not an essential component of financial reports. The Board's rationale for this decision is that condition assessment methods and reporting continue to evolve and there are no federal-wide uniform assessment or measurement methods that would increase comparability and understandability. Therefore, summarized condition information may not provide meaningful information to users. The Board believes the wide variation among entities in condition assessment methods and reporting (i.e., different condition ratings/rankings) could obscure user understanding of the government's fiscal exposure (realistic DM&R estimate). The Board believes that this is an area where entity administrative burden can be alleviated given the questionable benefits of summarized condition information.

A13. This Statement eliminates the requirement to report condition information. However, entities may include condition information in a manner they believe best presents and contextualizes DM&R and related performance matters.

Presenting Beginning and Ending DM&R Balances and Explanation of Significant Changes

A14. The majority of respondents agreed with the Board's proposal to require that entities present beginning and ending DM&R balances and explain significant changes. Respondents who disagreed noted that because many variables impact the change in DM&R estimates a significant change could result in wide disparities among the component entities.

A15. The Board believes that presenting DM&R balances and discussing significant changes increases comparability while also enhancing entity-specific consistency. Some respondents have noted that discussing significant changes is not only reasonable, but required inasmuch as it is a part of determining the underlying causes to such changes. As one respondent noted, discussing changes is essential for transparency and accountability.

A16. The Board believes that users need to know how much the M&R requirements increased (decreased) in dollar terms and the effect of this change on the DM&R balances. Moreover, it is important for users to (1) understand the events that occurred during the year and why they brought about significant increases or decreases and (2) whether or not DM&R levels have changed (e.g., the amount declined). To that end, federal entities are required to present their DM&R beginning and ending balances. As illustrated in Appendix B, entities should present these balances by category (i.e., general PP&E, heritage assets, and stewardship land), and explain significant changes by major asset category. The

determination of whether an item is significant is a matter of professional judgment. This determination is separate and distinct from materiality considerations. Factors that might be considered when determining whether an item is significant include the: (1) absolute dollar amount of the change in DM&R estimates, (2) percent change in DM&R estimates, (3) perceived importance of the reason for the change to financial statement users, and (4) potential consequences arising from the change (e.g., effect on mission). The Board believes that this will increase comparability and the relevance and reliability of the DM&R estimates and will significantly enhance entity-specific consistency from year to year.

Applying Reported Methods and Reporting Formats Consistently using an Interdisciplinary and Integrated approach

A17. The majority of respondents agreed with the Board's proposal to require that entities apply reported methods and reporting formats consistently unless management determines that changes are necessary and if changes to methods or formats are necessary, such changes should be explained. Furthermore, respondents agreed that input from professionals in diverse disciplines is necessary to effectively compile and report DM&R.

A18. Because consistency in measurement and reporting significantly adds to the informational value of DM&R estimates (i.e., trend information is useful to decision makers), management must use consistent assessment techniques, measurement methods and reporting formats from year-to-year. However, if management decides to change methods or formats, such changes should be accompanied by an explanation documenting the rationale for the change and any related impact to the DM&R estimate(s). This is consistent with Task Force concerns that (1) entities be allowed to adopt new and improved methods or technologies that might be brought about in the area of asset management and (2) greater rigor and discipline is needed in the area of DM&R measurement and reporting.

A19. Staff research found that some agencies have interpreted SFFAS 6 requirements to apply only to unfunded DM&R activities.[13] As a result, inaccurate reporting and increased lack of consistency and comparability has resulted. The Board notes whether funded or not, DM&R should be reported. For example, if funding exists but competing demands cause a schedule slippage and result in a delay to a future period, such costs should be reported as DM&R.

[13] Department of Defense Inspector General Report dated September 25, 2009, *Deferred Maintenance on the Air Force C-130 Aircraft* (Report No. D-2009-112.)

A20. Staff research also found that some entities have not reported DM&R because they have not distinguished between needed capital improvements (e.g., activities which extend the useful life of PP&E) and needed repairs (e.g., activities which allow PP&E to attain its original useful life). SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board,* states that "[g]enerally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. Consideration should be given to whether the substance of transactions or events differs materially from their form."[14] For DM&R amounts to be comparable, entities must consider the substance rather than the form—that is, the terms applied by management—of future activities relating to PP&E.

A21. An interdisciplinary and integrated approach is necessary to address completeness and consistency and meet the goal of DM&R reporting. This includes communicating among and considering input from experts in diverse disciplines such as engineering, facilities management, finance, budgeting, and accounting. Such input should be considered when determining acceptable condition and related costs to remedy assets. Such an approach will help to (1) ensure the increased value and efficacy of the reported information, (2) meet diverse user needs, and (3) foster system integration and process improvements via continual interaction among entity staff.

Narrative Information Describing M&R Policies and other Non-financial Information

A22. The majority of respondents agreed with the Board's proposal to require that entities provide narrative information describing M&R policies and other non-financial information including any significant changes to policies and other factors from the prior year. Respondents who disagreed noted that combining policy statements across a reporting entity with heterogeneous assets and varying missions is difficult.

A23. The Board believes that users need to understand how entities carry-out their stewardship responsibilities. Moreover, many entities maintain such information as part of their overall management and stewardship responsibilities.

A24. Although flexibility is necessary in the areas of determining asset condition and defining acceptable condition, the Board believes that additional disclosures are required in order to increase consistency, comparability, and the reliability and relevance of DM&R estimates. Consequently, the Board believes that:

[14] SFFAS 34, footnote 5.

a. disclosing M&R policies and how they are applied in practice assists users in understanding how an entity manages its DM&R.

b. disclosing policies for ranking and prioritizing M&R activities assists users in understanding how an entity efficiently and effectively manages its M&R resources. As such, preparers may provide general context in their explanations concerning the amount of the ending balance that the entity would need to incur in the near-term to avoid adverse impact to the entity's mission. Additionally, the Board believes that in order to enhance the relevance and reliability of the entity's estimated DM&R amount, an entity should explain how it decides to allocate its (available) resources. For example, entities frequently give top priority to maintenance and repair activities that maintain employee or constituent health and safety or are required to satisfy regulatory mandates. Once this is accomplished, entity rankings may be adjusted for asset condition assessments, and management considerations that include: capital improvement plans, asset disposal plans, and budgetary funding outlook.

c. identifying factors the entity considers in selecting acceptable condition standards assists users in understanding the unique nature of the entity's mission and operating environment and how these affect asset management. Regardless of whether entities report condition information, the underlying rationale an entity uses in making this managerial judgment enhances the relevance and reliability of the entity's estimated DM&R. For example, an entity might set different acceptable condition standards for identical assets because of geographical or environmental factors specific to each.

d. disclosing whether DM&R relates solely to capitalized general PP&E and non-capitalized stewardship PP&E or also includes amounts relating to non-capitalized or fully depreciated general PP&E assists users in understanding how an entity manages its DM&R. Partially as a result of increased emphasis in the reporting of real property information, it has come to the Board's attention that some entities, in addition to tracking DM&R on capitalized general and non-capitalized stewardship PP&E, also track and report DM&R on expensed or fully depreciated general PP&E; i.e., all accountable PP&E.

e. identifying PP&E for which management does not measure and/or report DM&R and the rationale for the exclusion assists users in understanding how an entity efficiently and effectively manages its M&R resources. Management should clearly disclose and provide a rationale for this exclusion. For example, PP&E designated as excess and subject to disposal or considered unserviceable may not have any associated DM&R.

Eliminating Dollar Ranges and Critical / Non-critical Designations

A25. The majority of respondents agreed with the Board's proposal to eliminate dollar ranges and critical / non-critical designations. However, a respondent noted that the intent of distinguishing critical from non-critical DM&R was to provide insight into the timing of such expenditures. As such, the respondent asked the Board to consider an alternative to providing information concerning the ending balance that the entity would need to achieve in the near term in order to avoid adverse impact to the entity's mission.

A26. The Board notes that requiring DM&R designations would be (1) overly prescriptive and difficult for agencies to calculate, (2) inconsistent with Board actions to-date that acknowledge the imprecise nature of DM&R estimates and (3) contrary to the goal of focusing on a singular DM&R estimate. However, the Board does believe that this may be beneficial information that preparers could consider providing.

A27. The stratification between critical and non-critical DM&R at SFFAS 6, paragraph 84 was intended to be optional and not an unnecessary burden to entities. It has come to the Board's attention that the Federal Real Property Guidelines define "critical" at the asset level (i.e., asset classification defines if M&R is critical or not) whereas the SFFAS 6 guidelines have been interpreted to apply to the discrete M&R activity (i.e., the nature of the work defines if M&R is critical or not). Furthermore, some entities are following Treasury guidelines which define "critical" as a matter of consequence or exigency (i.e., impact of not performing the M&R work/activity).[15] Consistent with the Task Force's recommendation, it is the Board's opinion that having three separate definitions for "critical" has led to confusion, increased lack of comparability, and estimates that are not necessarily reflective of what entities expect to incur. The Board believes that the reporting of critical and non-critical DM&R is not useful, can lead to inconsistency, and therefore should be not be addressed in the Statement.

[15] June 17, 2010, Appendix 4 of Chapter 4700 in Vol. 1 of the Treasury Financial Manual, Other Financial Report (FR) Notes Data and Instructions. *"Critical deferred maintenance is urgently needed, absolutely necessary, and is an element that needs immediate attention. Furthermore, critical deferred maintenance is any deferred maintenance that poses a serious threat to the public or employee safety or health, natural or cultural resources, and a bureau's ability to carry out its assigned mission."*

Other Matters

Active and Inactive PP&E

A28. Measuring DM&R related to active and inactive PP&E helps ensure that DM&R estimates capture reliable information on the estimated cost of the PP&E maintenance and repairs that have been deferred. For example, entities are often required by law or regulation to obtain approval(s) prior to disposing real property deemed inactive or excess. If entities continue to measure DM&R on PP&E pending disposition, DM&R estimates may be overstated because M&R having a low probability of occurrence may be included. As a result, DM&R that is not expected to be incurred due to an asset's inactive status may be separately identified in order to provide for a more realistic DM&R estimate, if deemed material.

Assessment Method Factors and Selection Criteria

A29. In measuring DM&R, entities are free to choose among assessment methods described in this Statement. For example, an entity may elect to use a life-cycle method to assess its PP&E as part of its overall project management strategy to enhance its ability to predict future maintenance and repair requirements. Another entity may elect to use a parametric method[16] due to the size and complexity of its portfolio and to realize efficiencies and cost savings while another entity requiring asset-specific condition information may select the condition assessment survey method. The Board realizes that entities need to consider many factors when selecting assessment methods. Such factors could include:

a. nature, size and complexity of the PP&E portfolio,
b. mission requirements,
c. cost versus benefit,
d. changes in economic outlook,
e. project management strategy,
f. nature or type of asset to be inspected,
g. asset-specific condition assessment requirements,
h. environmental or weather conditions,

[16] Similar to the life-cycle costing method, the parametric method is an accepted technique that entails performing condition assessments at the system level rather than the component level.

i. availability of commercial-off-the-shelf (COTS) software,

j. availability of government-off-the-shelf (GOTS) software,

k. software scalability and related vendor support,

l. regulatory requirements, and

m. health and safety considerations.

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A30. In order to obtain greater consistency and comparability this Statement provides that once selected, condition standards, related assessment methods and reporting formats should be consistently applied unless management determines that changes are necessary. General selection criteria management could use in evaluating different assessment methods include the following:

CONDITION ASSESSMENT SURVEYS (i.e., visual, physical inspections)

PROS

- Generates DM&R estimates
- More timely identification of health and safety issues
- Usually identifies and prioritizes work items / specific repairs
- Modified surveys are affordable
- Knowledge-based surveys (e.g., risk management strategies) eliminate over - and under-inspection
- Engineered-based surveys provide consistent and credible results

CONS

- Traditional surveys are expensive
- Does not always identify or prioritize work items / specific repairs
- Wasteful over-inspection, risky under-inspection
- Inspector bias could distort results

LIFE CYCLE COSTING METHODS (i.e., modeling)

PROS

- Generates DM&R estimates
- Affordable
- Efficient

- Focuses on buildings and systems
- Facilitates evaluation of large portfolios

CONS

- Determining the cumulative costs of deferring maintenance
- Does not identify or prioritize work items / specific repairs
- Not always appropriate for smaller portfolios
- Could require expensive updating of initial procurement information
- Credibility issues

Board Approval

A31. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Sample Illustration

Appendix B

Deferred Maintenance and Repairs Illustration

This appendix illustrates the requirements at paragraphs 14 and 15. The examples shown here are for illustrative purposes only. Different entities may develop different asset classes and descriptive terminology consistent with the set categories of general PP&E, heritage assets, and stewardship land. The following narrative discussion and Illustration #1, *General Purpose Display* meet the minimum requirements of this Standard. The various illustrations are not meant to articulate with one another and should be viewed on a stand-alone basis.

XYZ Entity

Deferred Maintenance and Repairs for Fiscal Year 20x2

The XYZ entity operates over 1,300 facilities throughout the world, preserves nearly 300 national historical landmarks of natural, cultural, educational, or artistic importance, and is responsible for maintaining over 80,000 acres of stewardship land. Most of the facilities are predominantly used for office space and warehousing defense assets. Additionally, the entity operates a hospital at one of its remote sites. It is entity policy to ensure that medical equipment and critical equipment systems are maintained and managed in a safe and effective manner. Therefore, deferred maintenance and repairs do not arise for these two types of equipment and no periodic assessment is performed. Additionally, since (1) it is entity policy to maintain and preserve all fixed property, plant and equipment (PP&E) regardless of recorded values and (2) accounting and asset management systems do not differentiate M&R between PP&E capitalized (i.e., items whose cost exceeds the capitalization threshold) versus those expensed, DM&R estimates reported herein relate to all PP&E whether capitalized or not or fully depreciated.

Defining and Implementing M&R Policies in Practice.

As permitted under SFFAS 42, *Deferred Maintenance and Repairs, Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*, the entity employs a parametric estimating method for the largest portion of its portfolio (real property such as office and warehouse space) and the condition assessment method for its hospital facility, defense and stewardship assets. With the exception of the hospital facility which is inspected on a yearly basis, the entity's real property portfolio is

assessed on a 3 to 5 year rotating calendar. Both methods measure current real property asset condition and document real property deterioration.

Real property assessment methods produce both a cost estimate of deferred maintenance and repairs, and a Facility Condition Index (FCI). Both measures are indicators of the overall condition of the entity's facilities. The parametric estimating methodology involves an independent, rapid visual assessment of nine different systems within each facility to include: structure, roof, exterior, interior finishes, HVAC (heating, ventilation, and air conditioning), electrical, plumbing, conveyance, and program support equipment. The parametric estimating method is designed to be cost-effective and appropriate for application to a large population of facilities; results are not necessarily applicable for individual facilities or small populations of facilities.

The entity's hospital is inspected on a yearly basis employing a physical inspection method which focuses on component as well as system distresses in addition to identifying deficiencies. The entity's defense assets are routinely surveyed by unit and depot maintenance personnel and stewardship assets are routinely surveyed by on-site personnel and regional inspection teams.

As stated above, it is entity policy to ensure that medical equipment and critical facility equipment systems are maintained and managed in a safe and effective manner. Therefore, deferred maintenance and repairs assessment methods are generally not applied to equipment assigned to hospitals as any DM&R would be negligible.

Ranking and Prioritizing M&R Activities.

Maintenance and repair activities are first prioritized via health, safety and regulatory considerations at all facilities. Once this is accomplished, the FCI values are then ranked based on the ratings obtained during the condition assessment site visits. Rankings are generally adjusted to take into account current capital improvement efforts underway, future capital improvement plans, asset disposal plans, and budgetary funding outlook.

Factors Considered in Setting Acceptable Condition.

For office and warehouse space, the entity defines acceptable condition in accordance with standards comparable to those used in private industry. For example, industry standards for administrative buildings can vary substantially depending upon their classification as either a Class A, B, or C property. Such classifications are affected by building location, design, and age. Condition standards for warehouses are primarily set by local jurisdictions and consider factors such as accommodating loads, materials to be stored, the associated handling equipment, the receiving and shipping operations, associated trucking, and the needs of the operating personnel. Acceptable condition for

the hospital facility is in accordance with federal statutory requirements and requirements adopted by the health care facilities industry substantially comparable to the requirements at 42 C.F.R. Part 483 entitled, *Requirements for States and Long Term Care Facilities*.

Military specifications and standards for defense assets vary greatly depending upon numerous factors such as the nature and type of equipment and mission expectations. Acceptable condition standards for defense assets are set at levels deemed to be mission capable or serviceable. Heritage assets and stewardship land adopt scientific conservation standards to preserve assets in a manner that fulfills the entity's obligation to stabilize, protect, and preserve the assets.

Significant Changes from Prior Year and Related Events.

The overall net increase of $2.0 billion in DM&R is a result of the $3.0 billion increase in General PP&E DM&R, offset by a $1.0 billion decrease in heritage assets DM&R.

Funded DM&R decreased by $1.0 billion as result of the entity's strategic initiative to repair and restore many of its historical landmarks. However, unfunded DM&R pertaining to inactive/excess general PP&E increased by $3.0 billion as a result of (1) the transfer of properties from other federal entities, (2) newly identified properties and equipment no longer needed by the entity, and (3) continued degradation of properties awaiting final disposition. Management policy is to comply with legal requirements to maintain inactive/excess property in safe condition and to pursue cost-beneficial measures to preserve the value of properties. The entity in collaboration with other entities and members of Congress is in the process of finalizing plans to either dispose of or find alternate uses for the aforementioned properties. For such properties, DM&R include those M&R activities management believes are warranted but not necessarily the M&R appropriate for an equivalent active property.

The following illustration presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs and meets the basic illustration requirements of this Standard:

ILLUSTRATION 1 - GENERAL PURPOSE DISPLAY

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	20x2 Ending Balance DM&R	20x2 Beginning Balance DM&R
General PP&E	$33,500	$30,500
Heritage Assets	5,000	6,000
Stewardship Land	2,500	2,500
Total	**$41,000**	**$39,000**

The following Illustration # 2 presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs with an emphasis on active versus inactive/excess assets:

ILLUSTRATION 2 - EMPHASIS ON ACTIVE vs. INACTIVE and EXCESS

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	20x2 Ending Balance DM&R	20x2 Beginning Balance DM&R
Active:		
General PP&E	$46,875	$45,000
Heritage Assets	0	1,500
Stewardship Land	1,500	1,500
subtotal -active	48,375	48,000
Inactive and Excess:		
General PP&E	13,125	10,500
subtotal –general PP&E – inactive and excess	13,125	10,500
Total	**$61,500**	**$58,500**

The following Illustration # 3 presents information on major asset classes experiencing material amounts of deferred maintenance and repairs with an emphasis on active versus inactive/excess assets:

ILLUSTRATION 3 - EMPHASIS ON ACTIVE vs. INACTIVE and EXCESS BY ASSET CLASS

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category / Class	20x2 Ending Balance DM&R	20x2 Beginning Balance DM&R
Active:		
General PP&E:		
Structures	$14,375	$14,000
Aircraft	53	5
Missiles	139	58
Ships	1,058	937
subtotal - general PP&E active	15,625	15,000
Stewardship Land	500	500
Heritage Assets	0	500
subtotal - all active	16,125	16,000
Inactive and Excess:		
General PP&E		
Buildings	2,500	2,500
Structures	1,875	1,000
subtotal - general PP&E - inactive and excess	4,375	3,500
Total	**$20,500**	**$19,500**

The following Illustration # 4 presents information on major PP&E categories experiencing material amounts of deferred maintenance and repairs with an emphasis on funded and unfunded maintenance and repairs:

ILLUSTRATION 4 - EMPHASIS ON FUNDED and UNFUNDED M&R

Deferred Maintenance and Repair Costs
(Dollars in Millions)

Asset Category	20x2 Ending Balance DM&R	20x2 Beginning Balance DM&R
Funded M&R:		
General PP&E -active	$26,500	$30,000
General PP&E - inactive and excess	19,500	16,000
Heritage Assets	0	2,000
Subtotal - funded	46,000	48,000
Unfunded M&R:		
General PP&E -active	15,000	15,000
General PP&E - inactive and excess	6,000	0
Heritage Assets	10,000	10,000
Stewardship Land	5,000	5,000
Subtotal - unfunded	36,000	30,000
Total	**$82,000**	**$78,000**

This is the original [Statement]; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_42.pdf

Appendix C: Abbreviations

DM&R	deferred maintenance and repairs
FASAB	Federal Accounting Standards Advisory Board
FCI	Facility Condition Index
FRPP	Federal Real Property Profile (GSA Asset Management Database)
GAO	Government Accountability Office
G-PP&E	general property, plant and equipment
M&R	maintenance and repair(s)
OMB	Office of Management and Budget
PP&E	property, plant, and equipment
RSI	required supplementary information
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Appendix D: Glossary

Condition - The physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. *Source: FASAB: Pronouncements as Amended, Appendix E: Consolidated Glossary.*

Deferred Maintenance and Asset Impairment (DM-AI) Task Force Members

U. S. Agencies

Department of Agriculture, U.S. Forest Service

Department of Commerce, National Oceanographic and Atmospheric Administration

Department of Defense, Office of the Secretary of Defense

Department of Defense, Acquisition, Technology, and Logistics

Department of Defense, Comptroller

Department of Energy, Office of Engineering and Construction Management

Department of Interior

Department of Labor, Office of the Inspector General

Department of State

Department of State, U.S. Agency for International Development

Department of State, International Boundary and Water Commission

Department of the Treasury, Financial Management Service

Department of Veterans Affairs

General Services Administration

General Services Administration, Public Buildings Service Central Office

National Aeronautics and Space Administration

Office of Management and Budget

Smithsonian Institution

Task Force Member Firms

American Institutes for Research

Duller Studios

Federal Facilities Council, Committee on Sustainable Operations and Maintenance

Institute for Responsible Infrastructure Stewardship

KPMG LLP

Navigant Capital Advisors

FASAB Board Members

Tom L. Allen, Chair

Debra J. Bond

Robert F. Dacey

Michael H. Granof

Norwood J. Jackson, Jr.

Mark Reger

Alan H. Schumacher

D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Domenic Nicholas Savini

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds*

Statement of Federal Financial Accounting Standards 43

June 1, 2012

This is the original Statement; please check for the most recent update in the FASAB Handbook at:
www.fasab.gov/pdffiles/handbook_sffas_43.pdf

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accounability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Summary

This Statement amends Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Earmarked Funds*, by:

- changing the term “earmarked funds” to “funds from dedicated collections.”
- modifying the definition of a fund from dedicated collections by:
    - clarifying that at least one source of funds external to the federal government must exist for a fund to qualify as a fund from dedicated collections, and
    - adding an explicit exclusion for any fund established to account for pensions, other retirement benefits, other postemployment or other benefits provided for federal employees (civilian and military).
- permitting either consolidated or combined data on funds from dedicated collections to be provided.
- permitting certain component entities to report on funds from dedicated collections for amounts related to the statement of changes in net position in a note rather than on the face of the statement.
- illustrating optional formats for displaying information on the face of the balance sheet and statement of changes in net position.

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Table of Contents

Summary 3
Introduction 5
  Purpose 5
  Materiality 5
Accounting Standard 6
  Applicability and Scope 6
  Amendments 6
  Updates for Subsequent Issuances 14
  Implementation Guidance 14
  Effective Date 14
Appendix A: Basis for Conclusions 15
Appendix B: Text of SFFAS 27 Accounting Standards, as Amended 25
Appendix C: Illustrative Component Entity Financial Statements 36
Appendix D: Earmarked Funds Task Force Participating Agencies 43
Appendix E: Abbreviations 44
Appendix F: Glossary 45

Introduction

Purpose

1. The Board evaluated Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, which has been in effect since fiscal year (FY) 2006, and identified areas for improvement. The review found some aspects of the requirements that should be clarified and identified challenges inherent in presenting understandable information that meets the reporting objectives of SFFAS 27. This Statement amends the requirements to resolve these matters.

Materiality

2. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Accounting Standard

Applicability and Scope

3. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

4. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*.

Amendments

New Term for "Earmarked Funds"

5. The title of SFFAS 27 is amended as follows: SFFAS 27, *Identifying and Reporting Funds from ~~Earmarked Funds~~* ***Dedicated Collections.***[1]

6. The term "earmarked funds" is changed to "funds from dedicated collections" in the accounting standards of SFFAS 27 and conforming grammatical changes are made throughout SFFAS 27.[2] Paragraphs amended for terminology are: 11 – 18, 20 – 24, 26 – 34, and 39. The entire text as amended is presented in Appendix B.

Definition of Funds from Dedicated Collections

7. SFFAS 27, paragraph 11 is amended as follows:

   [11] ~~Earmarked funds~~ ~~F~~ Generally, funds from dedicated collections are financed by specifically identified revenues,[3a] provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[2] For example, in places the adjective "earmarked" has been changed to "such" funds, for example in paragraph 24 of SFFAS 27.

the government's general revenues. The three required criteria for a~~n~~ ~~earmarked~~ fund from dedicated collections are:

1. A statute committing the federal government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source[3b] only for designated activities, benefits or purposes;

2. Explicit authority for the ~~earmarked~~ fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and

3. A requirement to account for and report[4] on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the ~~earmarked~~ fund from the federal government's general revenues.

Footnote 3a: Such specifically identified revenue can be either exchange or nonexchange.

Footnote 3b: In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

Footnote 4: A "report" may be something other than stand-alone financial statements for the ~~earmarked~~ fund from dedicated collections.

Predominant Source of Funds

8. To distinguish the definition from explanatory text relating to its application, a new subheading – "Application of the Definition" – is inserted in SFFAS 27 before paragraph 12.

9. SFFAS 27, paragraph 13 is amended as follows:

[13] **Fund** in this Statement's definition of ~~earmarked~~ funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[5] Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from

dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:

1. its predominant sources of revenue and other financing sources are non-federal sources meeting the paragraph 11.1 criterion, or

2. it has non-federal sources of revenue and other financing sources meeting the paragraph 11.1 criterion[5a] that are material to the reporting entity.

For example, as currently funded, Medicare Parts B and D do not have non-federal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.

Footnote 5: National Council on Governmental Accounting Statement 1, par. 16.

Footnote 5a: In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:

1. long-term expectations rather than periodic results that may fluctuate
2. 36-month averages

Changes in classification of funds from year to year should be disclosed.

10. SFFAS 27, paragraph 14 is amended as follows:

[14] Whereas ~~earmarked~~ funds from dedicated collections are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not ~~earmarked~~ dedicated by law for a specific purpose and by the proceeds of general borrowing. Although there are exceptions, funding decisions regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing ~~earmarked~~ funds from dedicated collections reflects a longer (if not indefinite) government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. ~~Earmarked~~ fFunds from dedicated collections may ~~have~~ be given authority to make expenditures by means of a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the ~~appropriation~~ budget authority is provided by authorizing legislation or

annual appropriations acts, the ~~cumulative results of operations~~ ~~earmarked~~ funds ~~is~~ are reserved or restricted to the designated activity, benefit or purpose.

Funds Excluded

11. SFFAS 27, paragraph 18 is amended as follows:

> [18] Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds are excluded because they are revolving funds that conduct business primarily within and between government agencies. Credit financing accounts are also excluded. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to federal credit programs. Fiduciary funds, which are not government-owned, are also excluded. Funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian or military) should not be classified as funds from dedicated collections because such funds account for employer-employee transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 56-96.[6a] In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that the large negative net position of these funds obscures the large cumulative amount that needs to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes.
>
> Footnote 6a: Because classification and reporting should be made at the level of an individual fund, portions of funds, such as the Federal Employees Compensation Account portion of the Unemployment Trust Fund, should not be excluded because of this provision.

Component Entity: Disclosures and Eliminations

12. SFFAS 27, paragraphs 19 and 20 through 24 and paragraph 26 and related headings are amended as follows:

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

[19] [~~Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position. Also t~~The portion of cumulative results of operations and unexpended appropriations attributable to ~~earmarked~~ funds from dedicated collections should be shown separately on ~~both the statement of changes in net position and~~ the balance sheet. This standard does not require ~~earmarked~~ funds from dedicated collections to be separately shown on the statement of net cost. Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the statement of changes in net position if:

1. dedicated collections are the predominant source of revenue and other financing sources for the **component entity**, or

2. one or more of the entity's funds from dedicated collections

    a. is of immediate concern to constituents of the fund,

    b. is politically sensitive or controversial,

    c. is accumulating large balances, or

    d. the information provided in the financial statements would be a primary source of financial information for the public

For example, the Social Security and Medicare programs are of immediate concern to their constituents; both programs have a direct current or future impact on the majority of the general public.

[19a] Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. ~~(See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)~~

[19b] Component entities that do not separately show amounts from dedicated collections on the statement of changes in net position should refer on the face of the statement of changes in net position to the note on funds from dedicated collections.

[20] Most ~~earmarked~~ revenues and other financing sources that are dedicated collections are reported in the basic financial statements of the entity carrying out the program and responsible for administration of the fund. If more than one component entity is responsible for carrying out the program financed with ~~earmarked revenues and other financing sources~~ revenues and other financing sources that are dedicated collections, and the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its

portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.[7]

Footnote 7: To determine program management/accounting responsibility, agencies should consider the legislation authorizing the program; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display,* as amended by this standard.

Disclosure

[21] A component entity should disclose[8] all ~~earmarked~~ funds from dedicated collections for which it has program management responsibility by either a list~~,~~ (by official title~~,~~) or a statement indicating where the ~~information~~ list can be obtained (e.g., a website reference or contact information). A~~n~~ ~~earmarked~~ fund from dedicated collections should not be characterized as a "trust" in general purpose external financial reports of federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Footnote 8: Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

[22] ~~The following~~ Information should be disclosed for each individual ~~earmarked~~ fund~~s~~ from dedicated collections. An exception is provided for component entities having numerous individual ~~earmarked~~ funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual ~~earmarked~~ funds from dedicated collections, ~~and~~ in aggregate for all remaining ~~earmarked~~ funds from dedicated collections, and in total for all the entity's ~~earmarked~~ funds from dedicated collections:

1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.

2. Condensed information providing gross cost, exchange revenue, net cost of operations, nonexchange revenues by major type and all other, other financing sources by major type and all other, and change in net position.

Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. The information required by this paragraph ~~for earmarked funds~~ may be presented separately on the face of

the entity's basic financial statements or disclosed in the accompanying notes. The information must be in sufficient detail to support reporting requirements for the U.S. government-wide financial statements in paragraphs 29 and 30. Information for funds not presented individually may be aggregated. ~~but must be provided even if the aggregate total is immaterial.~~ The total ~~cumulative results of operations~~ net position shown in the note disclosure should agree with the ~~cumulative results of operations~~ total net position for e~~armarked~~ funds from dedicated collections shown on the face of the component entity's ~~basic financial statements~~ balance sheet.[9] ~~(See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)~~

~~Footnote 9: For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.~~

Footnote 9 was rescinded by SFFAS 43, *Revisions to Identifying and Reporting Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27*

[23] The following information should be disclosed for each individually reported ~~earmarked~~ fund from dedicated collections, or portion thereof, for which a component entity has program management responsibility (see paragraph 24).

1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.

2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the government or the result of intragovernmental flows.

3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.

[24] Selecting ~~earmarked~~ funds from dedicated collections to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

a. quantitative factors such as

1. the percentage of the reporting entity's ~~earmarked~~ revenues from dedicated collections or
2. cumulative results of operations from ~~earmarked~~ such funds; and

b. qualitative factors such as

1. whether ~~a~~an ~~earmarked~~ fund from dedicated collections is of immediate concern to constituents of the fund,
2. whether it is politically sensitive or controversial,
3. whether it is accumulating large balances, or
4. whether the information provided in the financial statements would be the primary source of financial information for the public.

[25] The total ~~cumulative results of operations~~ net position of all ~~earmarked~~ funds from dedicated collections shown in the note disclosure should agree with the ~~cumulative results of operations~~ net position of ~~earmarked~~ funds from dedicated collections shown on the face of the component entity's balance sheet ~~and the statement of changes in net position~~.

[26] In accordance with the provisions of paragraph 20 or footnote 5a of paragraph 13, if a component entity reports a different portion of a~~n earmarked fund~~ program funded by dedicated collections than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change ~~in a note~~. This applies if a component entity does not report a~~n earmarked~~ fund from dedicated collections, ~~or portion thereof,~~ that it reported in the previous year. It also applies if a component entity ~~does~~ reports a~~n earmarked~~ fund from dedicated collections~~, or portion thereof,~~ that it did not report in the previous year.

Financial Statements and Disclosures for the U.S. Government-wide Financial Statements

13. Requirements for the U.S. Government-wide Financial Statements are amended as follows:

[30] Specific information should be disclosed for selected ~~earmarked~~ funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual ~~earmarked~~ funds from dedicated collections ~~and~~, in aggregate for all remaining ~~earmarked~~ funds from dedicated collections, and in total for all funds from dedicated

collections ~~with eliminations necessary to produce the Government-wide total of earmarked funds~~.

1. Condensed information about assets, liabilities and net position.
2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

The disclosure may present combined or consolidated amounts and the presentation must be labeled accordingly.

Updates for Subsequent Issuances

14. Footnote 6 of SFFAS 27, which refers to the exposure draft for SFFAS 31, is updated to refer to SFFAS 31.

15. Paragraph 37 of SFFAS 27 is updated as follows:

    [Paragraph 37 was superseded by paragraph 34 of SFFAS 31, which rescinded paragraphs 83 through 87 of SFFAS 7.]

Implementation Guidance

16. In the year this standard becomes effective, entities should restate prior period amounts displayed on the face of the financial statements and disclosed in notes.

Effective Date

17. This Statement is effective for periods beginning after September 30, 2012. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Note: This Statement changes the term "earmarked funds" to "funds from dedicated collections." Conforming changes have been made for clarity and grammar.

Project Background

A1. SFFAS 27 was established to distinguish between funds from dedicated collections and all other funds. Funds from dedicated collections have characteristics that justify special accountability. An explicit commitment associated with the statutory establishment of such funds is created that raises an expectation on the part of the public that the government will use the amounts collected from specific sources and accumulated in funds from dedicated collections for their stated purpose. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined.

A2. SFFAS 27 became effective in fiscal year 2006. It required each component entity to display nonexchange revenue and other financing sources, and net cost of operations[3] attributed to funds from dedicated collections and all other funds separately on the statement of changes in net position. The component entity also displays the portions of cumulative results of operations and unexpended appropriations attributable to funds from dedicated collections and all other funds separately on the statement of changes in net position and on the balance sheet. The government-wide financial statements display revenue, other financing sources and net cost of operations attributed to funds from dedicated collections and all other funds separately on the U.S. government statement of operations and changes in net position. The U.S. government balance sheet displays separately the portions of

[3] Revenue from dedicated collections can be either exchange or nonexchange. Exchange revenue is included in the net cost of operations on the statement of changes in net position.

net position attributable to funds from dedicated collections and all other funds.

A3. The Board reviewed SFFAS 27 to determine if the intended objectives were being achieved. Following an initial review by staff, a task force that included representatives from 23 federal agencies was formed. The task force assisted the Board by identifying concerns, testing alternatives, and reviewing proposals.

Outcome of Task Force Evaluation

A4. The following major issues were identified by FASAB staff and the Task Force:

a. **Term "Earmarked"** – Competing meanings of the term "earmarked" were causing confusion. This Statement changes the term "earmarked funds" to "funds from dedicated collections." Conforming changes have been made throughout.

b. **Appropriateness of Classifications** – The appropriateness of certain types of funds being classified as funds from dedicated collections was questioned for the following reasons:

i. no non-federal (external) source of funding exists for some funds reported as funds from dedicated collections,

ii. classification of funds with mixed sources of funding where the predominant source is general fund appropriations may be misleading, and

iii. funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian and military) should not be reported as funds from dedicated collections because such funds account for employee-employer transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government*.

c. **Understandability** – Presenting funds from dedicated collections information on the face of component-level financial statements may not be the most understandable format for financial statement readers.

d. **Eliminations** – There was confusion over whether and how to perform and disclose eliminations.

A5. These issues are discussed in more detail in the sections that follow.

SUMMARY OF OUTREACH EFFORTS

A6. The exposure draft, *Revisions to Identifying and Reporting Earmarked Funds: Amending Statement of Federal Financial Accounting Standards 27*, was issued June 22, 2011, with comments requested by August 22, 2011. Upon release of the exposure draft, notices and press releases were provided to

a. The Federal Register;
b. *FASAB News;*
c. The *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* and the *CPA Letter,* and *Government Accounting and Auditing Update;*
d. The CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network; and
e. Committees of professional associations generally commenting on exposure drafts in the past.

A7. This broad announcement was followed by direct mailings of the exposure draft to the members of the Earmarked Funds Task Force. A list of the participating agencies is provided at Appendix D.

A8. To encourage responses, a notice was sent to the FASAB's ListServ and to the FASAB's Twitter followers. In addition, a reminder was provided on August 16, 2011, to our Listserv. We also contacted affected agencies directly if a response had not been received by the date requested.

RESULT

A9. We received 23 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		3
Auditors	2	1
Preparers and financial managers	17	

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondents' comments are summarized below and are discussed in detail in the sections that follow.

A11. Terminology: All respondents agreed that the term "earmarked funds" should be changed, and most respondents agreed with the term "funds from dedicated collections."

A12. Appropriateness of Classifications:

a. All respondents agreed with the requirement for an external source of funding.

b. A majority of respondents agreed with the Board's proposal addressing the predominant source of funding when evaluating individual funds.

c. All respondents agreed with the exclusion of certain funds.

A13. Understandability:

a. A majority of respondents agreed with the Board's minority proposal to permit note-only reporting.

b. A majority of respondents agreed with the option of an alternative format of parenthetical amounts within line item titles.

A14. Eliminations: A majority of respondents agreed that combined or consolidated amounts may be reported and must be labeled accordingly.

A15. Other:

a. A majority of respondents agreed with an explicit requirement for data to be in sufficient detail to support government-wide reporting.

b. A majority of respondents agreed with the proposed effective date of fiscal year 2012.

Terminology – "Earmarked Funds" changed to "Funds from Dedicated Collections"

A16. The Board believes that the term "earmarked funds" has become confusing to readers because of the increasing focus on a similar term, "earmarking," which refers to earmarked spending. Earmarking occurs

when congressional direction (provided in legislation, report language or other communication) designates appropriations for a specific purpose. In contrast, the reporting requirements of SFFAS 27 are focused on collections that are distinct from the government's general revenues and are dedicated for a specific purpose.

A17. The Board believes that the new term, "funds from dedicated collections," is a unique and descriptive term that will not be confused with other commonly used terms. In addition, it explicitly states the reason for separate reporting (dedicated collections).

Appropriateness of Classifications

A18. A primary objective of SFFAS 27 was that:

> …under this standard the financial statements would thus present – in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use funds from dedicated collections for the designated activities, purposes or benefits.[4]

A19. The need for greater transparency was explained as follows:

> …the consolidated net position of the federal government reported on the U.S. government-wide financial statements does not include the effect of the claim on the U.S. Treasury that the various funds hold, just as the consolidated net position does not include the effect of other intragovernmental claims. Instead, the U.S. government-wide financial statements include the cumulative results of operations of earmarked funds – currently a large positive balance – as an offset against the cumulative results of operations of the general fund – currently a large negative balance. The result is that the financing provided by earmarked fund operations to general fund operations – which would otherwise be financed through the issuance of debt to the public, tax increases or other financing sources – is not shown on the face of the U.S. government balance sheet.[5]

A20. By providing separate presentation of the cumulative results of operations attributable to funds from dedicated collections, the commitment to restrict the use of net position, or "net assets," accumulated in funds from dedicated collections would be apparent. In developing SFFAS 27, the Board noted that a 2001 report identified three hundred and ninety-two possible funds from dedicated collections. Annual revenues and other financing sources for those funds ranged from negligible amounts to over half a trillion dollars. Accumulated balances ranged from zero to over a trillion dollars.[6] However, upon

[4] SFFAS 27, Basis for Conclusions, paragraph 63.
[5] SFFAS 27, Basis for Conclusions, paragraph 62.
[6] SFFAS 27, Basis for Conclusions, paragraph 3.

implementation in 2006, five of the sixteen largest funds from dedicated collections reported a negative net position.

A21. Not previously having been aware of funds from dedicated collections with negative net positions, staff questioned whether these funds are appropriately included as funds from dedicated collections. Further research showed that some of the funds with negative net positions did not receive any funding from dedicated collections. For example, the Department of Defense Medicare Eligible Retiree Health Care Fund receives income from three sources: an annual Treasury payment made on behalf of the military services at the beginning of the year based on average budgeted force strengths, annual payments from the Treasury to amortize the unfunded liability, and investment income on Treasury securities.

A22. The intent of SFFAS 27 was that the specifically identified revenues and other financing sources required to meet the criteria in paragraph 11 of SFFAS 27 should be from a source that is non-federal – that is, a source that is external to the federal government. Evidence of that intent is found in the SFFAS 27 explanation that such funding raises an expectation on the part of the public that the government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose.[7] However, SFFAS 27 did not explicitly state that a non-federal source of funds was required and current reporting practices vary. To ensure that funds reported as funds from dedicated collections are those where such a public expectation exists, this Statement provides amendments to SFFAS 27 to explicitly state that the source of the specifically identified revenues or other financing source must be external to the federal government, and to clarify the distinction between funds from dedicated collections and the general fund.

Funds with Mixed Sources of Funding

A23. In implementing SFFAS 27, agencies classified numerous funds primarily funded by general fund appropriations as funds from dedicated collections. The Board believes that guidance is needed for funds with mixed sources of funding (that is, a combination of (a) revenues and other financing sources that meet the criteria in paragraph 11 of SFFAS 27 ("non-federal") and (b) general fund appropriations ("federal")). In some such cases, the funding from non-federal sources is insignificant both to the component entity and the government as a

[7] SFFAS 27, Basis for Conclusions, paragraph 54.

whole. The Board believes that because a "fund" (usually associated with a Treasury account fund symbol) is the smallest financial accounting unit in the federal government, a fund with mixed sources of funding including dedicated collections presents special challenges in meeting the objectives of SFFAS 27. Conceptually, the portion representing dedicated collections should be separately identified. In the Board's view, separately accounting for the portion of these funds representing dedicated collections would impose reporting burdens in excess of any benefits. However, classifying both dedicated collections and general fund appropriations as "dedicated collections" would overstate restricted revenue in component entity reports.

A24. To avoid such overstatements while minimizing reporting burdens, the Board believes that to be classified as a fund from dedicated collections, a fund should be predominantly funded by revenues from non-federal sources that meet the definition and criteria in paragraph 11 of SFFAS 27 ("non-federal revenues"). However, if the non-federal revenues supporting the fund are material to the reporting entity, the Board believes that the fund should be classified as a fund from dedicated collections even if the non-federal revenues are not the predominant source of inflows of the fund for which they are collected. The Board believes that this approach will result in a cost-effective solution. Material non-federal revenues that meet the definition and criteria in paragraph 11 of SFFAS 27 will be disclosed and costs will not be incurred to provide special accountability for immaterial amounts of non-federal revenue that meet the criteria but are commingled with other financing sources provided through general fund appropriations. The Board has accordingly provided an exception to the "predominant source of funds" principle in cases where the revenue that meets the criteria of paragraph 11 of SFFAS 27 is material to the reporting entity. In such cases, such as Medicare Parts B and D, the entire fund should be included.

Funds Excluded

A25. The Board believes that funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian and military) should not be reported as funds from dedicated collections because such funds account for employee-employer transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraphs 56-96. SFFAS 5 addresses accountability for intra-governmental and employee contributions toward the cost of employee benefits and any resulting liabilities.

A26. In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that these funds reduce the cumulative amount to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes. Accordingly, this Statement provides that such funds should be excluded from the category of funds from dedicated collections.

Understandability

A27. Members of the task force expressed concerns regarding the understandability of the display of separate amounts on the face of the component entity financial statements for funds from dedicated collections and all other funds, as currently required by SFFAS 27. The task force believes that this adds complexity to an already challenging financial presentation. Further, it may prevent display of comparative financial statements on the same page. The task force believes that all information concerning funds from dedicated collections in the component entity financial statements should be disclosed in the notes.

A28. The Board believes that component entity financial statements need not display funds from dedicated collections and all other fund totals separately on each line item, provided that certain key data remains on the face of the statements. Component entity financial statements must be read with the understanding that they provide information about a single component of the federal government. Each component acts as an agent of that government and restrictions are placed on the use of most funds available to agencies whether the funds are from dedicated collections or not. While special accountability for the use of funds can be conveyed through component entity reports by presenting information on significant individual funds, the cumulative financial implications of total funds from dedicated collections are best understood from the government-wide perspective since the focus is on intra-governmental borrowing.

A29. However, the Board believes that users may be misled if a component entity has no information on the face of the basic financial statements about the magnitude of funds from dedicated collections that are reserved for use for designated activities, benefits, or purposes. Accordingly, the Board is requiring that component entities continue to report net position attributable to funds from dedicated collections on the balance sheet. In addition, the Board believes certain component entities

should continue to report funds from dedicated collections separately on the face of the statement of changes in net position, and that component entities not required to report on the face of the statement should include a reference to the note on the face of the statement of changes in net position.

Eliminations

A30. SFFAS 27 provided confusing guidance on eliminations for component entities by implying that the funds from dedicated collections disclosure should include eliminations between funds from dedicated collections and all other funds. Practice has varied as a result. The amendments eliminate the confusing guidance and instead provide that combined or consolidated totals are permitted so long as they are properly labeled.

A31. The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[8]

A32. Another objective of SFFAS 27 relates to special accountability:

> All earmarked funds have characteristics that justify special accountability. While many government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The government raises an expectation on the part of the public that the government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose.[9]

A33. The above objectives of SFFAS 27 focus primarily on the accumulated net position of funds from dedicated collections. Because net position is not affected by eliminations, presentation of eliminations is not necessary to meet the objectives of SFFAS 27. In addition, because the focus of special accountability is necessarily on individual funds (or programs) – members question whether the consolidated total is useful for assessing the status of funds from dedicated collections available for the individual purposes established in law.

[8] SFFAS 27, Basis for Conclusions, paragraph 63.
[9] SFFAS 27, Basis for Conclusions, paragraph 54.

A34. Members believe that a broader study of fund reporting is needed. Specifically, a fund reporting project would address the question of whether consolidated or combined amounts are more useful when reporting on a specific class of funds. Until such a study is completed, the Board believes it is acceptable to report either consolidated or combined amounts and the amounts must be labeled accordingly.

Support for Government-wide Reporting

A35. To address concerns expressed by representatives of the Department of the Treasury, this Statement also proposes amendments to explicitly require that component entity reporting should fully support the required government-wide reporting on funds from dedicated collections in accordance with paragraphs 29 – 33 of SFFAS 27.

Board Approval

A36. This Statement was approved for issuance by all members of the Board. Written ballots are available for public inspection at the FASAB's offices.

Appendix B: Text of SFFAS 27 Accounting Standards, as Amended

Definition of Funds from Dedicated Collections

11. Generally, funds from dedicated collections are financed by specifically identified revenues,[3a] provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the federal government's general revenues. The three required criteria for a fund from dedicated collections are:

    1. A statute committing the federal government to use specifically identified revenues and/or other financing sources that are originally provided to the federal government by a non-federal source[3b] only for designated activities, benefits or purposes;
    2. Explicit authority for the fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
    3. A requirement to account for and report[4] on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the federal government's general revenues.

    Footnote 3a: Such specifically identified revenues can be either exchange or nonexchange.

    Footnote 3b: In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

    Footnote 4: A "report" may be something other than stand-alone financial statements for the fund from dedicated collections.

Application of the Definition

12. The requirement to account for revenues and other financing sources that are statutorily available only for designated activities, benefits or purposes is usually created by statute. A fund from dedicated collections may be classified in the statute, the unified budget, or both, as a trust, special, or

public enterprise fund. Application of this standard, however, shall not be based on how a statute or the unified budget labels the fund. Rather, the Board intends that the term "funds from dedicated collections" be applied based on the substance of the statute and consistent with the three criteria described above.

13. **Fund** in this Statement's definition of funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[5] Classification and reporting should be made at the level of an individual fund. A fund should be classified as a "fund from dedicated collections" if it meets the criteria in paragraphs 11.2 and 11.3 and either:

    1. its predominant sources of revenue and other financing sources are non-federal sources meeting the paragraph 11.1 criterion, or

    2. it has non-federal revenue and other financing sources meeting the paragraph 11.1 criterion[5a] that are material to the reporting entity.

    For example, as currently funded, Medicare Parts B and D do not have non-federal sources as described in paragraph 11 as their predominant revenue and other financing sources. However, Medicare Parts B and D do have revenue and other financing sources material to the reporting entity that meet the criteria in paragraph 11. Therefore, Medicare Parts B and D should be classified as funds from dedicated collections.

    Footnote 5: National Council on Governmental Accounting Statement 1, par. 16.

    Footnote 5a: In situations where there is a mixed source of funding (so that not all of the revenue and other financing sources meet the criteria in paragraph 11) and the proportion and/or amounts of funding sources vary from year to year so that it is difficult to determine a predominant source and/or assess materiality, acceptable options for classification include but are not limited to:

    1. long-term expectations rather than periodic results that may fluctuate
    2. 36-month averages

    Changes in classification of funds from year to year should be disclosed.

Distinct from the General Fund

14. Whereas funds from dedicated collections are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not dedicated by law for a specific purpose and by the proceeds of general borrowing. Although there are exceptions, funding decisions

regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing funds from dedicated collections reflects a longer (if not indefinite) government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Funds from dedicated collections may be given authority to make expenditures by means of a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the budget authority is provided by authorizing legislation or annual appropriations acts, the funds are reserved or restricted to the designated activity, benefit or purpose.

Distinct from Fiduciary Activities

15. The activity of funds from dedicated collections differs from fiduciary activities primarily in that in funds from dedicated collections, fund assets are government-owned. A fiduciary activity is the collection or receipt, management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold.[6] Therefore, even though a fund from dedicated collections is designated exclusively for a specific activity, benefit or purpose, the federal government does not have a fiduciary relationship with the individuals or groups who potentially will benefit from the fund.

Footnote 6: See SFFAS 31, Accounting for Fiduciary Activities, for more on fiduciary activity in the federal government and the differences between private trust funds and federal government trust funds.

Distinct from Private Sector Trust Funds

16. Although funds from dedicated collections are predominantly in funds that are designated by law as trust funds, the meaning of the term “trust” in the federal government differs significantly from its meaning in the private sector. Whereas funds from dedicated collections in the federal government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship.

17. A fund from dedicated collections should not be characterized as a “trust” in general purpose external financial reports of federal entities. (The use of the term “trust fund” is acceptable only in the fund’s official title.)

Exclusions from Reporting Requirements

18. Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds are excluded because they are revolving funds that conduct business primarily within and between government agencies. Credit financing accounts are also excluded. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to federal credit programs. Fiduciary funds, which are not government-owned, are also excluded. Funds established to account for pensions, other retirement benefits, other postemployment benefits, and other employee benefits provided to federal employees (civilian or military) should not be classified as funds from dedicated collections because such funds account for employer-employee transactions and requirements tailored to those transactions are provided by SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 56-96.[6a] In addition, because these funds recognize significant long-term liabilities, the large negative net position offsets much of the generally positive net position of other funds from dedicated collections. The result at the government-wide level is that the large negative net position of these funds obscures the large cumulative amount that needs to be repaid by the general fund in order for the dedicated collections to be used for their intended purposes.

Footnote 6a: Because classification and reporting should be made at the level of an individual fund, portions of funds, such as the Federal Employees Compensation Account portion of the Unemployment Trust Fund, should not be excluded because of this provision.

Reporting for Funds from Dedicated Collections

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

19. The portion of cumulative results of operations and unexpended appropriations attributable to funds from dedicated collections should be shown separately on the balance sheet. This standard does not require funds from dedicated collections to be separately shown on the statement of net cost. Non-exchange revenue and other financing sources, including appropriations, and net cost of operations for funds from dedicated collections should be shown separately on the statement of changes in net position if:

    1. dedicated collections are the predominant source of revenue and other financing sources for the **component entity**, or
    2. one or more of the entity's funds from dedicated collections

a. is of immediate concern to constituents of the fund,

b. is politically sensitive or controversial,

c. is accumulating large balances, or

d. the information provided in the financial statements would be a primary source of financial information for the public.

For example, the Social Security and Medicare programs are of immediate concern to their constituents; both programs have a direct current or future impact on the majority of the general public.

19a. Entities may present combined or consolidated amounts and the presentation must be labeled accordingly.

19b. Component entities that do not separately show amounts from dedicated collections on the statement of changes in net position should refer on the face of the statement of changes in net position to the note on funds from dedicated collections.

20. Most revenues and other financing sources that are dedicated collections are reported in the basic financial statements of the entity carrying out the program and responsible for administration of the fund. If more than one component entity is responsible for carrying out the program financed with revenues and other financing sources that are dedicated collections, and the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.[7]

Footnote 7: To determine program management/accounting responsibility, agencies should consider the legislation authorizing the program; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display,* as amended by this standard.

Disclosure

21. A component entity should disclose[8] all funds from dedicated collections for which it has program management responsibility by either a list (by official title) or a statement indicating where the list can be obtained (e.g., a website reference or contact information). A fund from dedicated collections should not be characterized as a "trust" in general purpose external financial reports of federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Footnote 8: Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

22. Information should be disclosed for each individual fund from dedicated collections. An exception is provided for component entities having numerous individual funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all the entity's funds from dedicated collections:

    1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.

    2. Condensed information providing gross cost, exchange revenue, net cost of operations, nonexchange revenues by major type and all other, other financing sources by major type and all other, and change in net position.

    Entities may present combined or consolidated amounts and the presentation must be labeled accordingly. The information required by this paragraph for funds from dedicated collections may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying notes. The information must be in sufficient detail to support reporting requirements for the U.S. government-wide financial statements in paragraphs 29 and 30. Information for funds not presented individually may be aggregated. The total net position shown in the note disclosure should agree with the total net position for funds from dedicated collections shown on the face of the component entity's balance sheet. [9]

    Footnote 9 was rescinded by SFFAS 43, *Revisions to Identifying and Reporting Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27.*

23. The following information should be disclosed for each individually reported fund from dedicated collections, or portion thereof, for which a component entity has program management responsibility (see paragraph 24).

    1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.

    2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the government or the result of intragovernmental flows.

3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.

24. Selecting funds from dedicated collections to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to:

a. quantitative factors such as

1. the percentage of the reporting entity's revenues from dedicated collections or

2. cumulative results of operations from such funds; and

b. qualitative factors such as

1. whether a fund from dedicated collections is of immediate concern to constituents of the fund,

2. whether it is politically sensitive or controversial,

3. whether it is accumulating large balances, or

4. whether the information provided in the financial statements would be the primary source of financial information for the public.

25. The total net position of all funds from dedicated collections shown in the note disclosure should agree with the net position of funds from dedicated collections shown on the face of the component entity's balance sheet.

26. In accordance with the provisions of paragraph 20 or footnote 5a of paragraph 13, if a component entity reports a different portion of a program funded by dedicated collections than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change. This applies if a component entity does not report a fund from dedicated collections that it reported in the previous year. It also applies if a component entity reports a fund from dedicated collections that it did not report in the previous year.

Note on Investments

27. Investments in Treasury securities for funds from dedicated collections should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with funds from dedicated collections.

Instead, the cash generated from such funds is used by the U.S. Treasury for general government purposes.

- Treasury securities are issued to the fund as evidence of dedicated collections and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).

- Treasury securities held by a fund from dedicated collections are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. government-wide financial statements.

- When the fund from dedicated collections redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.

28. Below is one example of a note that addresses the points in paragraph 27 above.

Intra-governmental Investments in Treasury Securities

The federal government does not set aside assets to pay future benefits or other expenditures associated with funds from dedicated collections (or name/s of fund/s). The dedicated cash receipts collected from the public into the fund are deposited in the U.S. Treasury, which uses the cash for general government purposes. Treasury securities are issued to the (component entity) as evidence of its receipts. Treasury securities are an asset to the (component entity) and a liability to the U.S. Treasury. Because the (component entity) and the U.S. Treasury are both parts of the government, these assets and liabilities offset each other from the standpoint of the government as a whole. For this reason, they do not represent an asset or a liability in the U.S. government-wide financial statements. Treasury securities provide the (component entity) with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the (component entity) requires redemption of these securities to make expenditures, the government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the government finances all other expenditures.

Financial Statement Presentation and Disclosures for the U.S. Government-wide Financial Statements

Financial Statement Presentation

29. Funds from dedicated collections should be shown separately on the U.S. government statement of operations and changes in net position. The portion of net position attributable to funds from dedicated collections should be shown separately on the U.S. government balance sheet.[10] (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)

    Footnote 10: Net position is composed of unexpended appropriations and cumulative results of operations for component entities. Since unexpended appropriations are not applicable at the U. S. government-wide level, net position equals cumulative results of operations.

Disclosure

30. Specific information should be disclosed for selected funds from dedicated collections. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual funds from dedicated collections, in aggregate for all remaining funds from dedicated collections, and in total for all funds from dedicated collections.

    1. Condensed information about assets, liabilities and net position.
    2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

    The disclosure may present combined or consolidated amounts and the presentation must be labeled accordingly

31. The information for funds from dedicated collections should be disclosed in the notes accompanying the basic financial statements. Information for funds not shown individually may be aggregated (see paragraph 24). A total column should be presented that relates the disaggregated data to the data on the face of the principal financial statements. The net position shown in the note disclosure should agree with the portion of net position attributable to funds from dedicated collections shown on the face of the balance sheet.

32. A note disclosure should provide a reference to component reports for additional information about individual funds from dedicated collections.

33. A note disclosure should provide a general description of funds from dedicated collections and an explanation of how the federal government as a

whole could provide the resources represented by the balance in Treasury securities held by funds from dedicated collections.

34. A fund from dedicated collections should not be characterized as a "trust" in general purpose external financial reports of federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Basis of Accounting

35. All amounts reported and disclosed in the reporting entity's basic financial statements or the notes thereto, as required in paragraphs 19 through 34, should be recognized and measured using the standards provided in generally accepted accounting principles applicable to the federal government.

Effective Date and Implementation

36. This standard is effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

Effect on Existing Standards

37. [Paragraph 37 was superseded by paragraph 34 of SFFAS 31, which rescinded paragraphs 83 through 87 of SFFAS 7.]

38. This standard amends Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, footnote 3, as follows:

> For some trust funds, the collection of the revenues is performed by an organizational entity acting in a custodial capacity that differs from the organizational entity that administers the trust fund. In those instances, the organizational entity that collects the revenue would be responsible for reporting only the collection and subsequent disposition of the funds. The organizational entity responsible for carrying out the program(s) financed by a trust fund, ~~or in the case of multiple responsible entities, the entity with the preponderance of fund activity,~~ will report all assets, liabilities, revenues and expenses of the fund, notwithstanding the fact that another entity has custodial responsibility for the assets. In the case of multiple responsible entities, if the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of SFFAS 27, *Identifying and Reporting Funds from Dedicated Collections*. If

separate portions cannot be identified, the component entity with program management responsibility should report the fund.

39. This standard amends SFFAC 3, *Management's Discussion and Analysis-Concepts*, paragraph 26 as follows:

> Financial Results, Position and Condition-MD&A should help those who read it to understand the entity's financial results and financial position and the entity's effect on the financial position and condition of the government. It should give readers the benefit of management's understanding of the significance and potential effect from both a short- and a long-term perspective of:
>
> - the variations discussed in paragraph 14 in terms of major changes in types or amounts of assets, liabilities, costs, revenues, obligations and outlays;
>
> - particular balances and amounts shown in the basic financial statements, including the notes, such as those dealing with ~~earmarked funds~~ dedicated collections, if relevant to important financial management issues and concerns; and
>
> - the entity's required supplementary stewardship information (because RSSI describes economic conditions that cannot be expressed in the basic financial statements).

The provisions of this Statement need not be applied to immaterial items.

Appendix C: Illustrative Component Entity Financial Statements

Component entities have the option to use separate lines or columns to display information on funds from dedicated collections on the face of the balance sheet and statement of changes in net position (Option A), or to use an alternative format, such as parenthetical amounts within line item titles.(Option B).

The following examples are illustrative only and are intended to show how the information required in paragraph 19 might be displayed. These examples are not intended to be all inclusive and other acceptable alternatives may be developed by preparer.

Note: Although these illustrations show combined totals for dedicated collections and all other funds where those two categories of funds are reported separately, component entities may also opt to report consolidated amounts for dedicated collections and all other funds, respectively (i.e., after eliminations within each category of funds). Regardless of whether combined or consolidated amounts are reported for each category of funds, entity-wide totals for all funds should be consolidated amounts.

Option A: Illustrative Balance Sheet with Amounts in Separate Lines

	FY 2XX1	FY 2XX0
Entity assets:		
Fund balance with Treasury	$xxx	$xxx
Cash (and other monetary assets)	xxx	xxx
Investments:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Inventories and related properties	xxx	xxx
Physical assets	xxx	xxx
Total entity assets	**xxx**	**xxx**
Non-entity assets:		
Fund balance with Treasury	xxx	xxx
Cash	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx

Total non-entity assets	**xxx**	**xxx**
Total assets	**$xxx**	**$xxx**

	FY 2XX1	FY 2XX0
LIABILITIES:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	$xxx	$xxx
Governmental liabilities:		
Payables	xxx	xxx
Total liabilities covered by budgetary resources	**xxx**	**xxx**
Liabilities not covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	xxx	xxx
Governmental liabilities:		
Payables	xxx	xxx
Amounts held for others	xxx	xxx
Total liabilities not covered by budgetary resources	**xxx**	**xxx**
Total liabilities	**xxx**	**xxx**

NET POSITION		
Unexpended appropriations - Funds from Dedicated Collections (Combined Totals)– See Note X	xx	xx
Unexpended appropriations – All Other Funds (Combined Totals)	xx	xx
Cumulative results of operations - Funds from Dedicated Collections (Combined Totals) – See Note X	xx	xx
Cumulative results of operations – All Other Funds (Combined Totals)	xx	xx
Total Net Position – Funds from Dedicated Collections (Combined Totals) – See Note X	xx	xx
Total Net Position – All Other Funds (Combined Totals)	xx	xx
Total Net Position	xxx	xxx
Total liabilities and net position	**$xxx**	**$xxx**

Option B: Illustrative Balance Sheet with Parenthetical Amounts

	FY 2XX1	FY 2XX0
Entity assets:		
Fund balance with Treasury	$xxx	$xxx
Cash (and other monetary assets)	xxx	xxx
Investments:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Inventories and related properties	xxx	xxx
Physical assets	xxx	xxx
Total entity assets	**xxx**	**xxx**
Non-entity assets:		
Fund balance with Treasury	xxx	xxx
Cash	xxx	xxx
Receivables:		
Intragovernmental	xxx	xxx
With the public	xxx	xxx
Total non-entity assets	**xxx**	**xxx**
Total assets	**$xxx**	**$xxx**
LIABILITIES:		
Liabilities covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	$xxx	$xxx
Governmental liabilities:		
Payables	xxx	xxx
Total liabilities covered by budgetary resources	**xxx**	**xxx**

	FY 2XX1	FY 2XX0
Liabilities not covered by budgetary resources:		
Intragovernmental liabilities:		
Payables	xxx	xxx
Governmental liabilities:		
Payables	xxx	xxx
Amounts held for others	xxx	xxx
Total liabilities not covered by budgetary resources	**xxx**	**xxx**
Total liabilities	**xxx**	**xxx**
NET POSITION		
Unexpended appropriations (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) – See Note X)	xxx	xxx
Cumulative results of operations (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) - See Note X)	xxx	xxx
Total net position (Includes Funds from Dedicated Collections of $XX in FY 2XX1 and $XX in FY 2XX0 (Combined Totals) - See Note X)	**xxx**	**xxx**
Total liabilities and net position	**$xxx**	**$xxx**

Option A: Illustrative Statement of Changes in Net Position with Amounts in Separate Columns

Note: Certain component entities are not required to report on the face of the Statement of Changes in Net Position. Entities may present combined or consolidated amounts and the presentation must be labeled accordingly.

FY 2XX1	Funds from Dedicated Collections (Combined Totals) (See Note X)	All Other Funds (Combined Totals)	Eliminations	Consolidated Totals
Cumulative Results of Operations:				
Beginning balance, as adjusted	xxx	xxx	x	xxx
Budgetary Financing Sources:				
Other adjustments	xxx	xxx	x	xxx
Appropriations used	xxx	xxx		xxx
Non-exchange revenue	xxx	xxx	x	xxx
Donations and forfeitures of cash and cash equivalents	xxx	xxx		xxx
Transfers in/out without reimbursement	xxx	xxx	x	xxx
Other	xxx	xxx	x	xxx
Other Financing Sources (Non-Exchange)				
Donations and forfeitures of property	xxx	xxx		xxx
Transfers in/out without reimbursement	xxx	xxx	x	xxx
Imputed financing	xxx	xxx	x	xxx
Other	xxx	xxx	x	xxx
Total Financing Sources	xxx	xxx	x	xxx
Net Cost of Operations	xxx	xxx	x	xxx
Net Change	xxx	xxx	x	xxx
Cumulative Results of Operations	xxx	xxx	x	xxx
Unexpended Appropriations:				
Beginning Balance	xxx	xxx	x	xxx
Budgetary Financing Sources:				
Appropriations received	xxx	xxx	x	xxx
Appropriations transferred in/out	xxx	xxx	x	xxx
Other adjustments	xxx	xxx	x	xxx
Appropriations used	xxx	xxx		xxx
Total Budgetary Financing Sources	xxx	xxx	x	xxx
Total Unexpended Appropriations	xxx	xxx	x	xxx
Net Position	xxx	xxx	x	xxx

Option B: Illustrative Statement of Changes in Net Position with Parenthetical Amounts

Note: Certain component entities are not required to report on the face of the Statement of Changes in Net Position.

	FY 2XX1	FY 2XX0
Cumulative Results Of Operations:		
Beginning balance, as adjusted (includes Funds from Dedicated Collections of of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Budgetary Financing Sources:		
Other adjustments	xxx	xxx
Appropriations used	xxx	xxx
Non-exchange revenue	xxx	xxx
Donations and forfeitures of cash and cash equivalents	xxx	xxx
Transfers in/out without reimbursement	xxx	xxx
Other	xxx	xxx
Other Financing Sources (Non-Exchange):		
Donations and forfeitures of property	xxx	xxx
Transfers in/out without reimbursement	xxx	xxx
Imputed financing	xxx	xxx
Other	xxx	xxx
Total Financing Sources (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Net Cost of Operations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) – See Note X)	xxx	xxx
Net Change	xxx	xxx
Cumulative Results of Operations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Unexpended Appropriations:		
Beginning Balance (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) – See Note X)	xxx	xxx
Budgetary Financing Sources:		
Appropriations received	xxx	xxx
Appropriations transferred in/out	xxx	xxx
Other adjustments	xxx	xxx
Appropriations used	xxx	xxx
Total Budgetary Financing Sources (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Total Unexpended Appropriations (includes Funds from Dedicated Collections of $XX in FY XXXX and $XX in FY XXXX (Combined Totals) - See Note X)	xxx	xxx
Net Position	xxx	xxx

Appendix D: Earmarked Funds Task Force Participating Agencies

U.S. Department of Agriculture
Department of Commerce
Commodity Futures Trading Commission
Department of Defense
Department of Energy
Environmental Protection Agency
Federal Communications Commission
Government Accountability Office
Department of Health and Human Services
Department of Homeland Security
Department of Housing and Urban Development
Department of the Interior
Department of Justice
Department of Labor
Office of Management and Budget
Office of Personnel Management
Railroad Retirement Board
Securities and Exchange Commission
Social Security Administration
State Department
Department of Transportation
Treasury Department (main Treasury and CFR reporting)
Department of Veterans Affairs

Appendix E: Abbreviations

FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

Appendix F: Glossary

Component entities - The term "component entity" is used to distinguish between the U.S. federal government and its components. The U.S. federal government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, Entity and Display, pars. 11-12). Use of "component entity" in this standard is only intended to distinguish between the U.S. federal government's consolidated financial statements and financial statements of its components.

Dedicated Collections - Dedicated collections are specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the government's general revenues. The three required criteria for funds from dedicated collections are:

1. A statute committing the federal government to use specifically identified revenues and or other financing sources that are originally provided to the federal government by a non-federal source* only for designated activities, benefits or purposes;
2. Explicit authority for the fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the fund from the government's general revenues.

*In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).

Fund - Fund in this Statement's definition of funds from dedicated collections refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or

balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[10]

[10] National Council on Governmental Accounting Statement 1, par. 16.

FASAB Board Members

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D. Scott Showalter

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Eileen W. Parlow

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use

Statement of Federal Financial Accounting Standards 44

January 3, 2013

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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Table of Contents

Summary 4

Introduction 5

Purpose 5

Materiality 5

Effective Date 6

Standards 7

Scope and Applicability 7

Definition of Impairment 7

Identification of Potential Impairment Loss – A Two-step Process 8

Determining the Appropriate Measurement Approach 11

Recognizing and Reporting Impairment Losses 14

Diminished Service Utility Without Recognized Impairment Loss 14

G-PP&E That No Longer Provides Service 15

Remediating Previously Reported Impairments 15

Recoveries 15

Consolidated Financial Report of the U.S. Government 15

Effective Date 15

Appendix A: Basis for Conclusions 16

Table 1.0 - Summary of Respondent Types to Exposure Draft 27

Appendix B: Flowcharts, Decision Table and Illustrations 31

Appendix C: Abbreviations 70

Appendix D: Glossary 71

This is the original Statement;
please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_44.pdf.

Summary

This Statement establishes accounting and financial reporting standards for impairment of general property, plant, and equipment (G-PP&E) remaining in use, except for internal use software. G-PP&E is considered impaired when there is a significant and permanent decline in the service utility of G-PP&E or expected service utility for construction work in progress. A decline is permanent when management has no reasonable expectation that the lost service utility will be replaced or restored. [1]

This Statement does not anticipate that entities will have to establish additional or separate procedures beyond those that may already exist, such as those related to deferred maintenance and repairs, to search for impairments. Impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonably assure identification and communication of potential material impairments, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. Management may determine that existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments and implement appropriate additional processes and internal controls.

Entity management should consider documenting the decisions it makes while determining how to implement the requirements of this Statement. Such decisions should include consideration of materiality. Materiality considerations should include an assessment of the impact to the cost of service(s) before and after the impairment.

Recognition of impairment losses is dependent upon a two-step process that entails (a) identifying potential impairments and (b) testing for impairment. The losses should be reasonably estimated by determining the portion of the decline in the net book value of the G-PP&E attributable to the lost service utility.

This Statement improves financial reporting by requiring entities to report the effects of G-PP&E impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the G-PP&E or upon disposal of the G-PP&E. This will enable users of financial statements to discern the cost of impairments when they occur, the financial impact on the reporting entity, and the cost of services provided following the impairment. This Statement also enhances comparability of financial statements between entities by requiring all entities to account for impairments in a similar manner.

[1] This Statement should not be directed to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

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Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment,* contains principles-based guidance concerning **general property, plant, and equipment (G-PP&E)**[2] that is removed from service due to **total (full) impairment** of G-PP&E or other reasons. SFFAS 6 requires that G-PP&E be removed from G-PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement, or removal from service it no longer provides service in the operations of the entity.[3] SFFAS 6 does not address situations where there is less than total (full) impairment of G-PP&E.

2. SFFAS 10, *Accounting for Internal Use Software,* provides guidance for the impairment of **internal use software**.[4] This Statement does not alter existing requirements regarding internal use software.

3. This Statement provides accounting and reporting requirements for **partial impairments** of G-PP&E remaining in use and construction work-in-process.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to

[2] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[3] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment,* which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

[4] SFFAS 10, at paragraphs 28 through 31, provides additional procedures for recognizing and measuring impairment related to internal use software. The provisions in SFFAS 10 and SFFAS 6 are the same regarding situations where the software or G-PP&E is impaired and will be removed from service in its entirety. Both standards provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, SFFAS 10 also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

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which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

5. The standards are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

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Standards

Scope and Applicability

6. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

7. This Statement applies to G-PP&E[5] except internal use software. This Statement establishes guidance on accounting for the impairment of G-PP&E remaining in use, including construction work in process. The provisions of this Statement are to be applied when indicators of potential impairment, as specified in this Statement, are identified by the entity. The entity is not required to conduct an annual or other periodic survey solely for the purpose of applying these standards. Existing processes that may identify indicators for potential impairment include routine assessments regarding the continued operational and functional capacity of G-PP&E, entity mission requirements, impacts of significant events or changes in circumstances, and deferred maintenance and repairs. The results of such processes may serve as the basis for applying these standards.

Definition of Impairment

8. **Impairment** is a significant[6] and permanent decline in the **service utility** of G-PP&E, or expected service utility for construction work in process. Entities generally hold G-PP&E because of the services they provide or will

[5] G-PP&E is any property, plant, and equipment (PP&E) used in providing goods or services and includes, among other types of PP&E, multi-use heritage assets, capitalized improvements to stewardship land, and construction work-in-process. PP&E includes land and land rights that are acquired for or in connection with items of G-PP&E used to provide government services or goods. G-PP&E does not include heritage assets, such as historic and national landmarks, and stewardship land; reporting for these assets should be in accordance with SFFAS 29, *Heritage Assets and Stewardship Land*. The cost of G-PP&E is capitalized, i.e., recorded as assets on the balance sheet. For detailed characteristics of and accounting for G-PP&E, see SFFAS 6, par. 23 through 45.

[6] The determination of whether or not an item is significant is a matter of professional judgment. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations. Determining if a decline in service utility is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

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provide in the future; consequently, impairments affect the service utility of the G-PP&E. The events or changes in circumstances that lead to impairments are not considered normal and ordinary.[7] That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating its useful life.

9. The service utility of G-PP&E is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the **level of utilization**, which is the portion of the usable capacity currently being used. The current usable capacity of G-PP&E may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws, or regulations or other changes in environmental or economic factors, or change in the manner or duration of use. Usable capacity may be different from maximum capacity[8] in circumstances in which surplus capacity (the excess capacity over the usable capacity) is needed for safety, economic, operational readiness or other reasons. G-PP&E that experience decreases in utilization, and the simultaneous existence of or increases in surplus capacity not associated with a decline in service utility are not considered impaired.

Identification of Potential Impairment Loss – A Two-step Process

10. Generally, G-PP&E remaining in use is impaired if the decline in the service utility of the G-PP&E is significant and deemed permanent.

11. The determination of whether G-PP&E remaining in use is impaired, as defined in paragraph 8 above, includes (a) identifying potential impairment indicators and (b) testing for impairment. G-PP&E would be identified as potentially impaired as a result of the occurrence of significant events or changes in circumstances, or routine asset management processes.

[7] Normal and ordinary are defined as events or circumstances that fall within the expected useful life of the PP&E such as standard maintenance and repair requirements.

[8] Maximum capacity is the usable capacity plus any surplus capacity.

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Step 1 – Identify Indicators of Potential Impairment

12. Some common indicators of potential impairment include those listed below. The indicators identified are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment is necessary given the circumstances.

    a. evidence of physical damage
    b. enactment or approval of laws or regulations which limit or restrict G-PP&E usage
    c. changes in environmental or economic factors
    d. technological changes or evidence of obsolescence[9]
    e. changes in the manner or duration of use of G-PP&E
    f. construction stoppage or contract termination
    g. G-PP&E idled or unserviceable for excessively long periods[10]

G-PP&E Identified From Significant Events or Changes in Circumstances

13. Events or changes in circumstances affecting G-PP&E that may indicate impairment are sometimes significant. Significant events or changes in circumstances are conspicuous or known to the entity's management or oversight entities. This Statement does not require entities to conduct an annual or periodic survey solely to identify potential impairments of G-PP&E. Rather, significant events or changes in circumstances affecting G-

[9] Technological changes or evidence of obsolescence should be considered along with other factors when assessing impairment. For example, if obsolete G-PP&E continues to be used, the service utility expected at acquisition may not be diminished. Further, when obsolescence is expected, the declining service utility of G-PP&E subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as its utility diminishes when compared to that of later versions of the same asset.

[10] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

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PP&E that may indicate impairment are conspicuous or known to the entity's management or oversight entities and are generally expected to have prompted consideration[11] by management, oversight entities, or others (e. g., the media).

G-PP&E Identified from Asset Management Reviews (e.g., portfolio surveys)

14. Existing asset management processes may include portfolio surveys that consider matters such as the continued operational and functional capacity of G-PP&E, entity mission requirements, or deferred maintenance and repairs assessments. Potentially impaired G-PP&E may be identified from such surveys and further evaluated through the two-step process.

Reduced Demand Should Not Be Considered a Discrete or Sole indicator of Impairment

15. As explained in paragraph 9 above, reduced demand for the services of G-PP&E should not be considered a discrete or sole indicator of impairment. Instead, there should also be evidence of an underlying potential impairment resulting in the reduced demand. In these circumstances, the causes behind such changes in demand should be evaluated in light of the indicators listed in paragraph 12 and the G-PP&E should be tested for impairment.

Step 2 - Impairment Test

16. G-PP&E identified through the processes described in paragraphs 10 through 15 should be tested for impairment by determining whether the following two factors are present:

    a. **The magnitude of the decline in service utility (as defined in par. 9) is significant**. The costs are now disproportionate to the new expected service utility. Such costs should include operational and maintenance costs. Judgment is required to determine whether the decline is significant. Such judgments may be based on: (1) the relative costs of

[11] Consideration might include but is not limited to management discussions, internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

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providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations.

b. **The decline in service utility is expected to be permanent.** The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored. That is, management expects that the G-PP&E will remain in service so that its remaining service utility will be utilized. In contrast, reasonable expectation that the lost service utility will be replaced or restored may exist when management has: (1) specific plans to replace or restore the lost service utility of this G-PP&E, (2) committed or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E.

17. For construction work in process, the testing of impairment discussed in paragraph 16 above should be performed over the period of expected future service utility rather than current service utility.

Determining the Appropriate Measurement Approach

18. Impairment losses on G-PP&E that will continue to be used by the entity[12] should be estimated using a measurement method that reasonably[13] reflects the diminished service utility of the G-PP&E. The goal of the measurement methods discussed below is to reasonably estimate the portion of the net book value associated with the diminished service utility of the G-PP&E. A specific method, including one of the methods listed below, would not be considered appropriate if it would result in an unreasonable net book value associated with the remaining service utility of the G-PP&E. Within an entity, one method may not be appropriate for measuring all impairments. Also, a reasonable method may nonetheless result in no impairment loss to be recognized. Regardless of the method used, recognition of the loss should be limited to the asset's net book value at the time of impairment. Widely recognized methods for measuring impairment include:

a. **Replacement approach.** Impairment of G-PP&E with physical damage generally may be measured using a replacement approach. This approach

[12] See SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 38 and 39 for guidance regarding G-PP&E that will not continue to be used by the entity.

[13] Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.

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uses the estimated cost to replace the lost service utility of the G-PP&E at today's standards[14] to identify the portion of the historical cost of the G-PP&E that should be written off. For federal real property purposes, this cost can be derived from the plant replacement value (PRV). This estimate can be converted to historical cost by restating (i.e., deflating) the estimated cost to replace the diminished service utility using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of the estimated cost to replace the diminished service utility over total estimated cost to replace the G-PP&E, to the net book value of the G-PP&E.

b. **Restoration approach.** Impairment of improvements made to stewardship land and multi-use heritage assets with physical damage may generally be measured by using a restoration approach. This approach uses the estimated cost to restore the diminished service utility of the G-PP&E to identify the portion of the historical cost of the G-PP&E that should be written off. This approach does not include any amounts attributable to improvements and additions to meet today's standards. The estimated restoration cost can be converted to historical cost by restating (i.e., deflating) the estimated restoration cost using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of estimated restoration cost to restore the diminished service utility over total estimated restoration cost to the net book value of the G-PP&E.

c. **Service units approach.** Impairment of G-PP&E that are affected by enactment or approval of laws or regulations or other changes in environmental/economic factors or are subject to technological changes or obsolescence generally may be measured using a service units approach. This approach compares the service units provided by the G-PP&E before and after the impairment event or change in circumstance to isolate the historical cost of the service utility of the G-PP&E that cannot be used due to the impairment event or change in circumstance. The amount of impairment is determined by evaluating the service provided by the G-PP&E - either maximum estimated service units or total estimated service units throughout the life of the G-PP&E - before and after the event or change in circumstance.

[14] For example, *"at today's standards"* would generally mean the use of current market prices for materials, labor, manufactured items and equipment using current building, manufacturing, or fabrication techniques in compliance with current statutory, regulatory, or industry standards.

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d. **Deflated depreciated current cost approach.** Impairment of G-PP&E that are subject to a change in manner or duration of use generally may be measured using a deflated depreciated current cost approach. This approach quantifies the cost of the service currently being provided by the G-PP&E and converts that cost to historical cost. A current cost for a G-PP&E to replace the current level of service is estimated. This estimated current cost is then depreciated to reflect the fact that the G-PP&E is not new, and then is subsequently deflated to convert it to historical cost dollars. A potential impairment loss results if the net book value of the G-PP&E exceeds the estimated historical cost of the current service utility (i.e., deflated depreciated current cost).

e. **Cash flow approach**. Impairment of cash or revenue generating G-PP&E, such as those used for business or proprietary-type activities, may be assessed using a cash flow approach. Under this approach, an impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value[15] or value-in-use estimate.[16] The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-PP&E. That assessment should be based on the net book value of the G-PP&E at the date it is tested for recoverability, whether in use or under development. If the net book value is not recoverable, the impairment loss is the amount by which the net book value of the G-PP&E exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E's net realizable value or value-in-use estimate.

f. **Lower of (1) Net Book Value or (2) Higher of Net Realizable Value or Value-in-Use Approach.** G-PP&E impaired from either construction

[15] Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal.

[16] Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

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stoppages or contract terminations, which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate. Impaired G-PP&E, which are not expected to provide service, should be accounted for and reported in accordance with SFFAS 6.

Recognizing and Reporting Impairment Losses

19. The loss from impairment should be recognized and reported in the statement of net cost when management concludes that the impairment is (1) a significant decline in service utility and (2) expected to be permanent. Such loss may be included in program cost(s) or cost(s) not assigned to programs consistent with SFFAS 4, *Managerial Cost Accounting Standards and Concepts*. However, in cases where an entity decides that an impairment loss should not be recognized, it could consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates, as appropriate.

20. The impairment loss should be recognized and reported regardless of whether the G-PP&E remaining in use is being depreciated individually or as part of a composite group. The impairment loss may be reported as a separate line item or line items on the statement of net cost. Deciding to display a separate line item or items on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from the impairment and the size of the impairment loss relative to the G-PP&E; and qualitative factors including whether the loss would be of interest to decision makers and other users.

21. A general description of the G-PP&E remaining in use for which an impairment loss is recognized, the nature (e.g., damage or obsolescence) and amount of the impairment, and the financial statement classification of the impairment loss should be disclosed in the notes to the financial statements. Such disclosures should be made in the period the impairment loss is recognized.

Diminished Service Utility Without Recognized Impairment Loss

22. Events, changes in circumstances, or asset management reviews might indicate that the future service utility of G-PP&E remaining in use has been adversely affected. However, if future service utility has been adversely affected but the impairment test determines that a loss need not be recognized, a change to the estimates used in depreciation calculations such as estimated useful life and salvage value should be considered.

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G-PP&E That No Longer Provides Service

23. G-PP&E that no longer provides service or in the case of construction work in process where there is no expectation of future service by the entity, should be accounted for in accordance with SFFAS 6, paragraphs 38 and 39, and Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property Plant, & Equipment.*

Remediating Previously Reported Impairments

24. Subject to the entity's capitalization policies, if an entity later remediates the previously impaired G-PP&E remaining in use, the costs incurred to replace or restore the lost service utility should be accounted for in accordance with applicable standards. For example, costs to prepare the site and install replacement facilities would be recognized in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment*.

Recoveries

25. The impairment loss should be reported net of any associated recovery when the recovery and loss occur in the same year. Recoveries reported in subsequent years should be reported as revenue or other financing source as appropriate. If not otherwise apparent in the financial statements, the amount and financial statement classification of recoveries should be disclosed in the notes. The accounting for recoveries should be in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

Consolidated Financial Report of the U.S. Government

26. The U.S. government-wide financial statements should disclose the following if an impairment loss for G-PP&E remaining in use is recognized:

    a. a general description of what constitutes G-PP&E impairment,

    b. the consolidated G-PP&E impairment losses recognized by component entities, and

    c. a reference(s) to component entity report(s) for additional information.

Effective Date

27. The requirements of this Statement are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In Statement of Federal Financial Accounting Standards (SFFAS) 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* issued in May 2003, the Board identified impairment as one of three areas (the other two being depreciation and deferred maintenance) that it desired to consider integrating into a comprehensive project. Complete impairment was addressed in SFFAS 6, *Accounting for Property, Plant, and Equipment,* through the requirements that general PP&E "…*be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess."* However, SFFAS 6 does not address partial impairment, even though the effects of partial impairment may be material in some cases. The Board decided to address asset impairment at the time it addressed deferred maintenance. Subsequent to the issuance of Statement of Federal Financial Accounting Standards 40: *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment* in May 2011, the Board initiated work on addressing potential enhancements to existing FASAB guidance regarding impairment.

A2. In evaluating an approach applicable to federal G-PP&E, the Board considered the approaches used in the following documents:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (Superseded by FASB Accounting Standards Codification (ASC) 360)*

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- Governmental Accounting Standards Board (GASB) Statement (GASBS) 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*[17]

- International Public Sector Accounting Standard (IPSAS) 21, *Impairment of Non-Cash Generating Assets*

- IPSAS 26, *Impairment of Cash-Generating Assets*

A working group was organized to assist the Board in analyzing the impairment standards promulgated by the FASB, GASB, and the International Public Sector Accounting Standards Board (IPSASB). The working group's analysis was initially screened by the Deferred Maintenance and Asset Impairment (DM-AI) Task Force and subsequently tested with a broader community beyond the task force to obtain other points of view. The consensus recommendation was to use the GASBS 42 approach as a baseline for the development of a federal asset impairment standard.

Significant and Permanent Decline in Service Utility

A3. This Statement requires recognizing a potential impairment loss only when there is a significant and permanent decline in the G-PP&E's service utility. In reaching this decision, the Board considered and weighed (a) the need for relevant, reliable, and consistent financial reporting and (b) entity burden.

a. For financial reporting to be:

(i) relevant - a logical relationship must exist between the information provided and the purpose for which it is needed. G-PP&E impairment information is relevant because it is capable of making a difference in a user's assessment of how well the entity is meeting its federal asset stewardship responsibilities.

(ii) reliable - information needs to be comprehensive and nothing material should be omitted nor should anything be included that would likely cause the information to be misleading. The reporting of G-PP&E impairments

[17] © Financial Accounting Foundation, Governmental Accounting Standards Board, 401 Merrit 7, Norwalk, CT. All Rights Reserved. GASBS 42, November 2003.

significantly adds to the informational value and reliability of amounts presented in the entity's balance sheet and statement of net cost.

(iii) consistent over time - an accounting principle or reporting method should be used for all similar transactions and events unless there is good cause to change. Establishing G-PP&E impairment standards significantly adds to consistent financial reporting.

b. The Board is aware of the increased demands that entities confront due to initiatives that attempt to better align and integrate entity mission, budget, and performance objectives. As such, the Board desires to issue a G-PP&E impairment standard that entities can effectively adopt without undue administrative burden while still satisfying the objectives of federal financial reporting.

Recognizing Impairments

A4. As discussed in paragraphs 13 and 14, impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonable assure such identification and communication, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. In the event management determines existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments, additional processes and internal controls may be necessary.

A5. The Board notes that not all significant events and/or changes in circumstances discussed by oversight bodies, management, or the media would necessarily be considered material to an entity's financial statements. Consequently, an entity must exercise judgment in this regard considering whether omitting or misstating information about the significant event and/or changes in circumstances makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or the misstatement. However, in cases where an entity decides that a significant event or change in circumstance is immaterial, it should consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates.

The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews that include the following types of G-PP&E assessments:

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a. Condition assessments revealing evidence of physical damage, deterioration, and/or distresses such as for a building (1) damaged by fire or flood, (2) not adequately maintained or repaired, (3) associated with significant amounts of deferred maintenance and repairs and/or (4) exhibiting signs of advanced degradation that might adversely impact expected duration of use, each requiring remedial or replacement/restoration efforts to restore service utility

b. Functionality assessments revealing evidence of reduced capacity, inadequate configuration, change in entity mission, change in the manner or expected use, and enactment or approval of laws, regulations, codes or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet)

c. Obsolescence assessments revealing evidence of technological development or obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely or never used because newly acquired equipment provides better service

Common Indicators of Potential Impairment

A6. The Board considered the general approaches used by other standards-setters regarding the issues of impairment identification and testing. The DM-AI Task Force identified the GASB approach as being the most germane for federal application and recommended adopting its use with appropriate modifications. As a result, this Statement consists of a two-step process of (a) identifying potentially impaired G-PP&E through indictors of impairment and (b) testing to determine whether a potential impairment exists by comparing the net book value of the G-PP&E to a valuation reflecting the current state of the G-PP&E.

A7. Recognizing the administrative burden and costs involved in applying a test of potential impairment, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

A8. In order to limit the universe of G-PP&E tested for potential impairment because of cost-benefit considerations, the Board proposes two modifiers to the indicators: (a) the magnitude of the decline in service utility is significant and (b)

the decline in service utility is permanent. The first modifier would limit testing for potential impairment to only G-PP&E that have experienced a significant decline in service utility. The second modifier would limit testing to only those G-PP&E where the decline in service utility is expected to be permanent. The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored and that the G-PP&E's remaining service utility can continue providing value.

A9. G-PP&E is to be considered impaired only when both of these two modifiers are present. When either of these conditions is not present, the decline in the service utility of the G-PP&E may be recognized through other methods such as changing useful life or salvage value estimates.

Determining if Magnitude of Decline in Service Utility is Significant

A10. Because measurement of a potential impairment is not required unless a significant decline in service utility occurs, management should assess the magnitude of the service decline. In cases where there is physical damage to G-PP&E, the significance can often be objectively assessed because the costs of remediation (i.e., replacement or restoration) may be relatively easy to determine, at least within a range of estimates. In circumstances other than those involving physical damage, significance may be discerned by less objective assessments such as:

(1) Whether management acts to address the situation. Management decisions may be indicative of a potential decline in service utility. For example, a specific action taken by management after a service decline may confirm that expenses exceed future benefit. Likewise, a decision by management to not address a service decline may be an indication the decline is not significant and a test of impairment is not required.

(2) The costs are disproportionate with the new expected service utility. For example, when comparing the benefits and related costs associated with the new expected service utility after the potential impairment with those benefits and related costs existing prior to the impairment, management may confirm that costs significantly exceed future benefit. As a result, the decline is significant and a test of impairment is required.

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Selecting a Measurement Approach

A11. Professional judgment should be used when selecting a method to measure the decline in service utility of G-PP&E. Generally, potential impairments:

a. reflecting degradation or physical damage may be measured using a replacement approach or, for multi-use heritage assets, a restoration approach.

b. reflecting a change resulting from enactment or approval of laws or regulations or other changes in environmental/economic factors or from technological development or obsolescence generally may be measured using a service units approach.

c. reflecting a change in manner or duration of use or change in mission generally may be measured using deflated depreciated current cost approach.

d. for cash or revenue-generating G-PP&E may be measured using the cash flow approach.

e. arising from construction stoppages or contract terminations for assets which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate.

A12. The Board emphasizes that in estimating the diminished service utility of the G-PP&E, the measurement approach chosen should yield a reasonable estimate reflecting the diminished service capacity of the G-PP&E. Before using a specific method a determination should be made that it will result in (1) a reasonable estimate of diminished service capacity for the specific asset and (2) a reasonable net book value associated with the remaining service utility of the G-PP&E. There should not be a presumption of reasonableness attached to the use of any of these methods if the resultant calculations reflect an unreasonable estimate of the remaining service utility of the G-PP&E. For example, if using the replacement approach, a cost estimate to remediate the damage to an asset is equal to or greater than the asset's total replacement cost, the resultant calculation would lead to a full write-down of the carrying value. However, if the asset is to remain in use, the full write-down would be inappropriate because some service potential remains. In such a case, management should look to another method such as the deflated depreciated current cost approach to estimate the historical cost of the asset's residual service capacity that will continue to be used. Additionally, within an entity, one

method may not be appropriate for measuring asset impairments across all categories or classes of assets. The Board notes that a reasonable methodology may not result in the recognition of an impairment loss.

Among Comparable Methods – Choose the Most Efficient

A13. The Board recognizes that there may be cases where more than one comparable method could be used to measure the decline in an asset's service utility. In such cases, the entity should use whichever method most reasonably reflects the diminished service utility. In cases where the methods under consideration are expected to yield similar results, management should adopt the most efficient method available given the circumstances.

Reduced Demand

A14. The Board notes that reduced demand for the services of G-PP&E should not be considered as a discrete or sole indicator of potential impairment. That is, reduced demand absent evidence of an underlying potential impairment resulting in that reduced demand is not an indicator of impairment. For example, decreased demand for the processing services of a mainframe computer because former users of the mainframe have transitioned to PC and server-based systems should be considered a change in demand not requiring impairment testing. However, if associated with an indicator of potential impairment such as evidence of obsolescence, then the mainframe should be tested for potential impairment.

A15. In addition, a decrease in demand solely resulting from the conclusion of a special project requiring large amounts of processing time on a mainframe computer that runs other applications should not be considered for impairment testing.

A16. A decrease in occupancy is another example of a change in demand. If a decrease in the occupancy of hospital beds prompts management to close a hospital, a change in manner or duration of use has also resulted and a test for impairment should be performed. However, a test for impairment is not required if the decrease in hospital beds results solely because the hospital is changing from an overcrowded condition to one in which occupancy rates are now below the maximum allowed. However, care should be taken to ensure that there is not a potential indicator of impairment that could require testing.

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Estimating Potential Impairment Losses

A17. Measuring the cost of the lost service utility generally requires the use of estimates or approximations. According to Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, to be recognized an item must be measurable, meaning that a monetary amount can be determined with reasonable certainty or is reasonably estimable (underscoring added for emphasis). For this reason, the Board notes that it (1) does not seek exact precision in determining the lost service utility of the asset and (2) does not intend to direct or prescribe the use of any particular approach listed in paragraph 18.

A18. However, the Board notes that care should be taken when estimating potential impairment losses. For example, if a multi-use heritage asset requires testing for potential impairment, the restoration approach and not the replacement approach would generally provide for more accurate estimates. Although these approaches may appear to be identical, they are not. The replacement approach estimates the cost to replace the lost service utility of the G-PP&E at today's standards whereas the restoration approach does not. In either case, the required estimates used for the calculation inputs are different and can significantly affect the potential impairment loss measurement. Differences will arise because the replacement approach uses estimates reflecting today's current labor and material options and costs, modern standards, and installation methods whereas the restoration approach uses estimates that generally require using historically accurate (e.g., aesthetic or historic) materials and construction methods approved by an historic architect or historic preservationist to preserve the historic nature and value of the multi-use heritage asset.

A19. Entities should also ensure that impairment loss calculations exclude improvements or betterments. For example, assume that a portion of an old warehouse currently not being used suffers roof damage due to heavy snowfall. The entity decides not to repair the roof and to contain the damage by securing the adjoining area ensuring that there are no safety hazards. In this case, estimates for the construction of a new warehouse, including its roof should not include amounts for new types of roof ventilation systems, solar panel features, or green energy improvements, etc. Including such improvements or betterments might significantly affect the potential impairment loss measurement.

G-PP&E Impairment Loss Reversals and Remediation

A20. Impairments may be subsequently remediated or otherwise restored or may be reduced in future periods. The Board concluded that reversals of G-PP&E impairment losses should not be recognized. In reaching the decision not to allow for reversals of G-PP&E impairment losses, the Board concluded that because reversal events are expected to be rare occurrences, there is no compelling need for complexity or increased burden as benefits do not appear to justify costs.

A21. The Board concluded remediation of a previously reported impairment loss, is a change that results in an addition to the cost basis. Specifically, should management later decide to replace or restore an asset's lost service utility the costs incurred to do so become part of the G-PP&E's new cost basis. It is the Board's opinion that such a practice is consistent with the operating performance objective of federal financial reporting; users will be able to evaluate the service efforts, costs, and accomplishments of the reporting entity based on the revised cost basis.

Recoveries

A22. Recoveries may be accounted for as either exchange or non-exchange transactions, depending on the nature of the related revenue that would be recorded. In accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting:*

a. Exchange revenues should be recognized when goods or services are provided to the public or another government entity at a price. An example would be commercial insurance purchased in connection with G-PP&E belonging to a public-private arrangement.

b. Non-exchange revenues should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. An example would be a donor’s pledged contribution associated with a capital project restoration effort. In cases where the collecting and reporting entities are different, it is important to note that non-exchange revenue amounts should be measured by the collecting entities and recognized for financial statement reporting by the entities legally entitled to the revenue.

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Distinguishing between Depreciation and Impairment

A23. Depreciation systematically and rationally allocates the historical cost of the G-PP&E's service utility to the benefitting periods. The asset's costs are allocated (i.e., the asset is depreciated) across multiple periods based on asset management plans and formulas, including such variables as expected useful life of the asset, usage patterns, and residual or salvage value, if any. Costs are allocated because: (1) the G-PP&E is expected to benefit more than one period and (2) generally, there is no other practical or efficient way to directly assign or associate cause (i.e., entity activity or event) and effect (i.e., service utility consumption). That is, depreciation is allocated, because specific causation cannot be ascertained.

A24. On the other hand, impairment occurs when there is a significant and permanent decline in the service utility during the depreciation period of G-PP&E remaining in use, and that decline is reasonably estimable in monetary terms. Essentially, an event or circumstance alters the utility and/or value of the asset such that the systematic and rational allocation process noted in paragraph A23 directly above can no longer be reasonably applied and must be also altered accordingly. Moreover, primarily due to the significant nature of the event or changed circumstances, an entity can directly assign or associate cause (the event or circumstance) and effect (change in anticipated utility and/or value of the asset). As a result, the lost or diminished service utility (arising from the impairment) can be directly assigned in a practical and efficient manner.

A25. To the extent that an entity's depreciation policies and practices reflect a pattern of service utility consumption that reasonably accounts for discrete events and/or changed circumstances, impairment losses may not apply. For example, if an entity operates in multiple climates within a country or maintains a global presence, its regular and on-going depreciation may account for lost or diminished service utility resulting from damages likely to arise from reasonably anticipated climate or other environmental conditions. This could be evidenced by an entity deriving its useful life estimates from current and historical fixed asset records or maintenance and repair accounts, which include such events and/or circumstances. In such cases, the entity might shorten the useful life estimate, alter the anticipated consumption pattern, or reduce its salvage value estimate. Consequently, depreciation would inherently consider the conditions giving rise to the impairment, thus avoiding the need to recognize an impairment loss.

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Perceived costs versus benefits

A26. The Board believes that the benefits of implementing this Statement outweigh its administrative costs of implementation. The Board has clarified the Statement so that users understand that they are not required to search out impairments or to apply the Statement to immaterial items. Entities should consider G-PP&E impairments in the context of their existing practices and apply this Statement only when there is an indicator of significant impairment present. Although GASB, IPSASB, and FASB pronouncements are available to provide federal preparers with guidance relative to impairments, issuance of a Statement by FASAB will eliminate the need, time, and effort to search principles from another standard-setter or consider analogous entity transactions. Other perceived benefits include: reporting impairments when they occur rather than through depreciation expense or disposal, providing management with information useful for capital investment decisions, discerning the cost of impairments and impact on the entity and the cost of services provided following the impairment, and lastly, enhancing comparability between entities.

Summary of Outreach Efforts

A27. The Exposure Draft (ED), *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use,* was released on February 28, 2012, with comments requested by May 28, 2012.

A28. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter, Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A29. This broad announcement was followed by direct e-mailings of the press release to:

a) Relevant congressional committees: Senate Committee on Homeland Security and Governmental Affairs and House Committee on Oversight and Government Reform;

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b) Public interest groups: The *Institute for Responsible Infrastructure Stewardship* and the *National Academy of Sciences' Federal Facilities Council*;

c) Respondents to SFFAS 42, *Deferred Maintenance and Repairs Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*.

A30. Twenty-three (23) responses were received. Table 1.0 summarizes responses by respondent type.

Table 1.0 - Summary of Respondent Types to Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	**16**	**0**	**16**
Users, academics, others	**2**	**2**	**4**
Auditors	**2**	**1**	**3**
Total	**20**	**3**	**23**

A31. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

A32. Respondents generally favored the Exposure Draft. By a 9-to-1 ratio respondents agreed with the Board's proposal to recognize impairment losses. Additionally, 22 of the 23 respondents agreed with the Board that entities are

not expected to alter existing assessment methods as a direct consequence of this Statement. Some respondents offered suggestions that the Board adopted and revised the Exposure Draft accordingly. The most significant changes made to the proposed standards include: (1) simplifying the definition of impairment by not referencing either "gradual or sudden" and (2) clarifying entity reporting requirements. The most significant additions made to the Basis for Conclusions include (1) clarifying that recoveries take the form of exchange or non-exchange revenues and (2) a discussion concerning what distinguishes depreciation from impairment. Highlighted below are some respondent concerns that the Board decided to address.

Identifying Indicators of Potential Impairment

A33. Some respondents expressed concern over the indicators. Concerns ranged from the indicators being viewed as conclusive evidence of impairment necessitating an impairment loss test to the indicators being too vague and in need of expansion to address magnitude, permanence, and materiality. As stated at paragraph A7, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Furthermore, they are the first step in a two-step process and as a result cannot be deemed conclusive. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment may be unnecessary given the circumstances. Furthermore, as stated at paragraphs A6 through A9 in the section entitled *Common Indicators of Potential Impairment*, the paragraph 12 indicators are not meant to be definitive in nature nor a fully inclusive list. Therefore, management must exercise discretion and judgment when assessing potential impairment losses.

A34. Other respondents shared a concern that their auditors would require specific reviews or that the audit community could not determine the extent of additional audit procedures that could result from this Statement. The Board believes that this issue gets back to internal controls and processes. The Board is of the opinion that in most cases management would not have to apply additional or separate procedures to identify potential impairments. Rather, management might have to document (1) linkage to asset management systems (refer to paragraphs A4 and A5) that identify and communicate potential impairments and (2) materiality so that auditors would accept that the financial statements are presented fairly. At a minimum, management can be expected to document how it interprets and expects to apply this Statement.

Materiality

A35. Some respondents sought clarification concerning materiality. The Board has made clear that this matter depends on the degree to which omitted or missing information could influence a reasonable person's judgment and that this Statement is not to be applied to immaterial items. The Board notes two important matters in this regard. First, when assessing materiality management should consider the impact of the potential impairment to the entity's cost of service(s). It is not the Board's intent to direct application of this Statement to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Second, entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

Measurement

A36. Some respondents expressed concern over the measurement approaches. Concerns ranged from the approaches not being appropriate for real property asset classes to the Statement having too many methods from which to select. As stated at paragraphs 18 and A17, entities should use an approach that reasonably estimates the asset's diminished service utility. The Board has made clear that it seeks reasonable impairment loss estimates and is not prescribing any particular approach. Preparers are not restricted to the approaches shown at paragraph 18 and may use other approaches that accomplish the following two objectives: (1) reasonably estimate the diminished service utility and (2) reasonably estimate net book value associated with the remaining service utility.

G-PP&E Exemptions

A37. Some respondents noted provisions of this Statement should not apply to certain G-PP&E categories, classes, or base units. The Board explored the respondents' rationales for seeking to waive the requirements and determined that no exemptions would be warranted. A careful reading and implementation of the Statement would preclude application of this Statement to some G-PP&E classes. Specifically, as stated at paragraph 8, the events or changes in circumstances that lead to impairments are not considered normal and ordinary. That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the

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useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating the useful life. For example, in the case of military equipment "normal and ordinary" would come with the expectation that the G-PP&E would be responding to contingencies and entering into combat operations at some future time. As a result, lost service utility arising from such events or circumstances could not be considered unanticipated and would fall outside the realm of this Statement. Additionally, G-PP&E classified as mission critical will rarely be partially and permanently impaired as its service utility would generally be replaced or restored and if not, the asset would be removed from active service because it would no longer be mission capable.

A38. The Board notes that in those cases where an entity considers certain G-PP&E to be non-mission critical or immaterial, management can (1) read the views of the Board concerning materiality as detailed in paragraph A35 above, and (2) reevaluate its capitalization threshold and depreciation policies and procedures. For example, under the requirements of this Statement, office furniture and fixtures that have been capitalized could become impaired. However, management may determine that any resultant impact to its cost of service(s) would be immaterial. In such cases, an entity may elect to prospectively change its capitalization criteria and/or alter its depreciation policies.

Board Approval

A39. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

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Appendix B: Flowcharts, Decision Table and Illustrations

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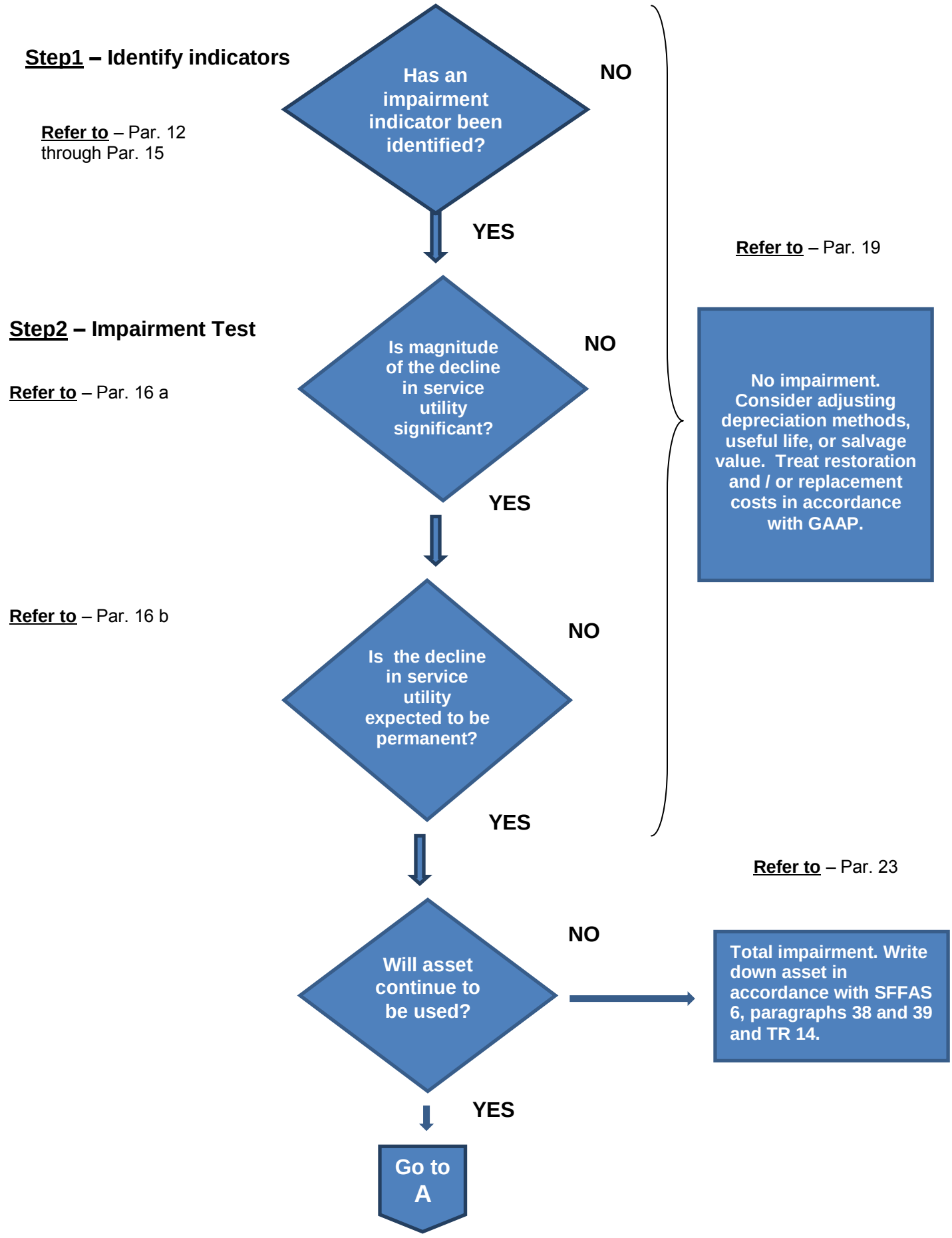

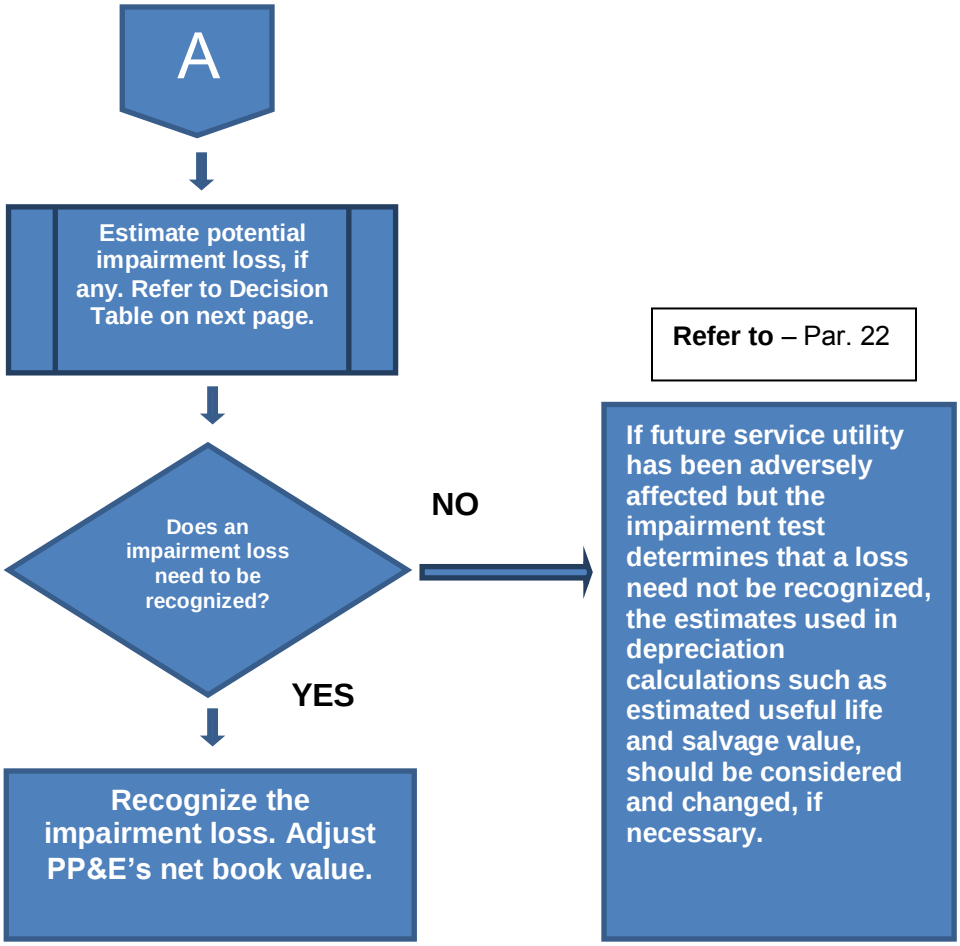
A
Refer to – Par. 18
Estimate potential impairment loss, if any. Refer to Decision Table on next page.
Refer to – Par. 22
Does an impairment loss need to be recognized?
NO
If future service utility has been adversely affected but the impairment test determines that a loss need not be recognized, the estimates used in depreciation calculations such as estimated useful life and salvage value, should be considered and changed, if necessary.
YES
Refer to – Par. 19 and Par. 26.
Recognize the impairment loss. Adjust PP&E's net book value.

Select a method that reasonably represents diminished service utility by considering potential indicators and type of PP&E.

If more than one method is reasonable, select the most efficient and practicable method.

Measurement Methods[18]	Potential Indicators	Type of PP&E *	Reference	Illustrations that may be appropriate
Replacement Approach	• Physical Damage	All G-PP&E	Par. 18 a	1c
Restoration Approach	• Physical Damage	Multi-use Heritage PP&E	Par. 18 b	2b
Service Units Approach	• Physical Damage • Enactment or approval of laws/regulations • Changes in environmental or economic factors • Technological changes or obsolescence	All G-PP&E	Par. 18 c	1d, 3a, 3b
Deflated Depreciated Current Cost Approach	• Change in manner or duration of use.	All G-PP&E	Par. 18 d	4a
Cash Flow Approach	• Any of the indicators as listed at Paragraph 12 (a through g)	Cash or Revenue Generating G-PP&E	Par. 18 e	7a, 7b, 7c, 7d
Lower of (1) Net Book value or (2) Higher of Net Realizable Value or Value-in-Use Approach	• Construction stoppage / Contract terminations	All G-PP&E	Par. 17 & 18 f	5, 6a, 6b, 7b

* = excluding internal use software

[18] Other industry-accepted methods may be appropriate.

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ILLUSTRATIONS

This remainder of this appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not intended to provide guidance on determining the application of materiality; as such, estimated impairment losses are labeled as “potential” in each illustration because they would still require a further assessment as to whether the estimated loss is material and should be recognized. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards to ensure each situation is considered in the appropriate context.

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Illustration 1a

Temporary Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination* [19]

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed. The mold remediation involves removing and rebuilding the interior walls and improving site drainage at a total cost of $4 million.

Management develops specific plans to begin remediation efforts as soon as possible and replace the lost service utility. In addition, funding has been identified and set-aside.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because management has specific plans to replace the lost service utility of the building and has identified and set-aside funding, there is reasonable expectation that the damage is temporary and no potential estimated impairment loss is recognized.

[19] Illustrations 1a through 1d have been adapted from GASB 42, Illustration 1, *Physical Damage – School with Mold Contamination*.

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Illustration 1b

Complete Removal from Service: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

Due to the extent of the damage, management does not believe that remediation efforts will begin and that the lost service utility of the building is not temporary. As a result, management has decided to remove this building from service and prepare it for disposal.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no potential estimated impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 38 and 39 are applicable.

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Illustration 1c

Replacement Approach - Permanent Declines in Service Utility: *Physical Damage to an Office Building due to an Earthquake*

Assumptions

In 2012, entity officials became aware of extensive masonry wall and building foundation damage at one of its office buildings as a result of a recent earthquake. The damage to the masonry walls was spread throughout the five-story building and the building foundation was damaged at non-critical vertical-load points. Facilities management personnel and engineers advised that despite a decline in service utility, the damaged building would still be capable of meeting reasonable, but reduced performance objectives in its damaged state, making major repairs and costly upgrading unnecessary. Limited and minor repairs, both cosmetic and structural, could be made to improve visual appearance and component damage at nominal cost. Facilities managers and engineers have estimated that the major repairs and upgrades (involving removal and rebuilding of the interior walls and improving site drainage) would cost $2 million.

After a detailed review, management decided to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million. Accumulated depreciation related to the building and to the improvements were $600,000 and $320,000, respectively.

Evaluation of potential estimated impairment loss

The masonry wall and building foundation damage is evidence of physical damage – an impairment indicator. Also, the magnitude of the decline in the lost service utility is significant because its remediation would involve major repairs and costly upgrades. Because management decides to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and engineers estimated that the major repairs and upgrades would have cost if incurred, $2 million. In accordance with the entity's capitalization policies, 10 percent of the remediation cost would be allocable to site clean-up and treated as a period expense, and 90 percent would be allocable to remediating the masonry wall and

building foundation damage. As recorded in the entity's asset management system, the estimated plant replacement value (PRV) of the office building is $8.5 million.

Calculate Net Book Value:

	Historical Cost	Accumulated Depreciation, 2012	Net Book Value, 2012
Land	**$100,000**		**$100,000**
Building acquisition, 1982	$1,200,000	$600,000	$600,000
Improvements	1,235,000	320,000	915,000
Total - Building & Improvements	**$2,435,000**	**$920,000**	**$1,515,000**

Calculate estimated cost to replace lost service utility:

Total remediation cost	$2,000,000
Percentage wall & foundation cost	90%
Wall & Foundation Remediation cost	**$1,800,000**

Calculate percentage of lost service utility in current dollars:

Wall & Foundation Remediation (estimate of lost service utility in current dollars)	$1,800,000
Plant Replacement Value (estimate to replace building in current dollars)	$8,500,000
Wall & Foundation Remediation cost percentage	**21.18%**

Calculate potential estimated impairment loss:

Net book value (historical cost)	**$1,515,000**
Multiplied by: Wall & Foundation Remediation cost percentage	**21.18%**
Potential estimated impairment loss	**$320,877**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $320,877.

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Illustration 1d

Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. The mold contamination in the walls of the building was limited to the top two floors of the five-story building and could be safely contained and encapsulated. Facilities management personnel advised that the first three floors of the building could continue to be safely used.

Management does not believe that the loss of service utility will impede their operations and consequently, do not plan to remediate the mold contamination. Management has decided to discontinue the use of the top two floors and commence containment and encapsulation efforts. The remainder of the building will be kept in service.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., contamination of two of the five floors of the building) is a significant decline in service utility. Because management does not plan to replace the lost service utility of these floors, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities management personnel in consultation with the Comptroller's office advise management to use the service units approach instead of the replacement cost approach because using construction cost estimates are not likely to result in a materially different potential estimated impairment loss amount. Management agrees to select the service units approach because it reasonably represents diminished service utility and given the circumstances, it is the most efficient and practicable method to use.

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Calculate percentage of lost service utility in terms of units:

Lost service utility in terms of floor units	2 floors
Total service utility prior to damage in terms of floor units	5 floors
Percentage of lost service utility in terms of units	**40.00%**

Calculate potential estimated impairment loss:

Net Book Value (historical cost)	**$1,515,000**
Multiplied by: percentage of lost service utility - units	**40.00%**
Potential estimated impairment loss	**$606,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $606,000.

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Illustration 2a

Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset* [20],[21]

Assumptions

Recent media reports have noted that acid precipitation (often called acid rain) is of increasing concern in the metropolitan area and, in particular to many of the area's historic and national landmarks including multi-use heritage assets. The entity's conservation scientists confirm the media reports and note that although normally rain is slightly acid, current rainfall has an average pH of more than 10 times normal levels.

Limestone and marble, the stones that form many of the buildings and monuments in the metropolitan area are especially vulnerable to acid precipitation because they are predominantly made of the mineral calcite (calcium carbonate), which dissolves (i.e., erosion) easily in acid. Capitalized alterations made over the years to accommodate the heavy traffic brought about by administrative and visitor use of one of the more prominent multi-use heritage assets has drawn management's attention. The entity's Inspector General (IG) has begun a review and in an interim draft report has noted the following,

> "The marble balustrade on the south side, main entrance of the administrative building shows damage from acid rain posing a serious threat to the hundreds of visitors and employees who walk by this concourse daily. Management must take immediate corrective action in order to avoid potential bodily harm and liability."

Management in consultation with the conservation scientists and facilities managers determines that (1) erosion (deterioration caused by exposure to the environment) is a natural part of the normal geologic cycle and was reasonably expected to occur, and (2) temporary braces and steel under-girding currently in-place are sufficient for the current year. Management plans to restore the balustrade during the next fiscal year.

Evaluation of potential estimated impairment loss

The erosion is evidence of l physical damage – an impairment indicator. Also, the prominence of the event (i.e., coverage by the media and the IG's recommendation)

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[20] Illustration 2a adapted from: Department of the Interior, *Acid Rain in Washington*, http://pubs.usgs.gov/gip/stones/acid-rain.html.

[21] Heritage Assets are PP&E that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic (e.g., aesthetic) importance; or, significant architectural characteristics. Multi-use Heritage Assets are heritage assets whose predominant use is general government operations. FASAB Appendix E: Consolidated Glossary,

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would be evaluated as a potential impairment indicator of significant loss in service utility. However, no potential estimated impairment loss is recognized because (1) the decline in lost service utility is “normal and ordinary” as it arises from a cyclical act of nature and (2) restoration efforts to cure the damage are planned to begin next fiscal year. Management should consider evaluating its depreciation policies and methods to reflect the adverse effect of the acid rain on buildings and monuments made of limestone and marble.

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Illustration 2b

Restoration Approach - Permanent Declines in Service Utility: *Physical Damage to a Multi-use Heritage Asset*

Assumptions

A fire recently destroyed most of a three-story wing addition of an historic building. The building addition housed senior administrative offices. The foundation and portions of the first level were not seriously damaged and considered salvageable.

The Secretary's proposal to the Board of Regents (Regents) requested a minimum of $4.5 million to restore the three-story administrative wing. The Regents questioned the reasonableness of the cost estimate noting that typical office building construction in the metropolitan area costs about $160.00 per square foot (psf). The Secretary advised that the $160.00 psf estimate was not appropriate to use because it represented a "replacement" estimate using today's current labor, materials, standards and methods and not a "restoration" estimate that required using historically accurate materials and methods, as well as historic preservation and conservation methods as appropriate to preserve the historic nature and value of the multi-use heritage asset.

As an example, the Secretary noted the limited supply of the red Seneca sandstone used to construct the building in the 19th century and the added wing in the 20th century. The local quarry could only supply sufficient quantities to restore one level. As a result, complete restoration could not begin until a second quarry could be located to supply the additional quantities. Furthermore, experienced masons would have to be used for the restoration effort.

As a result of this information, the Regents modified the Secretary's request to restore one level of the wing noting that subsequent levels should not be restored in the future and that no such plans should be undertaken nor should any monies be committed. Displaced staff was moved to nearby vacant office space.

Evaluation of potential estimated impairment loss

The destruction to the three-story wing is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., loss of senior administrative office space) would be evaluated as a significant decline in service utility. Because the Regents provided for partial restoration (one level) of the multi-use heritage asset, the lost service utility of the other two levels of the administrative wing is deemed permanent. As a result, because the lost service utility from these two levels is not reasonably expected to be restored, the potential estimated impairment loss is considered permanent and any resultant potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and reconstruction specialists have estimated that (1) the total remediation of the three-story wing would cost $4.5 million and (2) restoring the first level would cost $2.0 million. The net book value of the administrative portion of the building prior to the fire damage was $1.75 million. In accordance with the Restoration Approach, the following estimates and calculations were presented to management:

Calculate estimated cost to restore lost service utility:

Total restoration cost (all 3 levels)	$4,500,000
Less: portion to be restored (first level)	$2,000,000
Cost to restore lost service utility (2nd and 3rd levels)	**$2,500,000**

Calculate percentage of restored lost service utility in current dollars:

Cost to restore lost service utility of the 2nd and 3rd levels of the wing (estimate of lost service utility in current dollars)	$2,500,000
Total restoration cost (all 3 levels)	$4,500,000
Restoration cost percentage	**55.5%**

Calculate potential estimated impairment loss:

Net Book Value (historical cost of wing)	**$1,750,000**
Multiplied by: Restoration cost percentage	**55.5%**
Potential estimated impairment loss	**$971,250**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $971,250.

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Illustration 3a

Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine* [22]

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an "open" MRI system to the hospital. The transferred MRI system began to be used more frequently than the original "closed" MRI system because the "open" MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the "closed" MRI system continues to be incurred and management is evaluating the asset's continued service use and whether or not to book an impairment loss.

Upon inspection of the "closed" MRI system and closer examination of the related O&M costs, hospital administrators have determined that it is cost-beneficial to keep the system operational and that there is no impairment loss. They estimate that the system can be expected to last at least three years longer than originally estimated and achieve its expected service output. Furthermore, hospital administrators contend that a significant portion of the costs are (1) considered "sunk" due to the fixed-price nature of the long-term maintenance contracts and (2) fixed inasmuch as they will be incurred regardless of the closed MRI system's operating levels.

Evaluation of potential estimated impairment loss

Management initially identified that the change in technology was an indicator of potential impairment because it had resulted in a permanent reduction in the usage of the "closed" MRI system. Also, they believed that the magnitude test (i.e., decline in service utility relative to operating costs) had also been met due to the fact that the cost of operating the "closed" MRI system has remained the same while the service provided has decreased to 60 percent of prior levels. However, management has concluded that there is no potential estimated impairment loss (i.e., the MRI system did not meet Step

[22] Illustrations 3a and 3b adapted from: GASBS 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine.*

2 – Impairment test) because the asset can achieve its expected service output by being kept in service three years longer than originally planned. Using the service units approach, management determines the followings:

Measurement of potential estimated impairment loss

Calculate Net Book Value:

a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	**Net Book Value, 2013**	**$1,285,714**

Calculate Acquisition cost per service unit:

a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	**Acquisition cost per service unit (a divided by c) (rounded)**	**$124.00**

Calculate Remaining Number of Service Units & Related Costs to be recovered:

d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining number of service units = (4 years plus 3 extended years × 52 weeks per year × 5 days per week × 6 uses per day)	10,920
f	**Remaining service costs to be recovered (d multiplied by e)**	**$1,354,080**

Calculate Potential Estimated Impairment Loss:

Net Book Value, 2013 (b)	**$1,285,714**
Remaining service costs to be recovered (f)	**$1,354,080**
Potential estimated impairment loss (b minus f)	**N/A**

Reporting Considerations

Although there is no potential estimated impairment loss to consider or recognize because the remaining service costs to be recovered is greater than the PP&E's net book value, management should consider re-evaluating its depreciation policies and methods to reflect the additional 3 years of extended service.

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Illustration 3b

Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an “open” MRI system to the hospital. The transferred MRI system began to be used more frequently than the original “closed” MRI system because the “open” MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day; a decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the “closed” MRI system continue to be incurred and has drawn management’s attention to evaluate the asset’s continued service use.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the “closed” MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also been met due to the fact that the cost of operating the “closed” MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. Potential estimated impairment loss using the service units approach would be determined as follows:

Measurement of potential estimated impairment loss

Calculate Net Book Value:

a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	**Net Book Value, 2013**	**$1,285,714**

Calculate Acquisition cost per service unit:

a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	**Acquisition cost per service unit (a divided by c)**	**$124.00 (rounded)**

Calculate Remaining Number of Service Units & Related Costs to be recovered:

d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining service number of units = (4 years × 52 weeks per year × 5 days per week × 1 use per day)	1,040
f	**Remaining service costs to be recovered (d multiplied by e)**	**$128,960**

Calculate Potential Estimated Impairment Loss:

Net Book Value, 2013 (b)	**$1,285,714**
Remaining service costs to be recovered (f)	**$128,960**
Potential Estimated Impairment loss (b minus f)	**$1,156,754**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $1,156,754.

Illustration 4

Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*[23]

Assumptions

In 2013, management decided to close a training facility because enrollments declined due to outsourcing initiatives brought about as a result of Office of Management and Budget (OMB) Circular No. A–76, *"Performance of Commercial Activities."* The closed training facility has been converted for use as a storage warehouse.

This training facility was constructed in 2001 at a cost of $10 million. The estimated useful life of the facility is fifty years. Entity management has (1) no evidence that enrollments will increase in the future such that the building would be reopened for use as a training facility and (2) concerns with the significantly high operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc.

Because no physical damage occurred that would require detailed cost repair estimates, management decides to use the deflated-depreciated current cost approach to measure the potential estimated impairment loss. Facilities managers have been able to readily identify current plant replacement value (PRV)for a comparable warehouse of the same size as $4.2 million and commercial construction indices of 100 and 150 for years 2001 and 2013, respectively.

Evaluation of potential estimated impairment loss

Impairment is indicated because the manner of use of the training facility has changed from training students to storage. The situation passes the magnitude test (i.e., decline in service utility relative to operating costs) because the ongoing costs of the training facility would likely be considered high in relation to the benefit it is providing - storage. Potential estimated impairment loss using the deflated depreciated current cost approach would be determined as follows:

[23] Illustration 4a adapted from: GASB 42, Illustration 5, *Change in Manner or Duration of Use – School Used for Storage.*

Measurement of potential estimated impairment loss

Calculate Net Book Value:

	Historical cost, 2001	$10,000,000
	Accumulated depreciation (12 / 50 years)	2,400,000
a	**Net Book Value, 2013**	**$7,600,000**

Calculate Depreciated current cost (current dollars):

	Replacement cost of warehouse, 2013	$4,200,000
	Accumulated depreciation (12 / 50 years)	1,008,000
b	**Depreciated current cost**	**$3,192,000**

Calculate Deflation factor:

c	Commercial construction index, 2001	100
d	Commercial construction index, 2013	150
e	**Deflation factor (c divided by d)**	**0.67**

Apply deflation factor to depreciated current cost:

b	Depreciated current cost	$3,192,000
e	Deflation factor (c divided by d)	0.67
f	**Deflated depreciated current cost (b × e)**	**$2,138,640**

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Calculate Potential estimated impairment loss:

a	Net Book Value, 2013	$7,600,000
f	Deflated depreciated current cost (b × e)	2,138,640
	Potential estimated impairment loss (a - f)	**$5,461,360**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $5,461,360.

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Illustration 5

Construction Stoppage—Special Purpose Test Equipment [24]

Assumptions

In 2012, in response to a Congressional order canceling a major program, management stopped all construction activities related to the fabrication of program-related special purpose test equipment. The entity conducts numerous design and build projects for military and scientific purposes all of which have potential commercial application. The entity's program manager advised management that the special purpose test equipment was substantially complete at the time of stoppage and could be considered available for commercial use. The entity had accumulated costs totaling $10 million and was approximately 75 percent complete with the project.

Upon further inquiry, management determined that despite initial interest from two commercial firms, early in 2012, one of them filed for bankruptcy and the other withdrew its interest citing that the costs-to-complete are too high. There is no evidence to demonstrate that the construction stoppage is temporary or that other potential commercial interests can be found. Also, the program manager advises that there is no potential government use for this asset and that it should be disposed.

Evaluation of potential estimated impairment loss

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or $10 million) are significant in both percentage and monetary terms. However, there is no potential estimated impairment loss to report in accordance with this standard because the asset is totally impaired as it has no commercial or government use and cannot provide service. As such, the requirements in SFFAS 6, paragraph 38[25] should be followed. Specifically, in the period of disposal accumulated costs should be removed from the asset accounts and any difference between the book value of the equipment and amounts realized shall be recognized as a gain or a loss.

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[24] Illustration 5 adapted from: GASB 42, Illustration 9, *Construction Stoppage—Airport Pavements.*

[25] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

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Illustration 6a

Contract Termination - *Transferable Equipment Technology*

Assumptions

In 2012, the entity's chief contracting officer terminated a contract pursuant to the Federal Acquisition Regulations because the entity experienced substantial cost increases, schedule delays, and performance shortfalls. The terminated contract was to build the entity's next-generation surveillance equipment capable of covertly operating in adverse weather conditions. Despite several cure notices, the entity terminated the contract for default. The contractor has stated that it will not protest the termination. At the time of termination, the entity had incurred $150 million in contract costs.

In the meantime, the program manager determined that the operating environment had changed and that remaining funds would be better spent on other priorities and was able to transfer the system technology to other entity projects. The manner and use of the systems are not expected to change.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the event is significant and the termination decision will not be protested; i.e., permanent. However, because the entity was able to transfer the system technology to other entity projects, no potential estimated impairment loss exists.

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Illustration 6b

Contract Termination - *Partially-Transferable Equipment Technology*

Assumptions

Same assumptions used in Illustration 6a except that the program manager was unable to transfer the entire system technology to other entity projects. After an inspection and engineering review, it was determined that 70 percent of hardware and software could be transferred to existing projects. There is no potential use or application for the remaining 30 percent of equipment technology.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the termination decision is a significant event and is considered permanent because the decision will not be protested. As a result of the entity being unable to transfer the entire system technology to other entity projects, an impairment exists.

Measurement of potential estimated impairment loss

Because 30 percent of the system technology cannot be transferred to other entity projects, a potential estimated impairment loss of $45 million exists (30.0% X $150 million).

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $45 million.

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Illustration 7a

Cash flow approach – Grouped Assets

Assumptions

An entity manages and operates a shared-services center on a post-wide basis that provides administrative and information technology support. The entity groups the individual services separately into two distinct categories rather than on an individual basis. The net book values are $12 million and $11 million for the administrative and information technology (IT) groups, respectively.

In December 2012 the entity's management decided to implement a public-private strategic initiative that could eventually over several years transition these shared-services operations to private ownership. Both national and local private interests have asked their respective political representatives to accelerate the entity's implementation time-table and influence a favorable outcome. Management was directed to (1) immediately estimate the amount that could be recovered from selling the operations and (2) identify to the lowest level identifiable, operating information to include cash flows for each category. An appraisal was conducted to ascertain the amount that could be recovered from selling each of the groups. The appraisal report noted (1) that net realizable value (NRV) amounts were greater than value-in-use estimates and (2) the NRV amounts of $13 million and $8 million for the administrative and IT groups, respectively. The Chief Financial Officer identified the following cash flow information: (a) cash from continuing operations of $12 million and $9 million for the administrative and IT groups, respectively and (b) cash flows from disposal activities of $2 million and $1 million for the administrative and IT groups, respectively.

As a result of complying with this directive and evaluating the resultant financial information and appraisal analysis, management became concerned that its assets might be impaired and adversely impact its public-private strategic initiative.

Evaluation of potential estimated impairment loss

If an impairment indicator exists, an impairment analysis should be considered. In this case, the entity's public-private initiative includes a significant change in the manner or duration in which the assets will be used. This represents an impairment indicator that would trigger an impairment analysis. Furthermore, management's concern that its assets might be impaired passes the magnitude test.

Management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. To apply the cash flow approach, the entity will need to estimate the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The future cash flows are the

expected cash inflows to be generated by the asset net of any expected future cash outflows that are needed to produce the inflows.

Measurement of potential estimated impairment loss

This approach requires that an entity recognize a potential estimated impairment loss if (1) the undiscounted cash flows are less than the net book value of the assets (the net book value is not recoverable) **and** (2) the net book value exceeds the higher of the assets NRV [26] or value-in-use estimate.[27] A potential estimated impairment loss would be measured as the amount by which the net book value of the grouped assets exceed the higher of their net NRV or value-in-use estimate(s).

When identifying cash flows, assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

Calculate Net book value:

Net book value:	Asset Group: Administrative	Asset Group: IT
Assets' net book values at 12/31/2012 (a)	$12,000,000 (a)	$11,000,000 (a)

[26] Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal. Source: FASAB Glossary, Appendix E.

[27] Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, at paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

Calculate undiscounted cash flows:

Undiscounted cash flows:	**Asset Group: Administrative**	**Asset Group: IT**
Undiscounted cash flows from future operations	$12,000,000	$9,000,000
Undiscounted cash flows from future disposal of assets	2,000,000	1,000,000
Total - undiscounted cash flows (b)	**$14,000,000 (b)**	**$10,000,000 (b)**

Calculate Recoverability:

Recoverability: (b minus a)	**Asset Group: Administrative**	**Asset Group: IT**
Total - undiscounted cash flows (b)	**$14,000,000**	**$10,000,000**
Assets' net book values at 12/31/2012 (a)	**12,000,000**	**11,000,000**
Recoverability (b minus a)	**$2,000,000**	**$(1,000,000)**
Is net book value recoverable?	**Yes**	**No**
Is asset subject to potential impairment?	**No**	**Yes**

Calculate potential estimated impairment loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable **and** (2) exceeds the higher of its net realizable value or value-in-use estimate. Because the administrative group has undiscounted cash flows greater than related net book values, recoverability is met and there is no potential impairment. However, because the IT group has undiscounted cash flows lower than related net book values, recoverability is not met and the potential for impairment exists. The calculation below shows that a $3 million potential estimated impairment loss exists because the $11 million net book value of the IT group's G-PP&E exceeds the higher of its net realizable value or value-in-use estimate (in this case we are told that the $8 million NRV amount is higher than the value-in-use estimate).

Potential estimated impairment loss:	**Asset Group: Administrative**	**Asset Group: Information Technology**
Net Realizable Value of assets at 12/31/2012	**N/A**	**$ 8,000,000**
Less: Assets' net book values at 12/31/2012	**N/A**	**$11,000,000**
Excess of net book value over Net Realizable Value	**N/A**	**$3,000,000**
Potential estimated impairment loss	**N/A**	**$3,000,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the IT asset group is $3.0 million.

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Illustration 7b

Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*[28]

Assumptions

In 2009, a hospital operating in a major metropolitan area purchased a "closed" magnetic resonance imaging (MRI) system at a cost of $2.25 million to be used exclusively for non-service connected procedures. The hospital, which charges fees for non-service connected care estimated that the system would have an estimated useful life of seven years and that on average the system would be used for twenty tests per day for five days per week. The average user fee for MRI services is $20.00 per use. Shortly after installation, utilization levels dropped to ten tests per day because of reduced demand for the services attributable to the "closed" nature of the MRI system .

In 2012, the manufacturer introduced an "open" MRI system that was advertised as being more comfortable for patients and provided a superior image. Furthermore, the expenses associated with the continued operation and maintenance of the "closed" MRI system continue to be incurred and has drawn management's attention to evaluate the asset's continued service use. Because similarly used MRI machines in the open market can be purchased from authorized dealers for $750,000 (their mark-up percentages are unknown), management is considering the possibility of selling the old machine and using its proceeds to help purchase the "open" MRI system.

Hospital administrators and technicians believe that the "closed" system can continue being used at the current utilization level for at least 3 years beyond the originally estimated service life. Also, they believe that the "open" system provides for only marginal benefits that do not exceed their cost. In light of this information, management decides not to sell the "closed" system. However, because the service utility expected at acquisition (20 tests per day) can no longer be achieved and is accompanied by an underlying cause; reduced demand arising from the less comfortable "closed" system, a potential impairment loss exists.[29]

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[28] Illustration 7b adapted from: GASB 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine.*

[29] It is important to note that (1) the reduced demand alone is not a discrete or sole indicator of impairment and (2) technological changes or obsolescence should be considered along with other factors when assessing impairment. Regarding the former, had there been no underlying potential impairment (refer to the paragraph 12 indicators), no impairment test would have been required. Concerning the latter, had the utilization level (20 tests per day) and remaining service life (3 years) of the equipment stayed the same, no impairment test would have been required because the equipment's service utility that was expected at acquisition would be deemed recoverable.

Evaluation of potential estimated impairment loss

The indicators of potential impairment are (1) the change in technology and (2) reduced demand accompanied by an underlying cause; the less comfortable "closed" system. The magnitude test has also been met due to the fact that the cost of operating the "closed" MRI system has drawn management's attention to evaluate the asset's continued service use. Potential estimated impairment loss using the cash flow approach would be determined as follows:

Measurement of potential estimated impairment loss

Calculate Net Book Value:

a	Acquisition cost, 2009	$2,250,000
	Accumulated depreciation, 2012 (3 / 7 years)	964,286
b	**Net Book Value, 2012**	**$1,285,714**

Calculate undiscounted cash flows:

c	Average service fee per use	$20.00
d	Remaining service units (4 years plus 3 extra years × 52 weeks per year × 5 days per week × 10 use per day)	18,200
e	**Undiscounted cash flows (c multiplied by d)**	**$364,000**

Calculate Recoverability: (b minus a)

	MRI
Total - undiscounted cash flows (e)	$364,000
Asset's net book values at 9/30/12 (b)	$1,285,714
Recoverability (e minus b)	**$(921,714)**

Is Net book value Recoverable?	**No**
Is asset subject to potential impairment?	**Yes**

Calculate Potential Estimated Impairment Loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value or value-in-use estimate. Because management believes that the open market price of $750,000 is a reasonable estimate of the asset's net realizable value, it is compared to the asset's value-in-use estimate to determine which amount is higher. However, because the $364,000 undiscounted cash flows amount (prior to calculating the net present value to determine a value-in-use estimate) is lower than net realizable value amount of $750,000, there is no need to present value the cash flows to calculate a value-in-use estimate.

Because management believes that the open market price of $750,000 is a reasonable estimate, it is used as the "recoverable basis". Had the net realizable value estimate been unavailable to management, a value-in-use estimate (net present value of the future cash flows) could have been used as the "recoverable basis".

	MRI
Net Realizable value of asset	$750,000
Less: Asset's net book value	$1,285,714
Excess of net book value over fair value	**$ (535,714)**
Potential estimated impairment loss	**$ (535,714)**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $535,714.

Illustration 7c

Cash flow approach – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[30]

Assumptions

An entity operates a government owned-contractor operated (GOCO) manufacturing facility in an economically depressed area fabricating various commodities with commercial applicability. The facility's current net book value is $22,500,000 with an estimated salvage value of $5,000,000 and has a 25 year estimated remaining useful life. Under the terms of the contract, the government provides the contractor with exclusive use of the facility in exchange for negotiated lease payments in the amount of $150,000 per year. The contractor is responsible for all maintenance and operating costs.

Recently this unique partnership has come under federal and state scrutiny as many legislators and environmentalists have expressed concerns that the contractor whose operations have caused contamination found in and around the facility is not being held financially responsible for the cleanup costs.

Outrage which has surfaced during congressional hearings on environmental cleanups has become the focus of print and cable-news outlets.

Further complicating management's "crisis response" is that (1) the contract effectively prohibits modifying the facility to achieve greater environmental compliance without legislative relief and (2) the contracting officer has initiated debarment procedures that effectively would shut down the facility in 90-days for an indeterminable amount of time.

Facilities managers and engineers believe that a prospective buyer can be found but that it will take significant time to pass all necessary sale requirements. Until then, they advise that the facility can be quickly reconfigured and partitioned into commercially viable long-term storage space. The required modifications would cost $500,000 and lease agreements are estimated to generate approximately $35,000 in annual revenues. A fairly recent analysis completed 9 months ago reveals that the property's net realizable value (NRV) was at that time, $30,000,000; 20 percent of which is attributable to land.

Management has approved the reconfiguration and partition plan and believes that it will take a minimum of 5 years before all approvals are in place and disposal efforts can begin and an additional 2 years to ultimately dispose of the property. Because

[30] Illustration 7c adapted from: Military Law Review, Volume 131 Winter 1991; - Government Owned – Contractor Operated Munitions Facilities*: Are they appropriate in the age of strict environmental compliance and liability?;* Major Mark J. Connor.

management is concerned with the proper financial reporting of this event, it has asked its comptroller for advice.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in manner of use. The magnitude test has also been met due to (1) federal and state scrutiny, (2) media coverage, and (3) the fact that the cost of operating the facility has drawn management's attention to evaluate the asset's continued service use and seek the comptroller's advice. Because the entity is seeking appropriate approvals to commence disposal efforts and does not know when such permission will be granted, management intends to convert a portion of the facility for public storage; a change in the manner of use.

Measurement of potential estimated impairment loss

Calculate Net book value:

Calculate Net book value:	**Facility**
Assets' net book value at 12/31/X1 (a) (excluding land)	**$22,500,000 (a)**

Calculate undiscounted cash flows:

Calculate undiscounted cash flows:	**Facility**
Required modifications (outflow)	($500,000)
Undiscounted cash in-flows from future rental lease payments (7 x $35K)	$245,000
Undiscounted cash in-flows from disposal of assets (1.0 -0.2 X $30Mil)	24,000,000
Total - undiscounted cash flows (b)	**$23,745,000 (b)**

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Calculate Recoverability: (b minus a)

Calculate Recoverability: (b minus a)	Facility
Total - undiscounted cash flows (b)	$23,745,000
Assets' net book values at 12/31/X1 (a)	22,500,000
Recoverability (b minus a)	$1,245,000
Is Net book value Recoverable?	Yes
Is asset subject to potential impairment?	No

Reporting Considerations

There is no potential estimated impairment loss to consider or recognize because the undiscounted cash flows to be recovered are greater than the G-PP&E's net book value.

Illustration 7d

Cash flow Approach (Calculating value-in-use using discounted cash flows) – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[31]

Assumptions

Same facts as Illustration 7c above except that (1) management has decided to reconfigure the facility and lease available storage space for the remaining life of the facility, (2) the net realizable value estimate is $2 million, and (3) the salvage value is $500,000. Furthermore, because management does not believe that a prospective buyer can be found it decides not to seek disposal authority. The entity's comptroller advises management that to assess whether or not a potential impairment exists a value-in-use estimate would be appropriate to use because it is higher than the net realizable value estimate. A risk-free discount rate of 3 percent is used.

Evaluation of potential estimated impairment loss

In this case the entity should (1) use the undiscounted cash flows to calculate recoverability and (2) present value (i.e., discount) the undiscounted cash flows to calculate the value-in-use estimate. In so doing, a potential estimated impairment loss is realized. Calculations follow:

Calculate cash flows:

	Undiscounted	PV Factor	Discounted
Required modifications (outflow)	($500,000)	1.00	($500,000)
Undiscounted cash in-flows from future rental lease payments (25 x $35K)	$875,000	17.41315	$609,460
Undiscounted cash in-flows from disposal of assets)	$500,000	0.47761	$238,805
Total - cash flows (b)	**$875,000**		**$348,265**

[31] Adapted from: Military Law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

Calculate Recoverability: (b minus a)

Recoverability: (b minus a)	Facility
Total - undiscounted cash flows (b)	$875,000
Assets' net book values at 12/31/X1 (a)	22,500,000
Recoverability (b minus a)	($21,625,000)
Is net book value recoverable?	No
Is asset subject to potential impairment?	Yes

Calculate potential estimated impairment loss:

Potential impairment:	Facility
Higher of NRV or Value-in-Use: NRV = $2,000,000 (given) Value-in-Use = $348,265 (discounted Cash Flows)	
Use the higher - Net Realizable Value	$2,000,000
Less: Assets' net book value at 12/31/X1	$22,500,000
Excess of net book value over recoverable value (in use)	$20,500,000
Potential estimated impairment loss	$20,500,000

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $20,500,000.

This is the original Statement;
please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_44.pdf.

Appendix C: Abbreviations

ASC	Accounting Standards Codification (FASB)
CFR	Consolidated financial report of the U.S. government
DM-AI	Deferred Maintenance and Asset Impairment (task force)
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GASBS	Governmental Accounting Standards Board Statement
G-PP&E	General property, plant, and equipment
IG	Inspector General
IPSASB	International Public Sector Accounting Standards Board
IPSAS	International Public Sector Accounting Standards
IT	Information technology
MRI	Magnetic resonance imaging
NRV	Net realizable value
O&M	Operation and maintenance
OMB	Office of Management and Budget
PP&E	Property, plant and equipment
PRV	Plant replacement value
psf	Per square foot
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

This is the original Statement;
please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_44.pdf.

Appendix D: Glossary

General property, plant, and equipment (G-PP&E) - G- PP&E is any property, plant, and equipment (PP&E) used in providing goods or services and includes, among other types of PP&E, multi-use heritage assets, capitalized improvements to stewardship land, and construction work-in-process. PP&E includes land and land rights that are acquired for or in connection with items of general PP&E used to provide government services or goods. GPP&E does not include heritage assets such as historic and national landmarks and stewardship land; reporting for these assets should be done in accordance with SFFAS 29, Heritage Assets and Stewardship Land. The cost of general PP&E is capitalized, i.e. recorded as assets on the balance sheet. For detailed characteristics of and accounting for general PP&E, see SFFAS 6, pars 23 through 45.

Impairment - a significant[32] and permanent decline in the service utility of G-PP&E or expected service utility for construction work in progress.

Internal use software - software that is purchased from commercial vendors "off-the shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs (SFFAS 10, par. 8).

Level of utilization - the portion of the usable capacity currently being used.

Partial impairment - less than full or total impairment.

Service utility - the usable capacity that at acquisition was expected to be used to provide service.

Total (full) impairment - G-PP&E is no longer capable of providing service in the operations of the entity prior to the end of its estimated useful life.

[32] The determination of whether or not an item is significant is a matter of professional judgment. Determining if a decline in service utility is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

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FASAB Board Members

Tom L. Allen, Chair

Robert F. Dacey

Norman Dong

Michael Granof

Sam M. McCall

Mark Reger

D. Scott Showalter

Graylin Smith

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Domenic N. Savini

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

DEFERRAL OF THE TRANSITION TO BASIC INFORMATION FOR LONG-TERM PROJECTIONS

Amending SFFAS 36

Statement of Federal Financial Accounting Standards 45

July 8, 2013

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_45.pdf.

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be issued before an exposure draft is released on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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TABLE OF CONTENTS

Summary 3
Introduction 4
- **Purpose** 4
- **Materiality** 4

Standards 5
- **Scope** 5
- **Amendments** 5
- **Effective Date** 5

Appendix A: Basis for Conclusions 6
- **Project History** 6
- **Responses to the Proposal** 7
- **Board Approval** 7

Appendix B: Audit Considerations regarding Basic Information and RSI 8
Appendix C: Abbreviations 11
Appendix D: Glossary 12

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_45.pdf.

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SUMMARY

This Statement defers for one year the transition of the statement presenting long-term fiscal projections for the U.S. government and related disclosures from required supplementary information (RSI) to basic information. Basic information is the information that is deemed essential for the financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP). RSI is information that a body that establishes GAAP requires to accompany basic information. While both categories of information are required, the auditor subjects the two categories of information to different procedures and complies with different reporting requirements under generally accepted government auditing standards (GAGAS).

When an auditor is engaged to audit an entity's financial statements, basic information as a whole is subject to testing for conformity with GAAP. RSI is unaudited, but is subject to certain procedures specified by GAGAS. These procedures include (a) inquiring of management regarding the methods used to prepare the information, (b) comparing the information for consistency with management's responses to the foregoing inquiries, the basic financial statements, and other knowledge obtained during the audit of the basic financial statements, and (c) obtaining relevant written management representations.[1] Deficiencies in basic information affect the auditor’s opinion on the financial statements taken as a whole while deficiencies in RSI do not, but are noted in the auditor’s report on the financial statements.

[1] American Institute of CPAs, Auditing Standards – Clarified (AU-C), Section 730.05.

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INTRODUCTION

PURPOSE

1. This Statement amends the effective date of the phased implementation established in Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Projections for the U.S. Government*. When fully implemented, SFFAS 36 requires a basic financial statement in the consolidated financial report of the U.S. Government (CFR), disclosures, and related required supplementary information (RSI). To allow a phased implementation, a three-year transition period was provided during which all information was RSI. With this amendment, a four-year transition period is provided and beginning in fiscal year (FY) 2014 SFFAS 36 will require information to be presented as follows:
    a. The basic financial statement will present for all activities:
        i. the present value of projected receipts and non-interest spending under current policy without change,
        ii. the relationship of these amounts to projected Gross Domestic Product (GDP), and
        iii. changes in the present value of projected receipts and non-interest spending from the prior year.
    b. Disclosures will explain and illustrate:
        i. the assumptions underlying the projections,
        ii. factors influencing trends, and
        iii. significant changes in the projections from period to period.
    c. RSI will explain and illustrate the projected trends in:
        i. the relationship between receipts and spending,
        ii. deficits or surpluses,
        iii. Treasury debt held by the public as a share of GDP,
        iv. possible results using alternative scenarios, and
        v. the likely impact of delaying corrective action when a fiscal gap exists.
2. During the additional transition year – FY 2013 - all of the above information will be reported as RSI.

MATERIALITY

3. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE

4. This Statement applies to the consolidated financial report of the U.S. Government (CFR).
5. This Statement amends SFFAS 36, *Comprehensive Long-Term Projections for the U.S. Government,* to defer full implementation of its requirements by one year.

AMENDMENTS

6. Par. 45 of SFFAS 36 is replaced by the following:

> 45. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2013.
>
> a. These standards are effective for periods beginning after September 30, 2009.
>
> b. Information should be reported as RSI for the first four years of implementation (fiscal years 2010, 2011, 2012, and 2013).
>
> c. Beginning in fiscal year 2014, the required information should be presented as specified in paragraphs 12 - 42.
>
> d. Earlier implementation is encouraged.

EFFECTIVE DATE

7. The requirements of this Statement are effective upon issuance.

The provisions of this Statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. Inclusion of audited long-term fiscal projections in U. S. federal government financial reports began in fiscal year 2006 with the statement of social insurance. A number of individual programs, such as Social Security and Medicare, provide a statement of social insurance as well a statement of changes in social insurance amounts. In 2009, the Board issued SFFAS 36, *Comprehensive Long-Term Projections for the U.S. Government,* and broadened requirements for long-term fiscal projections beyond these discrete social insurance programs. SFFAS 36 requires comprehensive projections for all government receipts and expenditures.

A2. The Board recognized the uncertainty inherent in making the policy, economic, and demographic assumptions necessary for comprehensive projections. The standards, therefore, provide for the exercise of judgment in selecting assumptions and require information to aid the reader in understanding and considering uncertainty and alternative outcomes. The audit community is considering the need to revise the audit guidance, including initial guidance developed for the statement of social insurance, to address such comprehensive projections.

A3. The American Institute of CPAs (AICPA) Auditing Standards Board (ASB) organized the Prospective Information Task Force to consider the auditor's responsibility for prospective financial information. The task force charge is to consider audit guidance for both the prospective information proposed by the Governmental Accounting Standards Board (GASB) in its November 2011 preliminary views document, *Economic Condition Reporting: Financial Projections*, and the statement of long-term fiscal projections required by FASAB. Because the GASB's preliminary view is that projections would be presented as RSI, the task force does not anticipate a need for additional guidance regarding such projections. The task force is presently considering guidance for auditors and appropriate audit report language regarding the statement of long-term fiscal projections. The task force also may consider revisions to the audit report language regarding the statement of social insurance and the statement of changes in social insurance amounts.

A4. To allow the Prospective Information Task Force time to develop needed guidance, the Board considered amending SFFAS 36 to extend by one year the transition period established for eventually presenting long-term fiscal projections as basic information in the consolidated financial report of the U. S. government. During the extended transition period, all the required information would continue to be provided as RSI. The Board released an exposure draft (ED), entitled *Deferral of Transition to Basic Information for Long-Term Projections,* on November 20, 2012, with comments requested by January 31, 2013.

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RESPONSES TO THE PROPOSAL

A5. The Board received 13 response to the exposure draft from the following sources:

Table 1.0 – Types of Respondents

	Federal (Internal)	Non-federal (External)
Users, academics, others		4
Auditors	2	
Preparers and financial managers	7	

A6. The Board considered responses to the exposure draft at its February 27, 2013, public meeting. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised.

A7. Of the 13 responses, 11 supported the proposed extension. Of the remaining two, one offered no comment and the other suggested the Board seek input from citizens and particularly younger taxpayers. The Board welcomes and encourages the input of citizens and will consider ways to reach more citizens.

BOARD APPROVAL

A8. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

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APPENDIX B: AUDIT CONSIDERATIONS REGARDING BASIC INFORMATION AND RSI

This summary table serves as an aid to the reader in understanding the implications of the deferral. It is not complete as it does not present in detail the auditing standards established by the American Institute of CPAs. Also, it has not been updated since its original issuance.

	Basic Information	**RSI**
Is the information required to be in the federal financial report? Source: FASAB, Statement of Federal Financial Accounting Concepts (SFFAC) 2, Entity and Display, par. 73C and AICPA Auditing Standards as Clarified (AU-C) 730.04	Yes	Yes
Is the information deemed essential if the financial statements are to "present fairly" in conformity with GAAP? Source: FASAB SFFAC 2, par. 73B and 73C, and AICPA AU-C 730.04	Yes	No
What are the objectives of the auditor regarding basic information and RSI?	The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements. …As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level	The objectives of the auditor when a designated accounting standard setter requires information to accompany an entity's basic financial statements are to perform specified procedures in order to a. describe, in the auditor's report, whether required supplementary information is presented and b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standard setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standard setter.

	Basic Information	RSI
	of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (AICPA, AU-C 200 .04 and 200.06)	(AICPA, AU-C 730.03)
What audit fieldwork is required?	Audit procedures in accordance with applicable auditing standards and requirements.[2]	Limited procedures pursuant to AU-C 730.05-.06.
What is to be provided in the auditor's report?	When expressing an unmodified opinion on financial statements, the auditor's opinion should state that the financial statements present fairly, in all material respects, the financial position of the entity as of the balance sheet date and the results of its operations and its cash flows for the period then ended, in accordance with the applicable financial reporting framework. Also, the auditor's opinion should identify the applicable financial reporting framework and its origin. (AICPA AU–C Section 700.35 and .36)	Statement that the auditor has applied certain limited procedures and a statement that the auditor does not express an opinion or provide assurance on the information. (AICPA, AU-C 730-.08-.09)
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Include a Basis for Modification Paragraph in the Report: If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should so state in the basis for modification paragraph. (AICPA AU-C 705.18)	Include a statement that management has omitted the information and the information is required and is an essential part of financial reporting. Also, the auditor would state that the opinion on the basic financial statements is not affected by the missing information. (AICPA AU-C 730.08e) In addition, if the measurement or presentation of the information departs materially from the prescribed guidelines, the auditor would state that although the opinion on the basic financial

[2] The phrase "applicable auditing standards and requirements" is used to refer to auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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	Basic Information	RSI
		statements is not affected, material departures from the prescribed guidelines exist and the auditor would describe the departures. (AICPA AU-C 730.08f)
	If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor should include in the basis for modification paragraph an explanation of how the disclosures are misstated. (AICPA AU-C 705.19)	
	If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should describe in the basis for modification paragraph the nature of the omitted information; and include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (AICPA AU-C 705.20)	
	Modify the Auditor's Opinion: A qualified opinion states that except for the effects of the matter(s) described in the basis for qualified opinion paragraph, the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (AICPA AU-C 705.24)	
	An adverse opinion states that the financial statements are not presented fairly in accordance with the applicable financial reporting framework. (AICPA AU-C 705.25)	

Source: The Federal Accounting Standards Advisory Board developed this summary but does not establish audit standards. For guidance regarding auditing standards, please refer to the source documents identified in the summary.

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APPENDIX C: ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
ASB	Auditing Standards Board
AU-C	Auditing Standards - Clarified
CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal year
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
OMB	Office of Management and Budget
RSI	Required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

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APPENDIX D: GLOSSARY

Basic Financial Statements	As used in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* the basic financial statements are those on which an auditor would normally be engaged to express an opinion. The term "basic" does not necessarily mean that other financial information not covered by the auditor's opinion is less important to users than that contained in the basic statements; it merely connotes the expected nature of the auditor's review of, and association with, the information. The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the "principal financial statements." The Form and Content of these statements are determined by OMB. (see also Principal Financial Statements)
Basic Information	Information that is essential for financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).
Required Supplementary Information	Information that a body that establishes GAAP requires to accompany basic information. When an auditor is engaged to audit an entity's financial statements, basic information is subject to testing for fair presentation in conformity with GAAP. However, RSI for federal entities is unaudited but subject to certain procedures specified by Generally Accepted Government Auditing Standards for RSI.

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Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548

Telephone: 202-512-7350

FAX: 202-512-7366

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Federal Accounting Standards Advisory Board

DEFERRAL OF THE TRANSITION TO BASIC INFORMATION FOR LONG-TERM PROJECTIONS

Amending SFFASs 36 and 45

Statement of Federal Financial Accounting Standards 46

October 17, 2014

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
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SUMMARY

This Statement provides a second one-year deferral of the transition of the statement presenting long-term fiscal projections for the U.S. government and related disclosures from required supplementary information (RSI) to basic information. Basic information is the information that is deemed essential for the financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP). RSI is information that a body that establishes GAAP requires to accompany basic information. While both categories of information are required, the auditor subjects the two categories of information to different procedures and complies with different reporting requirements under generally accepted government auditing standards (GAGAS).

This second deferral permits:

- the audit community to complete its consideration of the need for revised guidance, and
- the preparer time to plan for the audit.

During the deferral period, the consolidated financial report of the U. S. government will continue to report as RSI the information necessary for the reader to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Deferral of the transition to basic information provides an additional year for the American Institute of CPAs (AICPA) to develop guidance for audit reports on long-term fiscal projections.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_46.pdf.

TABLE OF CONTENTS

Summary 1
Table of Contents 2
Introduction 3
Purpose 3
Materiality 4
Standards 5
Scope 5
Amendments 5
Effective Date 5
Appendix A: Basis for Conclusions 6
Project History 6
Responses to the Proposal 7
Board Approval 7
Appendix B: Audit Considerations regarding Basic Information and RSI 8
Appendix C: Abbreviations 11
Appendix D: Glossary 12

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_46.pdf.

INTRODUCTION

PURPOSE

1. This Statement amends the effective date of the phased implementation first established in Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Projections for the U.S. Government* and later amended by SFFAS 45, *Deferral of the Transition to Basic Information for Long-Term Projections*. When fully implemented, SFFAS 36 requires a basic financial statement in the consolidated financial report of the U.S. Government (CFR), disclosures, and related required supplementary information (RSI). To allow a phased implementation, a three-year transition period was provided during which all information was RSI. The transition period was deferred one-year from the originally planned effective date of fiscal year (FY) 2013 to FY 2014.
2. SFFAS 36, as amended, requires information to be presented as follows in FY 2014:
    a. The basic financial statement would present for all activities:
        i. the present value of projected receipts and non-interest spending under current policy without change,
        ii. the relationship of these amounts to projected Gross Domestic Product (GDP), and
        iii. changes in the present value of projected receipts and non-interest spending from the prior year.
    b. Disclosures would explain and illustrate:
        i. the assumptions underlying the projections,
        ii. factors influencing trends, and
        iii. significant changes in the projections from period to period.
    c. RSI would explain and illustrate the projected trends in:
        i. the relationship between receipts and spending,
        ii. deficits or surpluses,
        iii. Treasury debt held by the public as a share of GDP,
        iv. possible results using alternative scenarios, and
        v. the likely impact of delaying corrective action when a fiscal gap exists.
3. This Statement amends the transition period provided in SFFAS 36, as amended, to allow one additional year – FY 2014 – during which all of the above information would be reported as RSI.

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MATERIALITY

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE

5. This Statement applies to the consolidated financial report of the U.S. Government (CFR).
6. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Projections for the U.S. Government,* and SFFAS 45, *Deferral of the Transition to Basic Information for Long-Term Projections,* to defer full implementation of its requirements by one year.

AMENDMENTS

7. SFFAS 45 is rescinded.
8. Par. 45 of SFFAS 36 is replaced by the following:

    45. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2014.

        a. These standards are effective for periods beginning after September 30, 2009.

        b. Information should be reported as RSI for the first five years of implementation (fiscal years 2010, 2011, 2012, 2013, and 2014).

        c. Beginning in fiscal year 2015, the required information should be presented as specified in paragraphs 12 - 42.

        d. Earlier implementation is encouraged.

EFFECTIVE DATE

9. The requirements of this Statement are effective upon issuance.

The provisions of this Statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. Inclusion of audited long-term fiscal projections in U. S. federal government financial reports began in fiscal year 2006 with the statement of social insurance. A number of individual programs provide a statement of social insurance including Social Security and Medicare. In 2009, the Board issued SFFAS 36 and broadened requirements for long-term fiscal projections beyond these discrete social insurance programs. SFFAS 36 requires comprehensive projections for all government receipts and expenditures and the OMB prepares these projections.

A2. The Board recognized the uncertainty inherent in making the policy, economic, and demographic assumptions necessary for comprehensive projections. The standards, therefore, provide for the exercise of judgment in selecting assumptions and require information to aid the reader in understanding and considering uncertainty and alternative outcomes. The audit community has been considering the need to revise the audit guidance, including initial guidance developed for the statement of social insurance, to address such comprehensive projections.

A3. In 2012, the American Institute of CPAs (AICPA) Auditing Standards Board (ASB) organized the Prospective Information Task Force to consider the auditor's responsibility for prospective financial information. The Board provided a one-year deferral to allow time for the task force to develop guidance. The task force has been considering guidance for auditors and appropriate audit report language regarding the statement of long-term projections, the statement of social insurance, and the statement of changes in social insurance amounts. Final guidance is expected to be issued in 2014 or early 2015. Additional time will be needed for the preparer and the auditor to plan for the audit based upon the final guidance.

A4. Therefore, the Board proposed an additional one-year deferral of the transition of long-term fiscal projections from RSI to basic information is warranted. The Board released an exposure draft (ED), entitled *Deferral of Transition to Basic Information for Long-Term Projections: Amending SFFASs 36 and 45,* on April 30, 2014, with comments requested by June 2, 2014.

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RESPONSES TO THE PROPOSAL

A5. The Board received 12 responses to the exposure draft. Of these responses, five were from non-federal organizations or individuals, five from federal chief financial officer organizations, and two from federal offices of inspectors general. One respondent indicated the organization had no comment on the proposal. Three non-federal respondents objected to the proposal and the remaining respondents supported the proposal.

A6. The Board considered responses to the exposure draft at its June 25, 2014, public meeting. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' views are provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised.

A7. Respondents opposed to deferring the transition to basic information noted the importance of the information to citizens as well as the time already provided for development of audit guidance. The Board considered the importance of the information when developing the proposal. In making its decision, the Board weighed the need for appropriate audit guidance and for time to plan for an audit under that guidance against the effect of a one-year delay. Because the information has been and will continue to be provided as RSI, the Board decided to provide the deferral. Thus, even with the deferral, the information will continue to be available and subject to the existing auditing standards related to RSI (see Appendix B for more information about audit considerations).

BOARD APPROVAL

A8. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

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APPENDIX B: AUDIT CONSIDERATIONS REGARDING BASIC INFORMATION AND RSI

This summary table serves as an aid to the reader in understanding the implications of the proposed deferral. It is not complete as it does not present in detail the auditing standards established by the American Institute of CPAs.

	Basic Information	**RSI**
Is the information required to be in the federal financial report? Source: FASAB, Statement of Federal Financial Accounting Concepts (SFFAC) 2, Entity and Display, par. 73C and AICPA Auditing Standards as Clarified (AU-C) 730.04	Yes	Yes
Is the information deemed essential if the financial statements are to "present fairly" in conformity with GAAP? Source: FASAB SFFAC 2, par. 73B and 73C, and AICPA AU-C 730.04	Yes	No
What are the objectives of the auditor regarding basic information and RSI?	The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements. …As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion	The objectives of the auditor when a designated accounting standard setter requires information to accompany an entity's basic financial statements are to perform specified procedures in order to a. describe, in the auditor's report, whether required supplementary information is presented and b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standard setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated

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	Basic Information	RSI
	when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (AICPA, AU-C 200 .04 and 200.06)	accounting standard setter. (AICPA, AU-C 730.03)
What audit fieldwork is required?	Audit procedures in accordance with applicable auditing standards and requirements.[1]	Limited procedures pursuant to AU-C 730.05-.06.
What is to be provided in the auditor's report?	When expressing an unmodified opinion on financial statements, the auditor's opinion should state that the financial statements present fairly, in all material respects, the financial position of the entity as of the balance sheet date and the results of its operations and its cash flows for the period then ended, in accordance with the applicable financial reporting framework. Also, the auditor's opinion should identify the applicable financial reporting framework and its origin. (AICPA AU–C Section 700.35 and .36)	Statement that the auditor has applied certain limited procedures and a statement that the auditor does not express an opinion or provide assurance on the information. (AICPA, AU-C 730-.08-.09)
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Include a Basis for Modification Paragraph in the Report: If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should	Include a statement that management has omitted the information and the information is required and is an essential part of financial reporting. Also, the auditor would state that the opinion on the basic financial statements is not affected by the missing information. (AICPA AU-C 730.08e) In addition, if the measurement or presentation of the information departs materially from the prescribed guidelines, the auditor

[1] The phrase "applicable auditing standards and requirements" is used to refer to auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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	Basic Information	RSI
	so state in the basis for modification paragraph. (AICPA AU-C 705.18) If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor should include in the basis for modification paragraph an explanation of how the disclosures are misstated. (AICPA AU-C 705.19) If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should describe in the basis for modification paragraph the nature of the omitted information; and include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (AICPA AU-C 705.20) Modify the Auditor's Opinion: A qualified opinion states that except for the effects of the matter(s) described in the basis for qualified opinion paragraph, the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (AICPA AU-C 705.24) An adverse opinion states that the financial statements are not presented fairly in accordance with the applicable financial reporting framework. (AICPA AU-C 705.25)	would state that although the opinion on the basic financial statements is not affected, material departures from the prescribed guidelines exist and the auditor would describe the departures. (AICPA AU-C 730.08f)

Source: The Federal Accounting Standards Advisory Board developed this summary but does not establish audit standards. For guidance regarding auditing standards, please refer to the source documents identified in the summary.

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APPENDIX C: ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
ASB	Auditing Standards Board
AU-C	Auditing Standards - Clarified
CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal year
GAAP	Generally Accepted Accounting Principles
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GDP	Gross Domestic Product
OMB	Office of Management and Budget
RSI	Required supplementary information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States

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APPENDIX D: GLOSSARY

Basic Financial Statements	As used in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* the basic financial statements are those on which an auditor would normally be engaged to express an opinion. The term "basic" does not necessarily mean that other financial information not covered by the auditor's opinion is less important to users than that contained in the basic statements; it merely connotes the expected nature of the auditor's review of, and association with, the information. The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the "principal financial statements." The Form and Content of these statements are determined by OMB. (see also Principal Financial Statements)
Basic Information	Information that is essential for financial statements and notes to be presented in conformity with generally accepted accounting principles (GAAP).
Required Supplementary Information	Information that a body that establishes GAAP requires to accompany basic information. When an auditor is engaged to audit an entity's financial statements, basic information is subject to testing for fair presentation in conformity with GAAP. However, RSI for federal entities is unaudited but subject to certain procedures under Generally Accepted Government Auditing Standards for RSI.

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FASAB Board Members

Tom L. Allen, Chair

R. Scott Bell

Robert F. Dacey

Michael H. Granof

Sam M. McCall

Mark Reger

D. Scott Showalter

Graylin E. Smith

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548

Telephone: 202-512-7350

FAX: 202-512-7366

www.fasab.gov

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Federal Accounting Standards Advisory Board

REPORTING ENTITY

Statement of Federal Financial Accounting Standards 47

December 23, 2014

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be issued before an exposure draft is released on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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SUMMARY

This Statement establishes principles to include organizations for which elected officials are accountable in general purpose federal financial reports (GPFFRs). The principles guide financial reporting to recognize the complex diverse organizations possessing varying legal designations (for example, government agencies, not-for-profit organizations, corporations) that are used to address public policy challenges. The principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes. Rather, the principles guide preparers of financial statements at the government-wide and component reporting entity levels in determining what organizations should be included in the reporting entity's GPFFR for financial accountability purposes.

The government-wide GPFFR should include all organizations (1) budgeted for by elected officials of the federal government, (2) owned by the federal government, or (3) controlled by the federal government with risk of loss or expectation of benefits. In addition, this Statement establishes that an organization be included in the government-wide GPFFR if it would be misleading to exclude it even though it does not meet one of the three inclusion principles. When any of these conditions exists, information regarding the organization is necessary to provide accountability.

This Statement provides for determining the most appropriate means—consolidated financial statements or disclosures—to include information about these organizations in GPFFRs. Determining the most appropriate means requires an assessment of the degree to which the following characteristics are met: the organization is financed by taxes or other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards on the federal government, and/or provides goods and services on a non-market basis. Note, however, not all characteristics are required to be met to the same degree; classification is based on the assessment as a whole.

Generally, consolidated financial statements presenting the financial position and results of operations are appropriate for those organizations that are to a large degree financed by taxes and other non-exchange revenue, governed by elected officials, imposing risks and rewards on the federal government, and providing goods and services on a non-market basis. Consolidated financial statements present the financial information as if the organizations were a single economic entity. Such a presentation is needed to show-–in the aggregate—the net cost financed by taxes and other non-exchange revenue, the assets available for use, and the liabilities to be settled in the future. Organizations to be consolidated in the consolidated financial statements within the GPFFR are referred to as "consolidation entities." Consolidation entities should apply Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Some organizations that meet the principles for inclusion are to a large degree insulated from political influence and not intended to be funded primarily by taxes and other non-exchange revenue. Presenting information about these discrete organizations in consolidated financial statements would obscure the operating results and financial position of the reporting entity. Instead, information about these types of discrete organizations should be disclosed in notes to

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the consolidated financial statements of reporting entities applying federal financial accounting standards. The disclosures should reveal the nature of the relationship to the reporting entity, relevant activity during the reporting period, and the reporting entity's future exposures to risks and rewards resulting from the relationship. Organizations to be disclosed in the GPFFR are referred to as "disclosure entities." While the hierarchy of generally accepted accounting principles (GAAP) established for federal reporting entities may not necessarily apply to disclosure entities; information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

This Statement establishes that each component reporting entity's GPFFR include all organizations for which it is accountable. This includes all consolidation entities and disclosure entities administratively assigned to it. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs including information regarding disclosure entities.

In addition to the relationships that lead to organizations being included in the GPFFR based on the principles described above, the federal government may have significant relationships with other parties. This Statement requires disclosures if one party to an established relationship has the ability to exercise significant influence over the other party in making policy decisions, and the relationship is of such significance that it would be misleading to exclude information about it. The parties engaged in these relationships are "related parties." With respect to related parties, the disclosures would provide information about the nature of the government's relationship with the related party and other information to aid in understanding the relationship, including exposures to risk of loss or potential gain as a result of the relationship.

This Statement is effective for periods beginning after September 30, 2017. Earlier implementation is not permitted.

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TABLE OF CONTENTS

Summary **1**
Introduction **4**
Purpose **4**
Materiality **5**
Standards **6**
Scope and Applicability **6**
Definitions **6**
Organizational Approach to Defining Boundaries **7**
Principles for Inclusion in the Government-wide GPFFR **8**
In the Budget 9
Majority Ownership Interest 9
Control with Risk of Loss or Expectation of Benefit 10
Misleading to Exclude 12
Reporting on Organizations—Consolidation Entities or Disclosure Organizations **13**
Consolidation entities 13
Disclosure organizations 14
Identifying Organizations Component Reporting Entities Are Accountable For **16**
Scope of the Budget Process 17
Accountability Established Within a Component Reporting Entity 18
Misleading to Exclude and / or Misleading to Include 19
GPFFR Consolidation and Disclosure **20**
Consolidation entities 20
Reporting on Disclosure organizations 21
Minimum Disclosures Regarding the Central Banking System **25**
Related Parties **25**
Effect on Existing Concepts—Proposed Amendments to SFFAC 2, *Entity and Display* **28**
Effective Date **31**
Appendix A: Basis for Conclusions **32**
Appendix B: Flowchart **56**
Appendix C: Illustrations **57**
Appendix D: Abbreviations **88**
Appendix E: Task Force Members **89**
Appendix F: Glossary **90**

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas_47.pdf.

INTRODUCTION

PURPOSE

1. The federal government and its relationships with organizations have become increasingly complex. Notwithstanding these complexities, **general purpose federal financial reports**[1] (GPFFR) for the government-wide reporting entity should be broad enough to reflect the Congress and/or the President's accountability for those organizations. In addition, **component reporting entity** GPFFRs should allow the Congress and/or the President to hold management accountable. Although Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, addresses identifying **reporting entities** and criteria for including components in a reporting entity, questions have continued in this area indicating the need for standards.[2] Standards that can be used to identify organizations to include in the GPFFR of the government-wide reporting entity and each component reporting entity are important to meet federal financial reporting objectives.

2. This Statement guides preparers of GPFFRs in determining what organizations to report upon, whether such organizations are considered "consolidation entities" or "disclosure entities,"[3] and what information should be presented. This guidance, together with existing guidance, will ensure that users of GPFFRs are provided with comprehensive financial information about federal reporting entities and their relationships so that federal financial reporting objectives[4] are met. This Statement requires reporting entities to disclose certain information about disclosure entities administratively assigned to them. It does not require new **disclosures** regarding consolidation entities administratively assigned to reporting entities. Any existing required disclosures for the consolidated financial statements of the reporting entity, which include the consolidation entities, would continue to apply. While not specifying the inclusion or classification of the components of the central banking system, this Statement does establish certain minimum disclosures regarding the central banking system.

3. This Statement also guides preparers of GPFFRs in identifying **related parties** and in determining what information to provide about related party relationships of such significance that it would be misleading to exclude information. There are disclosures

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.
[2] Statement of Federal Financial Accounting Concepts 2 is considered Other Accounting Literature. See Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the Financial Accounting Standards Board,* for more information regarding the hierarchy.
[3] "Consolidation entities" and "disclosure entities" are terms used to distinguish between entities based on the degrees to which the entity is (1) financed by taxes or other non-exchange revenue, (2) governed by the Congress and/ or the President, (3) imposing or may impose risks and rewards to the federal government and (4) providing goods and services on a market or non-market basis. See paragraphs 38 - 55 for more information.
[4] Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting.*

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required regarding the nature of the relationship and financial-related exposures to risk of loss or potential gain resulting from relationships with such related parties.

4. The guidance recognizes that an organization's legal form may not reflect the substance of the relationship between the federal government and the organization. As such, the legal form or designation of an organization does not always determine whether it should be included in the government-wide GPFFR. Even in cases where legislation indicates an organization is "not an agency or instrumentality" of the federal government, the organization should be assessed against the guidance contained in this Statement to determine whether it should be included in the reporting entity's GPFFR. Inclusion results from a need for accountability given the nature of the relationship between the federal government and the organization but inclusion does not change the legal form of the organization.

MATERIALITY

5. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE AND APPLICABILITY

6. This Statement applies to federal reporting entities that prepare general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board* (FASB). Paragraph 66 of this Statement also applies to federal reporting entities that prepare GPFFRs in conformance with GAAP as provided by paragraphs 9 through 12 of SFFAS 34.[5]

7. This Statement does not require any entity to prepare and issue GPFFRs. The purpose of this Statement is to enable federal reporting entities preparing and issuing GPFFRs to determine:

   a. whether SFFAS 34 is applicable to an organization,

   b. what organizations should be included in the GPFFR of federal reporting entities applying SFFAS 34,

   c. the manner in which information should be presented for organizations included in the GPFFR, and

   d. what disclosures, if any, are needed regarding related parties.

DEFINITIONS

8. **Reporting Entity—**Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term "reporting entity" may refer to either the government-wide reporting entity or a component reporting entity (see definitions below).

   Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity.[6] The criteria focus on whether:

   a. An entity's management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that the entity is included in the budget), and is held accountable for the entity's performance.

[5] SFFAS 34, footnote 4, indicates Federal Accounting Standards Advisory Board (FASAB) GAAP would be the appropriate accounting standards for federal reporting entities within the executive, legislative, and judicial branches to adopt.

[6] SFFAC 2, paragraphs 29-38, provides a discussion titled "Identifying the Reporting Entities for General Purpose Financial Reporting."

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b. An entity's financial statements would provide a meaningful representation of operations and financial condition.

c. An entity's financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.

9. **Government-wide Reporting Entity—**The government-wide reporting entity's GPFFR includes all organizations for which the Congress and/or the President are accountable based on principles established in this Statement.

10. **Component Reporting Entity—"**Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.[7] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

11. **Control with risk of loss or expectation of benefit—**"Control with risk of loss or expectation of benefit" is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or to obtain financial resources or non-financial benefits.[8] See paragraphs 26 - 35 for further discussion of control.

12. **Related Parties—**Organizations are considered to be related parties in the GPFFR if the existing relationship[9] or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions.

ORGANIZATIONAL APPROACH TO DEFINING BOUNDARIES

13. The federal government is unique because its constitutionally established powers, motivations, and functions are different from those of all other organizations. It is an extremely complex organization responsible for the common defense and general welfare of the nation. Although there are various perspectives[10] for viewing the federal government, an organizational approach was established in SFFAC 2[11] as the most appropriate perspective for understanding the composition of the federal government. SFFAC 2 established that GPFFRs should include the aggregation of organizations for which the federal government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government are such that

[7] The larger reporting entity could be the government-wide reporting entity or another component reporting entity.
[8] For example, a non-financial benefit would be one in which the federal government benefits from a service being provided to it or on its behalf.
[9] Relationship, as used in this context, refers to material transactions or events involving both parties.
[10] SFFAC 2, paragraphs 13-28, discusses the organizational, budget and program perspectives of the federal government, as well as the intertwining of the perspectives.
[11] SFFAC 2, paragraphs 29-38.

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their exclusion would cause the federal government's financial statements to be misleading or incomplete.

14. Accountability demands comprehensive reporting. To provide comprehensive reporting, the federal government must report on organizations that serve varied purposes and have complex governance structures and finances. In some cases, disclosing financial and other information in the notes about an organization rather than consolidating financial and other information about all organizations may better meet federal financial reporting objectives.

15. This Statement first establishes the principles for identifying organizations to include in the government-wide GPFFR (see Principles for Inclusion in the Government-wide GPFFR beginning with paragraph 20) and then distinguishes between consolidation entities and disclosure entities (see Reporting on Organizations—Consolidation Entities or Disclosure Entities beginning with paragraph 38). In applying these principles and meeting the reporting requirements, "organization" refers to the organization in its entirety including all funding sources (for example, appropriations or donations). The term "organization" is used broadly and may include, among others, departments, agencies, bureaus, divisions, commissions, corporations, and components.

16. This Statement also establishes that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete (see Identifying Organizations for which Component Reporting Entities Are Accountable beginning with paragraph 56).

17. This Statement provides guidance for how to report on consolidation entities and disclosure entities (see GPFFR Consolidation and Disclosure beginning with paragraph 66).

18. This Statement establishes minimum disclosure requirements regarding the central banking system (see paragraph 79).

19. Lastly, this Statement provides for disclosure of related party relationships of such significance that it would be misleading to exclude information about them (see Related Parties beginning with paragraph 80).

PRINCIPLES FOR INCLUSION IN THE GOVERNMENT-WIDE GPFFR

20. This Statement provides three principles for determining which organizations should be included[12] in the government-wide GPFFR (see paragraph 21-35). This Statement also provides an additional principle requiring inclusion of organizations if excluding them would be misleading (see paragraph 36-37). The three principles are to be applied without considering whether the relationship is temporary or permanent. However, whether the relationship is temporary or permanent would influence the likelihood that the entity exhibits the characteristics of a consolidation entity or of a disclosure entity.

[12] "Included" means the information is either consolidated or disclosed.

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21. An organization meeting any one of the three principles below is included in the government-wide GPFFR:

    a. In the Budget

    b. Majority Ownership Interest

    c. Control with Risk of Loss or Expectation of Benefit

IN THE BUDGET

22. An organization with an account or accounts listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information[13] should be included in the government-wide GPFFR unless it is a non-federal organization receiving federal financial assistance.[14] An organization listed in the budget is a non-federal organization receiving federal financial assistance if it is:

    a. a state, local or territorial government, or component thereof, or

    b. a not-for-profit organization.

23. Notwithstanding the above provision regarding non-federal organizations listed in the budget, any entity meeting either of the next two principles (Majority Ownership Interest and Control with Risk of Loss or Expectation of Benefit) should be included in the government-wide GPFFR.

MAJORITY OWNERSHIP INTEREST

24. The federal government (directly or through its components) may have an ownership interest[15] in an organization. An ownership interest is a legal claim on the net residual assets of an organization such as holding shares or other formal equity instruments. The holding of an ownership interest usually but not always entitles the holder to an interest in voting rights.

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[13] The Budget presents information in various forms for different purposes. Only the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information should be used for determining whether information about an entity should be included in the government-wide GPFFR. In the fiscal year 2015 *Budget of the United States Government* (the Budget), the schedule was entitled "*Federal Budget by Agency and Account*."

[14] This Statement adopts the definition of "federal financial assistance" established in the Single Audit Act Amendments of 1996. However, an organization need not be subject to the requirements of the Single Audit Act in order to qualify as a non-federal organization receiving federal financial assistance. As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-federal organizations receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance. For the purposes of these standards, federally-authorized support fees and other charges would be considered other assistance even if legislation granting authority to collect them indicates that the fees or other charges are not considered public monies of the United States.

[15] "Ownership interest" is the possession of substantially all of the benefits and risks incident to ownership. *FASAB Handbook as of June 30, 2014--Glossary.*

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25. Majority ownership interest exists with over 50 percent of the voting rights or net residual assets[16] of an organization. When the federal government (directly or through its components) holds a majority ownership interest in an organization, it should be included as either a consolidation entity or a disclosure entity in the government-wide GPFFR.[17]

CONTROL WITH RISK OF LOSS OR EXPECTATION OF BENEFIT

26. An organization that is controlled by the federal government with risk of loss or expectation of benefit should be included as either a consolidation entity or disclosure entity in the government-wide GPFFR. For these purposes, control with risk of loss or expectation of benefit is defined as follows:

    Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or obtain financial resources or non-financial benefits.[18] Both the power and either the risk of loss or expectation of benefits aspects of the definition should be met to justify inclusion of an organization. Hereafter, control with risk of loss or expectation of benefit is referred to as "control."

27. Control refers to the ability to control, whether or not that ability is actively exercised, and should be assessed at the reporting date regardless of the federal government's ability to change it in the future. In determining whether control exists, it is necessary to determine the substance of the relationship between the federal government and the organization as it may not be completely reflected by the legal form of the relationship.

28. Control does not necessarily mean the federal government has responsibility for the management of the day-to-day operations of an organization. Rather, it is the federal government's authority to determine or influence the policies governing those activities that indicates control.

29. Determining whether control exists requires the application of professional judgment. The federal government achieves its objectives through a wide range of organizations which individually will fall on a continuum. At one end of the continuum, it is clear that an organization does not have the power to act independently and is controlled by the federal government—such as an executive department. At the other end, the organization has the power to act independently and, while the federal government may have a level of influence, it is clear that the federal government does not have control—such as a state or foreign government.

Indicators of Control

[16] For example, the federal government may hold more equity in preferred stock than all other stockholders but the preferred stock may be non-voting.
[17] Ownership interests 50% or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. However, the organization should still be assessed against the control inclusion principle and the misleading to exclude principle.
[18] For example, a non-financial benefit would arise when the federal government receives a service or a service is provided to others on its behalf.

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30. As discussed in the following paragraphs, there are indicators that should be considered in determining whether the federal government controls an organization. As noted above, consideration needs to be given to the nature of the relationship between the federal government and the organization and judgment applied to determine whether control exists.

31. Certain individual indicators provide persuasive evidence that control exists. Because each indicator provides strong evidence of control, meeting any one indicator would generally mean control is present. These indicators are when the federal government has the unilateral authority to:

    a. establish or amend the fundamental purpose and mission of the organization,[19] which may include authorizing the organization to exercise sovereign powers of the federal government and requiring the organization to carry out federal missions and objectives;

    b. appoint or remove a majority of the governing board members;

    c. direct the governing body regarding the establishment and subsequent revision of financial and operating policies of the organization; or

    d. dissolve the organization thereby having access to the assets and responsibility for the obligations.

32. Other indicators provide evidence that control may exist, but must be considered in the aggregate and often require the application of professional judgment in assessing. These indicators are when the federal government has the ability to or is obligated to:

    a. provide significant input into the appointment of members of the governing body of the organization or being involved in the appointment or removal of a significant number of members;

    b. direct the ongoing use of the organization's assets;

    c. direct investment decisions including the liquidation of investments;

    d. appoint or remove key executives or personnel;

    e. approve the budgets or business plans for the organization;

    f. require audits;

    g. veto, overrule, or modify governing board decisions or otherwise significantly influence normal operations;

[19] Congressionally chartered not-for-profit organizations identified under United States Code (U.S.C.) Title 36, Subtitle II and III, should not be considered controlled solely because amendments to their federal charter must be enacted through legislation. Instead, consideration of control over such organizations should be based on paragraphs 31 and 32.

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h. finance the deficits of, provide financial support to, or settle liabilities of the organization;

i. direct the organization to work with the government to provide services to taxpayers which may include determining the outcome or disposition of matters affecting the recipients of services;

j. establish, rescind, or amend the organization's governance framework;

k. establish limits or restrictions on borrowing and investments of the organization; or

l. restrict the capacity to generate revenue of the organization, especially the sources of revenue.

Situations Where Control Does Not Exist

33. Because of the federal government's broad powers and economic influence, control should not be inferred from either:

    a. authority to exercise regulatory powers over an organization; or

    b. economic dependency of the organization on the federal government.

34. The federal government has the power to regulate many organizations by use of its sovereign and legislative powers. For example, the federal government has the power to regulate the behavior of organizations by imposing conditions or sanctions on their operations. However, the governing bodies of the regulated organizations make decisions within the regulatory framework. Regulatory powers do not constitute control for purposes of this Statement because the federal government's interest in these organizations extends only to the regulatory aspects of the operations.

35. Certain organizations may be economically dependent on the federal government but ultimately retain discretion as to whether to accept funding or do business with the federal government. For example, many not-for-profit organizations rely on federal government funding but that does not mean they are controlled by the federal government. Although the federal government may be able to influence organizations dependent on federal funding or business through purchasing power, the federal government typically does not govern their financial and operating policies.

MISLEADING TO EXCLUDE

36. There may be instances when an organization does not meet any one of the three inclusion principles in paragraphs 22 through 35 yet the government-wide GPFFR would be misleading or incomplete if the organization were excluded.[20]

37. Organizations should be included in the government-wide GPFFR if it would be misleading to exclude them.

[20] Although such situations would be rare, this Statement provides for situations that may arise.

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REPORTING ON ORGANIZATIONS—CONSOLIDATION ENTITIES OR DISCLOSURE ENTITIES

38. The principles above should be used to assess what organizations to include in the GPFFR. Next, a distinction should be made between "consolidation entities" and "disclosure entities" as that distinction determines how the organizations will be reported. This distinction, which should be consistent at the government-wide and component reporting entity levels, is based on an assessment of the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis.[21] Note, however, not all characteristics are required to be met or to be met to the same degree; classification is based on the assessment as a whole.

CONSOLIDATION ENTITIES

39. The organizations that should be consolidated in the financial statements in the GPFFR are referred to as "consolidation entities." Generally, an organization is considered a consolidation entity if, based on an assessment[22] of the following characteristics as a whole, the organization:

    a. is financed through taxes and other non-exchange revenues.

    b. is governed by the Congress and/or the President.

    c. imposes or may impose risks and rewards to the federal government.

    d. provides goods and services on a non-market basis.

40. While greater judgment will be needed to classify other organizations, organizations listed in the budget, except for non-federal organizations receiving federal assistance (see paragraph 22), generally would qualify as consolidation entities.

41. For consolidation entities, the governance structure is vertically integrated, such that the chain of command and manner of decision-making leads directly to elected officials. Vertical integration may include the establishment of organizational authorities, development and/or approval of budgets, and the appointment of organizational leaders by elected officials.

42. Entities for which the relationship with the federal government is not expected to be permanent, such as receiverships, conservatorships, and other intervention actions, would be less likely to meet these characteristics as a whole. Such entities generally would not be classified as consolidation entities.

[21] Goods and services are provided on a non-market basis when they are provided free of charge or at charges that bear little relationship to the cost of providing such goods or services.
[22] As discussed in paragraph 38, not all characteristics are required to be met or to be met to the same degree; classification is based on the assessment as a whole.

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DISCLOSURE ENTITIES

43. The federal government has relationships with organizations afforded a greater degree of autonomy than consolidation entities. Some organizations may exercise powers that are reserved to the federal government as sovereign. Other organizations may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of (a) regulatory actions (such as organizations in **receivership or conservatorship**) or (b) other federal government intervention actions. Under such regulatory or other intervention actions, the relationship with the federal government is not expected to be permanent and such entities generally would be classified as disclosure entities when considering the characteristics taken as a whole. To avoid obscuring information about these more autonomous organizations while still providing accountability, such organizations are to be disclosed rather than consolidated in GPFFRs. Hereafter; these organizations are referred to as "disclosure entities."

44. Disclosure entities may maintain a separate legal identity, have a governance structure that vests most decision-making authorities in a governing body to insulate the organization from political influence, and/or have relative financial independence.

45. Disclosure entities may receive limited or no funding from general tax revenues. The Congress and/or the President have less direct involvement in decision-making (governance) than in consolidation entities. Limited risks and rewards fall to the federal government. Disclosure entities may provide the same or similar goods and services that consolidation entities do, but are more likely to provide them on a market basis.[23]

46. Disclosure entities may include but are not limited to: quasi-governmental and/or financially independent entities, organizations in receiverships and conservatorships, and organizations owned or controlled through federal government intervention actions. As noted above, in some cases, the relationship with the federal government is not expected to be permanent. The following disclosure entity types, while not inclusive of all the types, are presented to assist in identifying organizations that are disclosure entities. The accompanying Appendix C—Illustrations offers non-authoritative hypothetical examples that may be useful in understanding the application of the standards.

Quasi-Governmental and/or Financially Independent Entities

47. Quasi-governmental and/or financially independent entities have relationships with the federal government that are not temporary. Such relationships may be considered long-term, or even permanent in some cases, when compared to other types of disclosure entities. Quasi-governmental and financially independent entities have different governance and financial arrangements. Their classification takes into consideration such factors as:

    a. whether the governance of the entity is through officials appointed for terms aligning with the appointing official versus longer-term appointments or other governance structures intended to insulate the entity from political influence;

[23] Goods and services are provided on a market basis when prices are based on the prices charged in a competitive marketplace between willing buyers and sellers.

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b. whether the entity is financed primarily through taxes and other non-exchange revenues versus limited or no such financing; and

c. whether the entity provides goods and services on a non-market basis versus provides goods and services on a market basis.

48. Governance differences typically lead to greater independence. Characteristics may include the following:

a. Longer appointments of key executives or governing boards to allow these appointees a degree of independence from the Congress and/or the President

b. Delegated operational authority to provide a service or execute a program in a manner similar to private business enterprises

c. Private sector legal characteristics, such as not-for-profit status under the Internal Revenue Code

d. Exemption by statute from laws or regulations dealing with the federal budget, funds, personnel, ethics, acquisition, property, or works

e. Voluntary association with the federal government and shared purposes to implement government policies

49. Financial differences typically lead to greater fiscal autonomy. Characteristics may include the following:

a. Primarily funded from a source other than appropriations

b. Delegated financial authority to provide a service or execute a program in a manner similar to private business enterprises

c. Principally engaged in selling goods and/or services to organizations outside of the federal government

d. Intended, in the normal course of its operations, to maintain its operations and meet its liabilities from revenues received from sources outside of the federal government

50. Not all entities of a given type will meet the factors above. These factors are provided to assist in identifying entities that are quasi-governmental and/or financially independent. Examples of the types of entities that could be considered quasi-governmental and/or financially independent entities are **Federally Funded Research and Development Centers**, museums, performing arts organizations, universities, and venture capital funds. Each entity should be assessed objectively since there are likely to be differences among the entities within these example types such that some should be classified as consolidation entities and others as disclosure entities.

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Receiverships and Conservatorships

51. The federal government may take control or ownership of failed financial institutions, such as banks, with no goal to maintain control or ownership. Receiverships or conservatorships are established to liquidate failing financial institutions or to guide such institutions back to safe and sound conditions.[24] Entities controlled or owned through receiverships or conservatorships are generally disclosure entities.

Federal Government Intervention Actions Resulting in Control or Ownership

52. In exceptional circumstances such as economic instability or a national security crisis, the federal government may intervene in organizations not previously meeting the inclusion principles. Interventions arise because of the federal government's broad responsibility for the well-being of the country. Some, but not all, interventions establish ownership or control such that the organization then meets the inclusion principles. Although intervention actions are not expected to be permanent, they may not be subject to a defined time limit.

53. Typically federal government intervention actions are not routine activities. Strategic planning documents are unlikely to include objectives to routinely initiate such interventions or to permanently operate organizations acquired through interventions.

54. Examples of intervention actions resulting in control or ownership include:

    a. The federal government provides financial support and, in doing so, obtains control of an established organization but expects to relinquish or cede control.

    b. The federal government acquires an ownership interest in an organization but expects to end its interest as soon as practicable.

55. These relationships with the federal government are not expected to be permanent and such entities generally would be classified as disclosure entities when considering the characteristics taken as a whole. Nonetheless, entities controlled or owned as a result of intervention actions at the fiscal year-end must be assessed to confirm the classification.

IDENTIFYING ORGANIZATIONS FOR WHICH COMPONENT REPORTING ENTITIES ARE ACCOUNTABLE

56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity[25] and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all

[24] For example, the Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress with the mission "to maintain stability and public confidence in the nation's financial system by: insuring deposits; examining and supervising financial institutions for safety and soundness and consumer protection; and, managing receiverships."
[25] SFFAC 2, paragraph 38.

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consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

57. A component reporting entity's GPFFR should include all organizations that would allow the users to hold the component reporting entity's management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities[26] and disclosure entities administratively assigned to it.

58. Administrative assignments to component reporting entities are typically made in laws and policy documents such as statutes, budget documents, regulations, or strategic plans. Administrative assignments can be identified by evaluating:[27]

    a. Scope of the Budget Process

    b. Accountability Established Within a Component Reporting Entity

    c. Misleading to Exclude and/or Misleading to Include

SCOPE OF THE BUDGET PROCESS

59. Consolidation entities and disclosure entities subject to the budget approval and oversight process of the component reporting entity head should be included in the component reporting entity GPFFR. Each component reporting entity should include:

    a. all consolidation entities listed within its section of the *Budget of the United States Government: Analytical Perspectives--Supplemental Materials* schedule that provides budget account level information,[28] and

    b. all disclosure entities included within its congressional budget justification.[29]

[26] A consolidation entity comprises all consolidation entities administratively assigned to it and should present information about disclosure entities assigned to it.
[27] Component reporting entities should develop processes to ensure they identify and assess any organizations (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. It is anticipated that central agencies will determine if there is a need for coordinated guidance to ensure government-wide consistency.
[28] The Budget presents information in various forms for different purposes. Only the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information should be used for determining whether information about an entity should be included in the government-wide GPFFR. In the fiscal year 2015 *Budget of the United States Government* (the Budget), the schedule was entitled "*Federal Budget by Agency and Account*."
[29] A congressional budget justification is a document submitted annually to Congress to justify an organization's budget request.

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ACCOUNTABILITY ESTABLISHED WITHIN A COMPONENT REPORTING ENTITY

60. Consolidation entities and disclosure entities for which a component reporting entity has been assigned accountability responsibilities should be included in the GPFFR of that entity. Determining whether accountability was established or assigned to a component reporting entity requires the consideration of certain indicators and the application of professional judgment. Indicators[30] that accountability has been established in the component reporting entity include:

    a. Statutes or regulations establishing an organization state that it is assigned to or part of a larger federal organization.

    b. An organization is included in the component reporting entity's published organization chart.

    c. The component reporting entity acquires and/or monitors[31] ownership interests in organizations where there are ongoing responsibilities[32] such as:

        i. coordinating and/or conveying input on strategic plans,

        ii. providing appropriated funds to the organization and receiving requests for funding in the current and/or future years,

        iii. administering any federal grants or contracts awarded to the organization,

        iv. monitoring activities and/or reporting on outcomes, or

        v. monitoring the value of the ownership interest.

    d. A controlled organization[33] was established by statute or by action of the component reporting entity to support the mission of the component reporting entity, and a continuing relationship exists. Examples of continuing relationships include those in which the component reporting entity:

        i. approves bylaws including any amendments;

        ii. is represented on the governing board (for example, as an ex-officio member);

        iii. appoints members of the governing board;

        iv. coordinates and/or conveys input on strategic plans;

        v. monitors organizational performance;

[30] These indicators provide evidence that accountability was established or assigned to a component reporting entity. Meeting any one would typically mean accountability was established.
[31] Such responsibilities may be assigned to a program office.
[32] These responsibilities are examples of actions or activities performed by the component reporting entity that are indicative of monitoring an ownership interest in an organization, which is an indicator of accountability.
[33] Where control exists at the government-wide level based on paragraphs 26-35.

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vi. approves budgets, operating plans, or contracts with others;

vii. establishes and executes cooperative agreements with the organization;

viii. administers federal grants to or contracts with the organization;

ix. testifies before Congress regarding organization performance and objectives; or

x. has significant financial transactions or balances that indicate ongoing managerial involvement.

61. If more than one component reporting entity is assigned responsibilities as described above, the following guidance applies:

a. Disclosure entities should be included in the GPFFR of each component reporting entity assigned such responsibilities.

b. Consolidation entities should be administratively assigned to only one component reporting entity.[34] The component reporting entity assigned the largest share[35] of responsibilities described in paragraph 60 generally should include the consolidation entity.

62. If a disclosure entity has not been administratively assigned to a consolidation entity, the disclosure entity should be reported by a component reporting entity (a) assigned responsibility for transferring funds to or receiving funds from the disclosure entity or (b) with which its mission most closely aligns.

Misleading to Exclude and / or Misleading to Include

63. There may be instances where an organization is not administratively assigned to the component reporting entity based on the principles in paragraphs 59-62 yet the component reporting entity GPFFR would be misleading or incomplete if the organization were excluded. If so, such organizations should be included in the component reporting entity's GPFFR.[36]

64. There may be instances where the principles in paragraphs 59-62 are met in form but not substance so that consolidation at the component reporting entity level would result in misleading presentation for the component reporting entity. While such conditions are expected to be rare, if it would be misleading to consolidate the organization in the component reporting entity GPFFR, the organization may be excluded so long as it is consolidated in another component reporting entity or directly in the government-wide reporting entity.

[34] Note that the component reporting entity to which a consolidation entity is administratively assigned may also be administratively assigned to a higher-level component reporting entity.
[35] Largest share as used here is based on the most significant administrative role.
[36] Although such situations would be rare, this Statement provides for situations that may arise.

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65. Determining whether it would be misleading to include a consolidation entity administratively assigned to a component reporting entity requires the application of professional judgment. Examples[37] of indicators that it may be misleading to include an organization are:

    a. The budget submission is combined prior to submission but is not jointly developed or executed, as indicated by:

        i. the budget request not being directly approved by component reporting entity management, or

        ii. the absence of significant involvement by component reporting entity management regarding budget execution, investments, or strategic planning.

    b. The component reporting entity provides little or no direct oversight of the organization.

    c. The organization's funding is separate from the component reporting entity's funding.

    d. The consolidated cost information would be misleading.

    e. The organization operates itself as a stand-alone organization (either since its inception or for a long history), has routinely prepared annual audited financial statements, and has submitted financial data directly to the Department of the Treasury for the government-wide GPFFR.

GPFFR CONSOLIDATION AND DISCLOSURE

CONSOLIDATION ENTITIES

66. Consolidation entities' financial statements should be consolidated for the government as a whole to facilitate an assessment of the financial position[38] of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Component reporting entities should consolidate the financial information for all consolidation entities administratively assigned to them. Consolidation[39] aggregates the individual financial amounts of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing taxpayer-supported activities, resources, and obligations.

[37] The indicators listed in paragraph 65 a. – e. are examples and there may be other indicators not included on this list. Further, no specific number of indicators need be present to determine an organization would be misleading to include. This determination is based on the assessment as a whole after considering all facts and often requires professional judgment in making such decisions.

[38] The consolidated financial statements should include amounts and balances, consistent with applicable accounting standards, even if the amounts and balances arise from or are supported by different funding sources (for example, appropriations or donations).

[39] Consolidation is a method of accounting that combines the accounts of those entities line by line on a uniform basis of accounting and eliminates balances and transactions among the entities. For selected financial statements such as the statement of budgetary resources, a combined financial statement which does not eliminate balances and transactions among the entities is acceptable.

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67. Consolidation entities as defined herein are considered federal reporting entities and should apply GAAP as defined in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This Statement does not establish new disclosure requirements regarding consolidation entities but acknowledges existing standards require disclosures.

68. SFFAS 34 recognizes that some federal reporting entities prepare and publish financial reports pursuant to the accounting and reporting standards issued by the FASB. SFFAS 34 provides that GPFFRs prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP. Consolidation entities (that is, the consolidated government-wide reporting entity or a consolidated component reporting entity) may consolidate component or sub-component reporting entity financial statements prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the organizations.

Reporting on Disclosure Entities

69. Maintaining a distinction between the finances of consolidation entities and disclosure entities will more effectively meet federal financial reporting objectives. Such a distinction allows for separate presentation of financial information for organizations where there is a difference in purpose, governance structure, and financial relationships. Disclosing financial and other information in the notes about disclosure entities rather than consolidating financial and other information about all organizations included in a GPFFR may better meet federal financial reporting objectives. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities, information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

70. For those organizations classified as disclosure entities, the preparer should exercise judgment in determining the appropriate disclosures based on the factors and principles provided herein. Information regarding disclosure entities should be disclosed in accordance with Disclosure Requirements as detailed in paragraphs 72 to 75 below after considering the factors listed in paragraph 71.

Factors in Determining Disclosures

71. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining the information that should be presented regarding disclosure entities. Beyond materiality, the following factors[40] should be considered in making judgments about the extent of appropriate disclosures:

    a. **Relevance to reporting objectives—**Significance of the disclosure entity's information to meeting the reporting objectives established in SFFAC 1, *Objectives of Federal Financial Reporting*, with regard to the reporting entity. In particular, this

[40] The factors are presented in a list for consideration in the aggregate; no individual weights should be assigned or interpreted.

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would include the significance of the information regarding results of operations and financial position to meeting the operating performance and stewardship reporting objectives.

b. **Nature and magnitude of the potential risks/exposures or benefits associated with the relationship—**Information is needed to provide an understanding of the potential operational or financial impact, including financial-related exposures to risk of loss and potential gain, to the consolidation entity resulting from the disclosure entity's operations.

c. **Complexity of the relationship—**More complex relationships would involve additional detailed disclosures to ensure the relationship is understood by the readers.

d. **Extent to which the information interests, or may be expected to interest, a wide audience—**There may be a wide interest in the information due to the sensitivity of the relationship, materiality of the transactions, media attention, or other reasons. Interested parties may expect more extensive information regarding the disclosure entity or its relationship with the federal government.

e. **Extent to which there are no alternative sources of reliable information—**An objective of GPFFRs is to meet the needs of users who may have limited access to information or statements and lack the ability to demand the desired information.

Disclosure Requirements

72. In addition to the factors presented in paragraph 71 regarding the extent of disclosures, other qualitative and quantitative factors should be considered in determining whether information regarding a disclosure entity should be presented separately due to its significance or aggregated with the information regarding other disclosure entities. If information is aggregated, aggregation may be based on disclosure entity type, class, investment type, or a particular event deemed significant to the reporting entity.

73. Disclosures should be integrated so that concise, meaningful, and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure entity or entities and related balances, or by incorporating references to relevant notes elsewhere in the GPFFR but relating to the disclosure entity or entities. For example, a reference may be made to a note regarding investments in the disclosure entity.

74. For each significant disclosure entity and aggregation of disclosure entities, information should be disclosed to meet the following objectives:[41]

    a. **Relationship and Organization**: The nature of the federal government's relationship with the disclosure entity or entities.

    b. **Relevant Activity**: Nature and magnitude of relevant activity during the period and balances at the end of the period.

[41] The objectives are not listed in any order of preference.

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c. **Future exposures**: A description of financial and non-financial risks, potential benefits and, if possible, the amount of the federal government's exposure to gains and losses from the past or future operations of the disclosure entity or entities.

75. Examples of information that may meet the above objectives and provide the necessary understanding of the disclosure entity's relationship and organization, relevant activities, and future exposures specific to the federal government are provided below. The examples are provided to assist in determining the types of information that would meet the objectives in paragraph 74. No individual example is itself a required disclosure and the examples are not required in the aggregate. The examples are listed individually and should not be considered alternatives or substitutes for one another. The list of examples below is not exhaustive and additional items of information necessary to meet the objectives should be disclosed even if not specifically identified in the list below. Disclosures that meet the objectives in paragraph 74 should be provided. In determining what information is needed to meet the objectives in paragraph 74, the factors in paragraph 71, including the complexity, nature, and magnitude of the relationship, should be considered.

a. The name and description of the disclosure entity,[42] including information about how its mission relates to federal policy objectives, actions taken on behalf of the federal government, its organization, and any significant involvements with outside parties.

b. The nature of the relationship between the federal government and the disclosure entity including relevant information regarding:

i. How any control or influence over the disclosure entity is exercised;

ii. Key terms of contractual agreements, statutes, or other legal authorities; and

iii. The percentage of ownership interest and/or voting rights.

c. For intervention actions, the primary reasons for the intervention and a brief description of the federal government's plan relative to monitoring, operating and/or disposing of the disclosure entity and/or a statement that the intervention is not expected to be permanent.

d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the reporting entity as a consequence of transactions with or interests in the disclosure entity and the basis for determining the amounts reported (or a reference to other disclosures where such information is provided).

e. A discussion of the disclosure entity's key financial indicators and changes in key financial indicators.

f. Information regarding the availability of the disclosure entity's annual financial report and how it can be obtained.

[42] For simplicity, information is described in relation to a single disclosure entity. Nonetheless, the information may be presented for an aggregation of disclosure entities.

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g. In the event that contractual agreements, statues, or other legal authorities obligate the reporting entity to provide financial support to the disclosure entity in the future, information regarding potential financial impacts (including those terms of the arrangements to provide financial support and liquidity, including events or circumstances that could expose the federal government to a loss).

h. The nature of, and changes in, the risks and benefits associated with the control of, or other involvement with, the organization during the period.

i. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the disclosure entity, including how the maximum exposure to gain or loss is determined. (If this cannot be quantified, a narrative discussion could be offered.)

j. Other information that would provide an understanding of the potential financial impact, including financial-related exposures to risk of loss or potential gain to the reporting entity, resulting from the disclosure entity's operations including important existing, currently-known demands, risks, uncertainties, events, conditions, and trends—both favorable and unfavorable.

76. Any disclosure entity's financial information presented in the reporting entity's GPFFR should be based on accrual-basis standards provided in GAAP or an other comprehensive basis of accounting developed for its specific type of entity.[43] This includes GAAP for the relevant domain (FASAB, Governmental Accounting Standards Board, or FASB).

77. When information is derived from the disclosure entity's financial report, it is preferable but not mandatory that the report be for the same reporting period as the government-wide reporting entity. If a disclosure entity's reporting period differs from the government-wide reporting entity's and it is not cost-beneficial to align the reporting periods, any financial information disclosed from the disclosure entity's financial report should be for a reporting period ending within the government-wide reporting entity's reporting period.

78. Significant changes in information occurring from the end of the disclosure entity's reporting period should be reported consistent with the requirements of SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the American Institute of CPAs Statements on Auditing Standards*.

[43] Consolidation entities should apply the GAAP hierarchy established in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

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MINIMUM DISCLOSURES REGARDING THE CENTRAL BANKING SYSTEM[44]

79. The following information regarding the central banking system should be disclosed[45] in the government-wide GPFFR:

    a. Description of the central banking system, including information about how its mission relates to federal policy objectives, actions taken on behalf of the federal government, its organization, and any significant involvements with outside parties.

    b. The nature of the relationship between the federal government and the central banking system including relevant information regarding governance structure with particular emphasis on matters affecting its independence and insulation from political influence.

    c. A discussion of the significance and magnitude of financial actions reported during the year by the central banking system to achieve monetary and fiscal policy objectives.

    d. A description and summary of assets, liabilities, revenues, expenses, gains, and losses recognized in the financial statements of the reporting entity as a consequence of transactions with or interests in the central banking system and the basis for determining the amounts reported (or a reference to other disclosures where such information is provided).

    e. The amount that best represents the federal government's maximum exposure to gain or loss from its involvement with the central banking system, including how the maximum exposure to gain or loss is determined (If this cannot be quantified, a narrative discussion could be offered.).

    f. Information regarding the availability of the central banking system annual financial reports and how they can be obtained.

RELATED PARTIES

80. In addition to organizations for which the Congress and/or the President are accountable,[46] the federal government may have relationships with other parties. Only relationships of such significance that it would be misleading to exclude information about

[44] Central banking system functions are currently carried out by the Federal Reserve System (FRS). The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection. The Bureau was established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law provides that the Bureau's financial statements should not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System.

[45] Depending on the circumstances, some of the listed information may be disclosed due to other requirements. The resulting disclosures should be integrated so that concise, meaningful and transparent information is provided and information is not repetitive.

[46] Entities for which the Congress and/or the President are accountable are in the budget, majority owned, or controlled and would meet the inclusion principles and be reported as either a consolidation entity or disclosure entity and not be subject to related party reporting.

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such relationships warrant disclosure.[47] Guidance is provided below but judgment will also be required to identify relationships that warrant disclosure as related parties.

81. Related parties: Organizations are considered to be related parties in the GPFFR if the existing relationship[48] or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions.

82. Significant influence (for the purpose of this Statement) is the power to participate in the policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, sometimes by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy-making process, interchange of managerial personnel, or dependence on technical information. Significant influence may be gained by a minority ownership interest, statute, or agreement.

83. Significant influence does not arise from regulatory actions or economic dependency alone. However, regulation or economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of regulation and economic dependence on a relationship.

84. Although component reporting entities of the federal government may significantly influence each other, component reporting entities are subject to the overall control of the federal government and operate together to achieve the policies of the federal government and are not considered related parties. Therefore, component reporting entities need not be disclosed as related parties by other component reporting entities.

85. Related parties *generally* would include (see paragraph 86 for organizations *generally* not included) but are not limited to:

    a. **Government sponsored enterprises** not meeting the inclusion principles

    b. Organizations governed by representatives from each of the governments that created the organization, including the United States, wherein the federal government has agreed to ongoing or contingent financial support to accomplish shared objectives (for example, certain multi-lateral development banks)

86. In the context of this Statement, the following generally would not be considered related parties:[49]

    a. Organizations meeting the inclusion principles

[47] Significance is assessed at the reporting entity and may differ among component reporting entities and the government-wide reporting entity.
[48] Relationship, as used in this context, refers to material transactions or events involving both parties.
[49] As described in paragraph 87 below, paragraphs 86a. – 86g. identify potential exclusions but judgment will be required to determine whether some pose risks that warrant disclosures.

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b. Organizations with which the federal government transacts a significant volume of business resulting in economic dependence such as government contractors, state and local governments, and not-for-profit organizations[50]

c. Organizations owned or managed by full-time employees of the federal government or members of their immediate families

d. Full-time employees of the federal government

e. Foreign governments

f. Organizations created through treaties or trade agreements that define common goals and means for joint action where the U.S. role in governing and financing the organizations is not significant

g. Special interest groups[51]

87. Although paragraph 86 discusses the potential exclusion of certain organizations as related parties, other factors may create a need for related party disclosures for such organizations. The use of judgment will be necessary in identifying those factors consistent with the information needs described in paragraph 88.

88. Certain information regarding significant related party relationships may enable users to better understand the financial statements of the reporting entity because:

a. related party relationships might expose the federal government to risks or provide opportunities that would not have existed in the absence of the relationship;

b. related party relationships can influence the way in which the federal government operates with other entities in achieving its individual objectives; and

c. related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties.

89. For related party relationships of such significance to the reporting entity that it would be misleading to exclude information about such relationships, the following should be disclosed:

a. Nature of the federal government's relationship with the party, including the name of the party or if aggregated, a description of the related parties. Such information also would include, as appropriate, the percentage of ownership interest.

[50] However, economic dependency, together with other factors, may give rise to significant influence and, therefore, a related party relationship.
[51] Special interest groups refers broadly to organizations whose members share common concerns and try to influence government policies. Examples include but are not limited to labor unions, trade associations, religious organizations, membership organizations, and lobbying organizations.

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b. Other information that would provide an understanding of the relationship and potential financial reporting impact, including financial-related exposures to risk of loss or potential gain to the reporting entity resulting from the relationship.

EFFECT ON EXISTING CONCEPTS—AMENDMENTS TO SFFAC 2, *ENTITY AND DISPLAY*

90. This section establishes conforming amendments to the Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, as described in the following paragraphs.

91. Paragraph 2 is replaced with the following paragraph which describes the amended purpose and contents of SFFAC 2.

> The purpose of this statement is to establish concepts regarding what would be encompassed by a Federal Government entity's financial report. The statement specifies the types of entities for which there should be financial reports (hereinafter called "reporting entities"), establishes an organizational perspective for considering the makeup of each type of reporting entity, identifies types of financial reports for communicating the information for each type of reporting entity, suggests the types of information each type of report would convey, and identifies the process and factors the Board may consider in determining whether information should be basic information, required supplementary information (RSI), or other accompanying information (OAI).

92. Paragraphs 3 - 5 are rescinded because the preamble applicable to all concepts statements, which was adopted at the time SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* was issued, addresses the topics covered.

93. Paragraph 6a below is inserted following paragraph 6 to recognize the importance of accountability in determining organizations to be included in the reporting entity GPFFR:

> 6a. SFFAC 1 also discusses accountability and users' information needs as the foundation for the objectives of federal financial reporting. Specifically, paragraphs 71-72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. …The assertion of accountability therefore leads to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability." Based on the concepts established in SFFAC 1, it is clear that accountability is a fundamental goal of financial reporting to be considered in establishing the boundaries of general purpose federal financial reports.

94. Paragraph 7 is rescinded because the preamble applicable to all concepts statements addresses the topics covered.

95. Paragraph 10, first bulleted item is amended by replacing it with the following bulleted item addressing an understanding of what the reporting entity entails:

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- ensure each reporting entity includes information to support accountability by including all relevant organizations—those that are in the budget, owned by the Federal Government, or controlled by the Federal Government with risk of loss or expectation of benefit;

96. Paragraph 18, the last sentence is amended by changing 'earmarked collections' to 'dedicated collections.'

97. Paragraph 29 is amended by adding the following footnote after the first sentence:

    The Office of Management and Budget specifies the form and content of agency financial statements, pursuant to its authority under the Chief Financial Officers Act of 1990, as amended (title 31, U.S. Code, section 3515(d)) through issuance of Bulletins and Circulars. OMB intends to base form and content on the concepts contained in this Statement. Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees.

98. Paragraph 38 is amended to exclude references to other paragraphs amended by this Statement. Paragraph 38 is replaced with the following:

    The ultimate aggregation of organizations is into the Federal Government which, in reality, is the only independent economic entity. The Federal Government encompasses all of the resources and responsibilities existing within the component reporting entities. The aggregation includes organizations for which the Federal Government is accountable as well as other organizations for which the nature and significance of their relationship with the Federal Government are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.

99. Paragraphs 39 -50 are rescinded because the standards herein provide guidance on the same matters. It is not necessary or appropriate to retain the guidance in SFFAC 2.

100. The sub-heading before paragraph 51 - "Other Aspects Concerning Completeness of the Entity" - is revised to read "Other Aspects Concerning Completeness of the Component Reporting Entity."

101. Paragraph 51 is replaced with the following:

    Identifying the organizations to include in the reporting entity is one aspect of ensuring that the users of a reporting entity's financial reports are provided with all the information relevant to the reporting entity. However, because the only independent economic entity is the entire Federal Government, financial resources or free services are often provided from one component in the government to another component without a quid pro quo. For example, a portion of the retirement costs of Federal employees is reported by the Office of Personnel Management rather than the organizational entities employing the persons. Thus, within parameters more appropriately established in accounting standards, it is important to ensure that the reporting entity's financial reports include amounts that are attributable to the reporting entity's activities, even though they are recorded elsewhere. This is particularly important for costs associated with the use of human resources; personnel services are such a major part of most government activities. It is also important for the costs of services provided by other reporting entities, such as computer services provided by another unit.

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102. Paragraphs 52 – 53 are rescinded because these paragraphs relate to issues covered in standards and are not necessary for understanding the notion of the reporting entity.

103. A new sub-heading “Need to Distinguish between Consolidation Entities and Disclosure Entities” is inserted at paragraph 53A.

104. Insert Paragraphs 53A – 53 E under the sub-heading: “Need to Distinguish between Consolidation Entities and Disclosure Entities” - The language provides a high level explanation of consolidation entities and disclosure entities. These are new terms introduced in this Statement critical to understanding the reporting entity concept in the federal government. More importantly, the language describes the need to distinguish them and the reason for this distinction in terms of financial statement presentation.

53A. The Federal Government is a large and complex organization. In order to fulfill public policy objectives, the Federal Government may use both consolidation entities (such as departments and agencies) and organizations that are distinct from consolidation entities to fulfill public policy objectives (such as financially independent organizations). These distinct organizations are referred to collectively as “disclosure entities.”

53B. Disclosure entities may maintain a separate legal identity, have a governance structure designed to insulate the organization from political influence, and/or be granted relative financial independence. Despite disclosure entities’ relative operational and financial independence, accountability for all organizations owned or controlled by the Federal Government rests with the Congress and/or the President. So, both consolidation entities and disclosure entities should be included in financial reports to provide accountability.

53C. It may be difficult to provide accountability, by meeting financial reporting objectives, through consolidated financial statements because they blur the distinction between consolidation entities and disclosure entities. Consolidated financial statements may obscure the fact that resources and resource allocation decisions for disclosure entities are more independent than similar decisions for consolidation entities. While consolidation entities are financed by taxes and other non-exchange revenue and governed by elected officials, disclosure entities often do not rely on taxes and other non-exchange revenue for financing or elected officials for spending authority. For example, a single-column presentation of information for all organizations likely would create a risk of incorrect inferences. Such inferences may include the amount of assets and revenues available for consolidation entities to use in general government activities, and the extent to which taxpayers stand ready to liquidate liabilities and meet expenses of disclosure entities.

53D. Maintaining a distinction between consolidation entities and disclosure entities may more effectively meet federal financial reporting objectives. Such a distinction may be maintained through discrete presentation of information regarding disclosure entities. Nonetheless, disclosures are not a substitute for consolidation entities recognizing the financial effects of transactions with disclosure entities.

53E. Consolidated financial statements for only consolidation entities will facilitate an assessment of the financial position of the federal government and the cost of operations financed by taxes and other non-exchange revenue. Consolidation aggregates the individual financial statements of organizations that constitute a reporting entity and results in presentation of information for a single economic entity representing consolidated activities supported by taxes and other non-exchange revenue, resources, and obligations. Consolidation entities are considered federal entities and should apply GAAP as defined in

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SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. The following sections discuss display of information in consolidation entity financial reports.

105. Paragraph 78 is rescinded because it is not conceptual guidance. It identifies an expectation that material differences between the recognition and measurement requirements under the FASB and the FASAB standards will be adjusted before consolidation.

EFFECTIVE DATE

106. This Statement is effective for periods beginning after September 30, 2017. Earlier implementation is not permitted.

The provisions of this Statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–-not the material in this appendix–-should govern the accounting for specific transactions, events, or conditions.

Introduction

A1. The federal government and its relationships with other organizations have become increasingly complex. These complex relationships make it difficult to identify federal entities for financial accountability purposes. In addition, some organizations may be viewed as "non-federal" and yet be owned or controlled by the federal government. Identifying the organizations to be included in the government-wide and component reporting entity general purpose federal financial reports (GPFFRs) is necessary to ensure the completeness of GPFFRs.

A2. GPFFRs should include the varied organizations for which the Congress and/or the President are accountable regardless of their form. Therefore, the primary reason for developing standards for the government-wide and component reporting entity GPFFRs is to ensure that users will be provided with complete financial information about the federal government. While SFFAC 2, *Entity and Display*, provides criteria for determining if an organization should be included, questions have continued in this area that resulted in the need for standards.

Project History /Task Force

A3. In 2008, the Board formed a task force to support the project. The objective of the task force was "to assist in developing the proposed standards on the boundaries of the reporting entity and specific criteria for determining whether an organization should be included."

A4. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were presented to the Board for its consideration during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and survey work that led to the release of the *Reporting Entity* Exposure Draft. (See Appendix E for a list of task force members.)

Summary of Outreach Efforts

A5. The Exposure Draft (ED), *Reporting Entity,* was issued on April 3, 2013 with comments requested by July 3, 2013.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional

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associations generally commenting on exposure drafts in the past (for example, Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A7. This broad announcement was followed by direct mailings of the exposure draft to the following relevant congressional committees:

a) Senate Committee on Homeland Security and Governmental Affairs
b) Senate Committee on Banking, Housing, and Urban Affairs
c) Senate Committee on Rules and Administration
d) House Committee on Science, Space, and Technology
e) House Committee on Oversight and Government Reform
f) House Committee on Financial Services

A8. Additional types of relevant organizations were contacted with direct mailings such as museums and performing art organizations, organizations that apply FASB GAAP, and intelligence agency organizations.

A9. Thirty-nine responses were received from preparers, auditors, professional associations, and citizens. In addition, over ten participants provided testimony on the issues surrounding the project to the Board at a public hearing.

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response, as well as the testimony provided at the public hearing, and weighed the merits of the points raised. Due to the complexity of the standard and the issues raised, it was deemed most efficient and appropriate to include the summary of the issues raised by respondents and disposition in the narrative relating to the Board's deliberation of the issue.

Organizational Approach to Defining Boundaries

Underlying Concepts

A11. The federal government is complex and therefore defining the boundary of GPFFRs may be difficult. Its constitutionally established powers and often its motivations and functions are different from other organizations. Despite these complexities, difficulties, and differences, accountability is a fundamental goal of financial reporting. As noted in SFFAC 1:

> The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the citizens, their elected representatives, federal executives, and program managers. Providing this information to the public, the news media, and elected officials is an essential part of accountability in government.[52]

A12. SFFAC 1 discusses accountability and users' information needs as the foundation of governmental financial reporting. Specifically, paragraphs 71 and 72 state "It may be said that 'accountability' and its corollary, 'decision usefulness,' comprise the two fundamental values of governmental accounting and financial reporting. They provide the foundation for the objectives of federal financial reporting. …The assertion of accountability therefore leads

[52] SFFAC 1, paragraph 8.

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to identifying, first, those to whom government is accountable and, second, the information needed to maintain and demonstrate that accountability."

A13. SFFAC 1 explains that the federal government has a special responsibility to report on its actions and the results of those actions. SFFAC 1 discusses the information needs of both internal and external users including the citizens, their elected representatives, federal executives, and program managers because meeting user information needs is an essential part of accountability in government.

A14. An organizationally based approach to defining boundaries supports accountability to all users but particularly to external users who may be unaware of the nature of organizational relationships. Focusing on organizations helps to identify who is accountable and for what. In addition, an organizational approach provides meaningful financial statements by aligning boundaries with defined organizations for which there would likely be users of GPFFRs.[53]

Identifying and Classifying Organizations

A15. The Board considered several alternative approaches to identifying organizations for which elected officials—the Congress and/or the President-–are accountable. This Statement provides that reporting entities should first identify what organizations[54] are to be included[55] in the reports. The three principles for including organizations in the government-wide GPFFR are: In the Budget, Majority Ownership Interest, and Control with Risk of Loss or Expectation of Benefit. This Statement also includes a provision requiring inclusion of an organization if it would be misleading to exclude it.

A16. Next, for those organizations to be included, a distinction is made between consolidation entities and disclosure entities. This distinction determines how financial information is to be presented in the GPFFR. Consolidation entity financial information is to be presented in consolidated financial statements and related notes. Disclosure entity financial information is to be disclosed in notes to the financial statements.

A17. Professional judgment is required in the application of the standards in this Statement. This Statement presents a principles-based approach to determining which organizations should be included[56] in the government-wide GPFFR because of the wide and varying relationships of the federal government. General purpose federal financial reports for the government-wide reporting entity should be broad enough to report the Congress' and the President's accountability for organizations. This ensures that the financial reports contain all the information essential for fair presentation of the government's financial position and results of operations.

A18. One controversial matter addressed in this Statement was the inclusion of organizations where the ownership or control is intended to be temporary; such as receiverships, conservatorships, and entities owned or controlled due to intervention actions. The Board

[53] See SFFAC 2, paragraphs 29-38, for a discussion of the organizational approach.
[54] "Organization" refers to the organization in its entirety including all funding sources (for example, appropriations or donations) for which the entity is accountable. It is used broadly and may include among others departments, agencies, bureaus, divisions, commissions, corporations, and components. .
[55] "Included" means an organization's information is either consolidated or disclosed.
[56] Note that this Statement does not specify which organizations must prepare and issue financial statements.

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considered many options in developing the exposure draft and concluded that preparers and auditors would find it difficult to apply the notion of "temporary" absent clear guidance in the standards. In some circumstances, temporary relationships evolve into permanent relationships. Also, some federal government components are subject to sunset provisions and are also temporary. Because it was unlikely the Board could anticipate the full range of circumstances preparers and auditors may face, the Board proposed in the exposure draft that the same principles be applied to all organizations.

A19. A few respondents asked the Board to provide that relationships intended to be temporary be excluded but most agreed with the proposal. Some respondents also asked that the Board explain how the temporary status of the relationship should be considered in applying the principles. The Board revised the proposal to explicitly state that whether relationships are temporary or permanent should not be considered in determining whether an organization is included in the GPFFR. Instead, the revised standards explain that whether a relationship is temporary or permanent is likely to influence whether the entity exhibits the characteristics established for a consolidation entity or for a disclosure entity. The standards also acknowledge that receiverships, conservatorships, and intervention entities would generally be disclosure entities but also state that entities controlled or owned as a result of intervention actions at the fiscal year-end must be assessed to confirm the classification.

A20. Members discussed the potential that inclusion of such entities in GPFFRs might lead users to conclude that entities receiving temporary federal government financial assistance have become part of the federal government. The summary alerts readers that the "principles herein are not intended to establish whether an organization is or should be considered a federal agency for legal or political purposes." The Board recognizes that its responsibility is to ensure GPFFRs meet federal financial reporting objectives and that is the focus of this Statement. By avoiding subjective provisions such as "temporary" and instead establishing principles that can be applied to all relationships, this Statement supports meeting federal financial reporting objectives.

Principles for Inclusion in the Government-wide GPFFR

In the Budget

A21. Identification of an organization in the President's Budget is the clearest evidence that an organization should be included in the government-wide report. Absent budgetary actions – originating with the President's Budget and leading to appropriations – federal organizations would be unable to conduct operations. Financial reporting objectives – budgetary integrity, operating performance, stewardship, and systems and controls – could not be met if organizations identified in the budget were not included in the financial reports. Therefore, the most efficient means to identify organizations for inclusion in the GPFFR is by their participation in the budget process as evidenced by being listed in the schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information.

Application to Legislative and Judicial Branches

A22. Although the legislative and judicial branches (and most organizations within those branches) may not be required to prepare financial statements, based on the '*In the Budget'* principle, those organizations would be reported upon in the government-wide report. FASAB GAAP would be the appropriate accounting standards for those entities within the

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judicial and legislative branches that prepare GAAP-based financial statements. While this Statement does not require any entity to prepare and issue a GPPFR, it does enable federal reporting entities preparing and issuing GPPFRs in conformance with GAAP as defined by SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board,* to determine what organizations should be included in GPFFRs.

Organizations Receiving Federal Financial Assistance

A23. The schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information also sometimes identifies specific recipients of federal financial assistance. SFFAC 2 (prior to the amendments set forth in this Statement) acknowledged that the schedule sometimes names an organization to receive a "subsidy" and stated "This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation." Thus, "subsidy" is the term used in SFFAC 2 (before amendments set forth in this Statement) to distinguish such "non-federal" organizations from the organizations intended to be included in the GPFFR.

A24. While the provision in SFFAC 2 was correct, this Statement establishes standards and terms used in standards should be defined. The Board considered ways to define "subsidy" but concluded it was more appropriate to rely on the existing definition of "federal financial assistance."

A25. As exposed, the proposed language attempted to ensure organizations that receive federal financial assistance[57] as defined by the Single Audit Act Amendments of 1996 but listed under an appropriation in the schedule of the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information are not automatically included in the GPFFR. Most grants are provided through programs and the recipient organizations are not necessarily listed in the budget. However, in some cases an organization is listed. The Board believes a means to confirm whether specifically identified recipient organizations are "non-federal organizations receiving federal financial assistance" is needed. When such organizations are listed in the budget, they should be assessed against the "majority ownership interest" and "control with risk of loss or expectation of benefit" principles before being excluded from the government-wide GPFFR.

A26. Although few organizations are listed in the budget as receiving subsidies, respondents questioned (1) whether such organizations had to be subject to the requirements of the Single Audit Act to be considered, (2) whether federally authorized "support fees" would meet the definition of assistance, and (3) whether listing within the budget should be an

[57] This Statement adopts the definition of "federal financial assistance" established in the Single Audit Act Amendments of 1996. However, an organization need not be subject to the requirements of the Single Audit Act in order to qualify as a non-federal organization receiving federal financial assistance. As defined by the Single Audit Act Amendments of 1996, federal financial assistance is assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance. For the purposes of these standards, federally-authorized support fees and other charges would be considered other assistance even if legislation granting authority to collect them indicates that the fees or other charges are not considered public monies of the United States.

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inclusion principle given this practice. Because of these questions, the wording was clarifed to provide that such non-federal organizations would be state, local, or territorial governments (or components thereof) or not-for profit organizations. In addition, the footnotes clarify that the exclusion is not limited to organizations subject to the Single Audit Act or to specific forms of financial assistance. Lastly, if an organization listed in the budget is to be excluded it is because it is neither owned nor controlled as defined in these standards.

Organizations Partially in the Budget

A27. The Board deliberated the issue of certain organizations being partially in the budget (for example, some of their operations or accounts are not in the President's Budget), such as a museum receiving substantial donor support. The Board determined organizations should be included in the government-wide GPFFR based on the "in the budget" principle. The Board further decided that such organizations should be presented in the same manner as other consolidation entities or disclosure entities, as discussed later in this Statement. Therefore, the language in the principle ("in the budget") does not provide separate and distinct guidance for organizations partially funded by non-budgetary sources. This means the organization is either a consolidation entity or a disclosure entity and should be reported as one or the other, in its entirety.

A28. Certain respondents expressed concern because donated funds are for specific purposes and are not available for general government use. They believed full consolidation may be misleading. However, entities receiving donations administer and are accountable for both appropriations and donated funds. Presently, the financial statements for museums receiving donations display consolidated totals along with separate columns for federal and donor funds. This presentation provides accountability for all funds under the entity's management while alerting the reader to restrictions. Similar presentation at the government-wide level may be accomplished by presenting donated funds as dedicated collections to the extent they meet this definition. For example, such reporting would reveal that donor funds are unavailable for general use by the government.

Need for Additional Principles

A29. While the principle "in the budget" is the most efficient means to identify organizations for inclusion, there are additional principles to be considered to identify other organizations that should be included in the government-wide GPFFR. The budget principle represents a starting point in analysis but accountability goals could not be met solely through that principle. Because the budget's purposes differ from financial reporting objectives in many respects (such as the focus on the allocation of budgetary resource flows versus costs of operations), it is possible that organizations or activities might be excluded from the budget for reasons that do not justify exclusion from financial reports. For example, some organizations may be established to operate in a manner similar to businesses and are excluded from the budgetary process. Therefore, additional inclusion principles are necessary to ensure completeness in the context of the federal financial reporting objectives.

Majority Ownership Interest

A30. Ownership interests typically provide owners access to resources and exposure to risks while supporting their desired goals. Federal financial reporting objectives require that

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information about service efforts, costs, and accomplishments be made available. To ensure such information is included, when the federal government holds a majority ownership in an organization, the organization should be included in the GPFFR. As described in this Statement, majority ownership interest exists with over 50 percent of the voting rights or the net residual assets of an organization.

A31. The Board noted that some may question how to account for minority ownership interests (less than 50 percent). The Board agreed addressing minority interests through the project is likely to be less effective than allowing the GAAP hierarchy to fill any void. To address the potential question, the Board included within this Statement a footnote stating ownership interests 50 percent or less should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy.

Control with Risk of Loss or Expectation of Benefit

A32. When the federal government controls an organization with risk of loss or expectation of benefit, the organization should be included in the government-wide GPFFR to provide accountability. As detailed in this Statement, control involves the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to obtain financial resources or non-financial benefits or be obligated to provide financial support or assume financial obligations as a result of those actions. Both the power and the risk of loss or expectation of benefit aspects of the control definition should be present to justify inclusion of the organization in the GPFFR.

A33. For example, this Statement provides for situations where the risk of loss or expectation of benefit does not exist—in the instance of the federal government exercising regulatory powers over an organization. In these cases, the federal government is unable to exercise that power for its own benefit and rarely explicitly assumes risk of loss. Therefore, including such an organization in the GPFFR would misrepresent the financial position and results of operation of the government. This would not support achievement of the objectives of financial reporting.

A34. For financial reporting purposes, assessment of control is made at the reporting date and based on current legislation, rather than legislation that may or may not be enacted in the future.

A35. Determining control requires judgment, and this Statement provides indicators to assist in making determinations. The first set of indicators is “persuasive” as the federal government has the authority to control and any one of the listed items would generally mean control is present. The second set of indicators requires more judgment because the set of indicators is considered in the aggregate to assess whether the federal government has the ability to control the organization.

A36. Because the federal government does not usually seek only financial benefits, the expected benefit associated with control does not have to be a financial benefit. Instead, it may be non-financial. For example, it may be in the form of a service provided on the federal government’s behalf or the ability to direct the work of the other organization to deliver goods and services.

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Misleading to Exclude

A37. This Statement includes a general provision requiring inclusion of an organization if it would be misleading to exclude it. In developing the proposal, some Board members and respondents to the proposal believed this may be problematic because no criteria are offered. However, the Board ultimately agreed the general provision could accommodate unique situations that may arise in the future. This is consistent with provisions of SFFAC 2 and the Governmental Accounting Standards Board Statement 14, *The Financial Reporting Entity*.

A38. Requiring inclusion of an organization that would be misleading to exclude allows for judgment in unique situations not anticipated when the standards were developed. If it were feasible to anticipate such situations and develop criteria, then there would be no need for the misleading to exclude provision. While there are concerns regarding possible unanticipated consequences, the Board believes the provision will be of benefit during the implementation period. If adjustments are needed, agencies may seek amendments to the standards or additional guidance as appropriate. Further, the Board also may consider whether the provision is necessary after implementation.

Reporting on Organizations—Consolidation or Disclosure

A39. Differences in purposes and governance structures by organizations may require different presentation of related financial information. This Statement provides that the reporting entity should first determine which organizations are to be included in its GPFFRs. Next the reporting entity should classify each included organization as a consolidation entity or a disclosure entity. Different means of presenting relevant information are provided for consolidation entities and disclosure entities. Consolidation entities[58] should apply the hierarchy of GAAP established for "federal reporting entities" in Statement of Federal Financial Accounting Standards (SFFAS) 34. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities; information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

A40. The distinction between consolidation entities and disclosure entities is based on the degree to which the following characteristics are met: the organization is financed by taxes and other non-exchange revenue, is governed by the Congress and/or the President, imposes or may impose risks and rewards to the federal government, and/or provides goods and services on a non-market basis. Maintaining a distinction between consolidation entities where financial and operational decisions are more directly governed by the Congress and/or the President, and disclosure entities that are more financially (or operationally) independent will provide information to users that is more understandable and relevant. In some cases, disclosure of information regarding an individual organization is more useful than consolidation of the individual organization's financial statements in the government-wide financial statements. In other instances, consolidation of individual organizations'

[58] Consolidated financial statements provided for "consolidation entities" will include all disclosures and required supplementary information required by existing standards. Existing standards will ensure that adequate information is provided regarding the nature and organizational structure of consolidation entities as well as the activities and future exposures.

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financial statements is needed to provide fair presentation of activities financed by taxes and other non-exchange revenue, and/or relying on the taxpayers to settle liabilities.

A41. While principle-based standards do not explicitly classify specific organizations as consolidation entities or disclosure entities, the Board considered the need to illustrate how the inclusion principles and the criteria for classification as a consolidation entity or disclosure entity might be applied to certain significant individual organizations or classes of organizations. For many classes of organizations, illustrations are provided in Appendix C. With respect to certain significant organizations with particularly unique characteristics, such as the central banking system (Federal Reserve System (FRS)),[59] a majority of the Board did not believe illustrations would be appropriate because the illustrations might become de facto requirements regarding that entity's classification.

A42. The role of preparers and auditors is to assess each organization against the principles in paragraphs 22 – 55 and reach their own conclusions. In contrast, the role of standards-setters is to set accounting standards and consider the potential implications. In doing so, the Board acknowledges some members believe the Board should explicitly address inclusion and classification (as a consolidation entity or disclosure entity) of the FRS in GPFFRs because of the magnitude of its operations. While different individuals could reach different conclusions due to the unique and changing role of the central banking system, most members believe explicitly classifying the FRS, or any entity, at a point in time would be inappropriate and result in this Statement becoming outdated as circumstances change.

A43. Despite the decision not to explicitly classify the FRS, the Board considered each possible classification of the FRS. This consideration did not take into account all the facts and circumstances that would be considered by the preparer and auditor. Instead, like the illustrations in Appendix C, high-level facts were considered in sufficient detail to provide reasonable assurance to the Board that preparers and auditors would consider the appropriate matters in making decisions. The majority of the Board believes the principles are sufficient to aid preparers and auditors in assessing any organization, including the FRS, and in making decisions regarding inclusion and classification as a consolidation entity or disclosure entity.

A44. If the assessment of the FRS resulted in its classification as a consolidation entity, the government-wide consolidated financial statements and related notes would present information as if the FRS and other consolidation entities operate together as a single economic entity. Any balances and transactions among the consolidation entities would be eliminated. For example, all Treasury securities held as investments by the FRS and reported as liabilities by the Department of the Treasury would be eliminated. Significant additions to the government-wide balance sheet as a result of consolidating the FRS would be liabilities for deposits of depository institutions and Federal Reserve notes outstanding as well as assets for investments in non-federal organizations. Consolidation would also affect

[59] The FRS comprises the Board of Governors, the Federal Open Market Committee, the regional Federal Reserve Banks, and the Bureau of Consumer Financial Protection. The Bureau was established in 2010 as an independent bureau within the FRS pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The law provides that the Bureau's financial statements should not be consolidated with the financial statements of either the Board of Governors or the Federal Reserve System. (The Bureau has been consolidated directly in the government-wide report to date.) For simplicity, the basis for conclusions discusses the system as a whole rather than its individual components.

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the reported operating results of the government; interest expense would be reduced by the amount paid by the U.S. Treasury to the FRS and revenue would be reduced by the amount paid by the FRS to the U.S. Treasury.

A45. If the assessment of the FRS resulted in its classification as a disclosure entity, disclosures regarding the FRS would aid users in understanding the FRS, its relationship with the federal government, any significant activities, and any risks posed to the federal government. Such disclosures would allow the reader to consider monetary policy and fiscal policy as distinct activities. The government-wide consolidated financial statements would present the results of fiscal policy. Consolidation of fiscal and monetary policy financial information, as described above, would result in elimination of some Treasury securities. Thus, the use of Treasury securities to conduct monetary policy and their elimination upon consolidation could obscure the Treasury securities (debt) that result from the fiscal policies of the federal government. Further, liabilities for Federal Reserve notes outstanding and deposits by depository institutions differ in character from liabilities arising from fiscal policy. In contrast, disclosures may provide an understanding of the relationship between monetary and fiscal policy and support consideration of these distinct activities.

A46. The Board recognizes the FRS performs a unique federal function—central banking—and there is only one organization of this type. The FRS is unique not only in its mission, but also in its governance, structure, activities, and the need to maintain independence. Its responsibilities are broad reaching and of great interest because of the impact of monetary policy on the country. The magnitude of its role and transactions led the Board to require certain minimum disclosures about the FRS. The minimum disclosures recognize that there is special interest in the activity of the central banking system. The minimum disclosures for the government-wide report are in addition to any other reporting requirements at the government-wide or component reporting entity levels. The minimum disclosures focus on governance, significant roles and responsibilities, the significance and magnitude of financial actions reported by the FRS to achieve monetary and fiscal policy objectives, transactions with the reporting entity, risks to the federal government, and future exposures to gains and losses. The disclosures should be integrated and, depending on the circumstances, also may be required by other provisions in this Statement or other GAAP requirements.

Consolidation entities

A47. Consolidation entities generally provide goods and services on a non-market basis. That is, prices are not established solely through market transactions where supply and demand determine price. Goods and services provided on a non-market basis may be free of charge or provided at prices that are either not economically significant or bear little relationship to the cost of the goods or services.

A48. Consolidation entities generally are financed through taxes and other non-exchange revenue as evidenced by inclusion in the budget. Significant risks and rewards fall to the federal government for consolidation entities. Inclusion in the budget is the clearest evidence an organization is relying on taxes and other non-exchange revenue and that elected officials are key decision makers.

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A49. The budget is a political document serving many purposes. The 1967 *Report of the President's Commission on Budget Concepts* indicates that "the budget must serve simultaneously as an aid in decisions about both the efficient allocation of resources among competing claims and economic stabilization and growth." On the topic of coverage of the budget, the Commission recommended that "the budget should, as a general rule, be comprehensive of the full range of Federal activities." Because the budget includes "federal activities," entities listed in the budget, except those receiving federal financial assistance, generally qualify as consolidation entities.

A50. The assessment of whether an organization meets the attributes for a consolidation entity is based on the assessment of all the attributes and the degree to which each is met. As such, not all attributes are required to be met; classification is based on the assessment as a whole.

Disclosure entities

A51. Disclosure entities receive limited or no funding from general tax revenues. Disclosure entities, in contrast to consolidation entities, are often structured so there is a clear barrier or limit on taxpayer financing of the entity. Disclosure entities have relative financial independence and often provide goods and services on a market basis. This may be an effort to shield the federal government from risk.

A52. Another contrast with consolidation entities is that with disclosure entities, the Congress and/or the President have much less direct involvement in decision-making. Decision-making may rest with a governing board insulated from political influence and there may be situations where disclosure entities have a separate legal identity. In some cases, the relationship with the federal government is not expected to be permanent.

A53. It is important to recognize the continuum that exists among disclosure entities. For example, despite a greater degree of autonomy, some disclosure entities may still exercise powers that are reserved to the federal government as sovereign. Other disclosure entities may not themselves carry out missions of the federal government but, instead, are owned or controlled by the federal government as a result of regulatory or intervention actions.

A54. This Statement provides categories of disclosure entities primarily as a way to help identify disclosure entities. However, this Statement does not require presentation by any specific class or category and allows flexibility in presenting information about disclosure entities. The categories of potential disclosure entities include quasi-governmental and/or financially independent entities, receiverships and conservatorships, and federal government intervention actions.

Quasi-Governmental and/or Financially Independent Entities

A55. This Statement describes quasi-governmental and/or financially independent entities as those entities where governance and/or financial differences lead to greater independence. This Statement identifies both governance and financial characteristics that would be found in this type of entity.

A56. Quasi-governmental and/or financially independent entities may include certain Federally Funded Research and Development Centers (FFRDCs), museums, performing arts organizations and universities, and venture capital funds. Because details may differ among

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organizations in each example type, an objective assessment may classify some individual organizations as consolidation entities rather than disclosure entities. Appendix C-Illustrations offers examples that may be useful in application.

Receiverships and Conservatorships

A57. This Statement describes receiverships and conservatorships as those failed financial institutions and banks the federal government takes control or ownership of with no goal to maintain the relationship. Absent a decision to make control permanent, such controlled or owned organizations generally would be disclosure entities.

Federal Government Intervention Actions

A58. This Statement describes federal government intervention actions as resulting from exceptional circumstances where the involvements are not expected to be permanent. SFFAC 1 acknowledges the unique nature of federal government activity and its broad responsibilities. Paragraph 50 explains "The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society…" SFFAC 1 describes the federal government's responsibility for the general welfare of the nation in paragraph 53-54 as "a broad responsibility that involves multiple goals."

A59. With these broad responsibilities, the federal government may decide to take certain actions or intervene in certain situations. Examples may include actions to provide stability to the financial markets, key industries, states, cities, or counties. These types of federal government interventions are considered rare.[60] Historically the federal government has been involved in few commercial enterprises on an equity basis or shared ownership basis.[61] Although the federal government may not act to maximize profits, the federal government may intervene and act in capacities to protect citizens. This may ultimately lead to taking control of organizations or acquiring some form of ownership.

A60. The federal government may also intervene by providing assistance through extending loans or debt guarantees that do not meet the inclusion principles established in this Statement. Such transactions should be accounted for in accordance with the appropriate accounting standards per the GAAP hierarchy. This Statement does not require additional disclosures for intervention actions that do not meet the inclusion principles.

A61. The initial SFFAC 2 provided an exception for situations where the criteria leading to consolidation are met temporarily. Specifically, paragraph 45 of SFFAC 2 stated "The entity or any of the above criteria are likely to remain in existence for a time, i.e., the interest in the entity and its governmental characteristics are more than fleeting." "Fleeting" may imply periods of one year or less to some and the Board considered how to clarify the term "fleeting." Ultimately, the Board decided terms such as "fleeting" and "temporary" imply a time limit.

[60] The financial crisis that began in 2007 is considered to be the most severe since the Great Depression. (White Paper on Changes to Financial Regulations)
[61] Congressional Research Service (CRS) Report for Congress RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*

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A62. However, there may be instances where an intervention is longer than one year due to the extreme factors of the national crisis. In most instances, it is difficult to establish and meet a timeline for ending an intervention. In these instances, the focus continues to be on governance and protection, rather than maximizing profits or establishing new federal government lines of business. Although the actions may be longer than one year, the interventions are "not expected to be permanent." The Board notes that this "non-permanent" expectation would generally lead to the entities exhibiting more of the characteristics of a disclosure entity than of a consolidation entity. This is preferable to relying on "temporary" or "fleeting" which implies that a time limit could be established.

A63. A further implication the Board wishes to avoid is that organizations owned or controlled as a result of interventions are considered "federal government entities" when applying the Code of Professional Conduct established by the American Institute of CPAs.[62] This Statement recognizes that such interventions create a need for accountability but they do not make the disclosure entities arising from intervention actions "federal government entities" or federal reporting entities. While the hierarchy of GAAP established for federal reporting entities may not necessarily apply to disclosure entities, information about such organizations is still needed for accountability purposes and to meet federal financial reporting objectives.

Component Reporting Entities

A64. The Board believes there should be consistency in treatment of organizations at the government-wide and the component reporting entity levels. The reasons for including organizations at the component reporting entity level should be consistent with the reasons in the government-wide entity GPFFR. Further, classification as consolidation entities or disclosure entities should be consistent in government-wide and component reporting entity GPFFRs. The Board believes a single set of principles for inclusion and classification presented from the government-wide perspective provides for the desired consistency. This is appropriate and necessary because the government-wide reporting entity is the only federal reporting entity that is an independent economic entity.

A65. Nonetheless, implementation of these principles involves the component reporting entities because the government-wide report is, for the most part, a consolidation of the reports provided by component reporting entities. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

A66. The Board believes that component reporting entities should identify consolidation entities and disclosure entities administratively assigned to the component reporting entity. Standards that are based on organization and accountability provide a more realistic view of how component reporting entities become accountable for organizations and how component entity boundaries are likely to be determined. The result will be component

[62] The American Institute of CPAs establishes ethics rules for its members through its Code of Professional Conduct. Rule 203, Accounting Principles, designates three bodies to establish accounting principles for three different domains—nongovernmental entities, state and local governmental entities, and "federal government entities." (ET Section 203, paragraph .01)

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reporting entity GPFFRs that include all organizations for which the component reporting entity management (for example, appointed officials) are expected to be accountable.

A67. Administrative assignments to component entities are typically made in policy documents such as laws, budget documents, regulations, or strategic plans. Ultimately, component reporting entities would identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete.

A68. Administrative assignments can be identified by evaluating the following three areas:

a. Scope of the Budget Process

b. Accountability Established Within a Component Entity

c. Misleading to Exclude and/or Misleading to Include

A69. Component reporting entities should develop processes to ensure they identify and include those consolidation entities and disclosure entities that are: (1) within the scope of their budget process, (2) for which accountability is established within their component reporting entity, or (3) which are misleading to exclude. In rare cases, a component reporting entity may find that it would be misleading to include a consolidation entity that appears to be within the scope of their budget process or to have accountability established within the component reporting entity. While most respondents agreed with the proposal, several indicated a need for implementation guidance, especially regarding the misleading to include provision. In addition, there was some confusion about how the inclusion principles applied from the government-wide perspective relate to the administrative assignments at the component reporting entity level.

A70. The Board does not intend to provide detailed administrative assignment implementation guidance at this time. Central agencies are anticipated to determine if there is a need for coordinated guidance to be developed to ensure government-wide consistency. A coordinated effort from the central agencies could promote a process to ensure the component reporting entities are performing the necessary procedures to capture the material organizations from their perspectives and also for consideration at the government-wide level. The effective date considered this and allowed sufficient time for a coordination of efforts as well as development of any needed implementation guidance.

A71. Regarding the “misleading to include provisions,” the Board made editorial changes to clarify that they expect this to occur only in rare cases where the substance of relationships between consolidation entities differs from their form. For example, the Pension Benefit Guarantee Corporation (PBGC) is legally established within the Department of Labor. Nonetheless, PBGC has always operated as a separate legal entity with a mandate to fund its operations from premiums and has provided separate audited financial statements since its inception. Some believe that it would be misleading to consolidate PBGC and Department of Labor financial statements. In contrast, the misleading to include provision would not be an appropriate justification for excluding an office such as the Office of the Inspector General from the consolidated financial statements of its associated Department.

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A72. Also, some respondents questioned whether the misleading to include provision would be applicable to disclosure entities. The Board does not believe disclosure entities can be misleading to include because disclosures explain the relationship. Such explanations would prevent misleading presentations about disclosure entities.

A73. During due process, some respondents questioned the difference between the inclusion principles and administrative assignments. The inclusion principles are to be applied from a government-wide perspective; whereas administrative assignments are determined from the component reporting entity perspective. Prior to implementation of this Statement, based on initial provisions of SFFAC 2, component reporting entities apply the conclusive and indicative criteria from their perspective as individual government agencies. In some cases, no individual government agency has direct involvement in the operations of entities that nonetheless are controlled through legislation established by and/or officials appointed by elected officials. Also, some ownership documents identify the federal government as owner rather than a particular government agency. To ensure that all owned or controlled entities are included, the inclusion principles must consider the relationship of an organization and the federal government as a whole.

A74. Another key difference is that administrative assignments are assessed from the component reporting entity perspective. Therefore, component reporting entities will need to adapt to a multi-step process involving varying perspectives (inclusion principles applied from a government-wide perspective and administrative assignments from the departmental perspective). Accordingly, coordination with the central agencies during the implementation process will be important.

GPFFR Consolidation and Disclosure

A75. As noted above, decisions about the government-wide GPFFR require determining what organizations are to be included in the reports and identifying appropriate means to present relevant information about organizations. The final determination of the presentation of financial information through consolidation or disclosure is based upon the results of two assessments—first, if the organization is included and second, if those included organizations are classified as consolidation entities or disclosure entities.

A76. The Flowchart at Appendix B is a useful tool in applying the principles established. It is helpful in the assessment and applying the standards in order. It includes paragraph references to underlying principles and major decision points.

Consolidation Entities

A77. This Statement provides that consolidation entities should apply SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. In addition, it provides for the consolidation of the financial statements of consolidation entities so citizens may assess the financial position and the cost of operations of the federal government. Consolidation of financial information regarding the activities financed by taxes and other non-exchange revenue, resources, and obligations where governance rests with the Congress and/or the President ensures that the reporting objectives of SFFAC 1 are met.

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A78. Existing guidance may also require additional information—either through disclosures or required supplementary information—regarding consolidation entities. While the term "disclosure entities" is used to refer to organizations included in GPFFRs through disclosures, readers should not infer that disclosures would not also be provided regarding consolidation entities and related activities and transactions consistent with existing standards.

Consolidation of FASB-based and FASAB-based Information

A79. While FASAB is the appropriate source of GAAP for federal entities, the Board has considered the potential ramifications when some federal entities follow GAAP for nongovernmental entities promulgated by the Financial Accounting Standards Board (hereafter "FASB GAAP") and their information is consolidated with information based on FASAB standards. For example, federal government corporations, the U.S. Postal Service, certain component reporting entities of the U.S. Department of the Treasury and the Department of Housing and Urban Development, and some other organizations in the executive and legislative branches have historically applied FASB GAAP and continue to do so. SFFAS 34 recognizes that "general purpose financial reports prepared in conformity with accounting standards issued by the FASB also may be regarded as in conformity with GAAP for those entities that have in the past issued such reports." SFFAS 34 also provides that a federal reporting entity preparing audited financial statements for the first time may adopt FASB standards in the rare case that the needs of its primary users would be best met through the application of FASB standards. The acceptance of these practices raises the question of whether the information prepared under FASB standards may be consolidated with information prepared under FASAB standards in consolidated reports prepared by component reporting entities and in the consolidated government-wide reporting entity.

A80. The Board has considered such issues on several occasions and provided concepts as follows:

> The reporting entities of which the components [preparing reports under FASB or regulatory accounting standards] are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB issued standards that would not be required by the other standards.[63] (SFFAC 2, *Entity and Display*, paragraph 78 (excerpt from section on "Financial Reporting For An Organizational Entity"))

A81. The Board determined in SFFAS 34 that FASB-based statements are acceptable in certain circumstances. While there may be significant differences between FASB and FASAB standards, both standards result in accrual-basis information and disclosures that aid users in understanding the information. Converting FASB-based information to FASAB-based

[63] In October 1999, FASAB was recognized as the Rule 203 standards-setting body for the federal government. As such, FASAB now issues the standards, rather than issuing recommendations to OMB and GAO for issuance of the standards.

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information for consolidated financial reports of larger organizations may not be justifiable since conversion may not aid users.

A82. Users may be confused by the presentation of different amounts for a component in its own financial report and in the consolidated financial reports of larger organizations; particularly when both amounts would be in accordance with GAAP for federal entities per SFFAS 34. In addition, conversion imposes a cost and it is not clear that the cost is justifiable based on benefits to the user. Therefore, this Statement establishes that amounts derived for component reporting entities in compliance with SFFAS 34 may be consolidated without adjustment and the aforementioned concepts from SFFAC 2 paragraph 78 are rescinded.

A83. However, if this leads to consolidation in a single line item of amounts measured differently due to differences between FASB and FASAB principles, then one would anticipate disclosures of the different accounting policies and the related amounts to aid the reader in understanding the information provided. The Board considered adopting requirements for such disclosures but believes that existing requirements and long-standing professional practices are sufficient.

A84. The Board initially proposed that activities measured in accordance with FASAB standards and amounts related to intragovernmental were required to be disclosed in the notes of component reporting entities to facilitate eliminations at the government-wide reporting level. However, after further consideration of the comments, the board determined this information may not be relevant for the component reporting entity GPFFRs and was more appropriately obtained in the Treasury closing package. Likewise, the budgetary reporting issues highlighted by respondents appeared to be a reconciliation and system issue that should be addressed in the Treasury Financial Manual instead of an accounting standard. Also during due process it was determined that certain component reporting entities reporting on a FASB basis convert their information to a FASAB basis upon consolidation. The preparers, auditors, and users believe the information is meaningful for their purposes. As this may be the case in certain instances, but not all, the Board did not want this Statement to prevent those wishing to convert from doing so if it aids the users by providing this meaningful information. Hence, while conversion may be appropriate in certain situations, it is not for all.

Disclosure Entities

A85. The Board believes consolidation of disclosure entities would not result in information meeting the basic qualitative characteristics of information in financial reports because it would not provide the most relevant, understandable, or consistent information. The Board believes consolidation of disclosure entities may obscure the boundaries of the risks and rewards intended to be assumed or gained. Further, assets that are not available for purposes other than the specific business operation of the non-consolidated organization might be commingled with federal assets, and liabilities not fully guaranteed by the federal government might be added to federal liabilities. Instead, financial balances and amounts for organizations having the characteristics of disclosure entities should be kept separate from balances and amounts for those organizations having the characteristics of consolidation entities to prevent distortions to the consolidated financial statements.

A86. The Board believes SFFAC 1 recognizes the challenges that may arise in applying traditional approaches to financial reporting. SFFAC 1 paragraph 49 states “…Federal

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accounting and financial reporting are shaped by, and need to respond to, the unique characteristics and environment of the federal government." SFFAC 1 paragraph 105 further explains "reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the people, their elected representatives, and federal executives…" SFFAC 1 also provides the qualitative characteristics of information in financial reports, by identifying these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.[64]

A87. This Statement provides flexibility in identifying needed information regarding disclosure entities because the range of disclosure entities is broad and different information may need to be disclosed to meet the reporting objectives. Providing this flexibility allows the preparer to present information judged most necessary to meet reporting objectives while also providing an understanding of the potential effect of the relationship on the consolidation entity's financial statements.

Factors in Determining Disclosures

A88. Because of the flexibility needed regarding disclosures, preparers are provided a list of factors to assist in determining what disclosures to include. Materiality is an overarching consideration in financial reporting. Preparers should consider both qualitative and quantitative materiality in determining disclosure entity presentation and disclosure. Beyond materiality, the factors provided in this Statement assist in determining the nature and extent of information regarding a disclosure entity to be provided.

A89. The factors are to be considered in the aggregate; no individual weight should be assigned or interpreted. The assessment of the appropriate disclosures should be made after considering all the factors. During due process, several respondents disagreed with the factor "*Disclosure entity views/perspective*" that provided for consideration and judgment of about how the disclosure entity views its relationship with the federal government. Most respondents did not believe this should influence the level of disclosures and noted that often the reporting entity would not be aware of the disclosure entity views. The Board recognized that there may be situations where the disclosure entity's view regarding its relationship with the federal government should influence the type and extent of information that is disclosed. However, it may be difficult to state operationally how this would affect disclosures in given situations. Therefore, while the Board agrees this factor may be relevant, the Board nonetheless removed it from this Statement.

Disclosure Requirements

A90. The Board recognizes that although this Statement provides flexibility in meeting the disclosure objectives, a wide variety of information is listed as examples to meet the intended objectives and there are not requirements for how information must be aggregated. Qualitative and quantitative factors are considered in determining whether information regarding a disclosure entity is presented separately due to its significance or aggregated with the information regarding other disclosure entities. If information is aggregated, aggregation may be based on disclosure entity type, class, investment type, or a particular event deemed significant to the reporting entity. For example, one reporting entity may

[64] SFFAC 1, paragraph 156.

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determine it appropriate to aggregate by investment types, such as equity or loan; another by disclosure entity type, such as receiverships; and yet another by class, such as museum.

A91. Further, disclosures should be integrated so that concise, meaningful and transparent information is provided. Integration is accomplished by providing a single comprehensive note regarding the disclosure. Care should be taken to ensure the objectives are met, without producing unintended consequences. Preparers should keep in mind there are associated costs and potential audit implications with any information included in a GPFFR. Incorporating by reference or including other entities' summary financial statements or summary financial information generally would result in an auditor being required to gain audit assurance on that information and thereby may result in additional audit costs.

A92. The Board believes any financial information about disclosure entities in the reporting entity's GPFFR should be based on accrual basis standards specific to the type of organization while minimizing additional costs on the disclosure entity. There will be instances where information about disclosure entities is produced for reporting periods that differ from the reporting entity's reporting period. To minimize additional costs, the Board agreed that if disclosure entities have a different reporting period than the reporting entity's GPFFR, disclosure of information from a reporting period ending within the reporting entity's reporting period is acceptable. The Board performed outreach on this issue to the audit community and to the federal entity task force. Generally, the feedback supported this approach.

A93. However, due to the fact there could be a large time lag, there should be a provision for disclosing significant changes in the information as a result of events occurring after the issuance of the disclosure entities' audited financial statements and before the issuance of the reporting entity's audited financial statements for a later fiscal year-end. The Board notes this would only be necessary if the disclosure entities' summarized financial statements or summarized financial information were presented. Otherwise normal transactions would be captured throughout the year so this would be a somewhat narrowed focus.

Related Parties

A94. The Board determined it should define "related parties" and address them within this Statement for several reasons. Related party reporting is such a fundamental notion within GAAP and the auditing standards that addressing how related party concepts apply in the federal domain is important. Absent clear related party standards in the federal domain, the Board believes the private sector concepts would be applied by default and that application would be inappropriate.

A95. Because of the extent of the federal government's relationships—whether already established or implied—"related parties" concepts may result in numerous relationships requiring disclosure. Therefore, the Board requires disclosure of related party relationships of such significance to the reporting entity that it would be misleading to exclude information about them. For clarity of intent, the standards rely heavily on listing parties to be included and excluded.

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A96. In addition, this Statement provides room for judgment because one cannot anticipate all types of relationships the federal government may have or might have in the future that should be reported. While the standards identify potential exclusions that generally would not be related parties (and those that may) one should consider the many complex relationships where significant influence is exerted. Judgment will be required to determine which significant influences may pose risks that warrant disclosures and these standards do not preclude the reporting of a related party if factors deem it appropriate. The related parties category is needed to provide for disclosure of those organizations that are not included under the inclusion principles but where there is an existing relationship of such significance that it would be misleading to exclude.

A97. Component reporting entities of a single controlling entity are generally subject to related party reporting requirements in other standard-setting domains but will not be considered related parties under federal standards.[65] In reaching this conclusion, the Board discussed how jointly controlled component reporting entities present information about their relationships. Presently, component reporting entities are required by OMB guidance to state in the management's discussion and analysis section that: "The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity." In addition, existing standards require recognition of inter-entity costs to ensure that cost information is not misstated as a result of relationships between component reporting entities. While members noted that readers may need additional contextual information to understand what these complex relationships imply about component reporting entity information, the decision to exclude these entities from related party reporting placed such information requirements outside the scope of this Statement.

A98. During its due process, the Board considered a request that 'related parties' language be modified to clarify that members appointed to boards as individuals and the entities they are affiliated with are not in related party relationships with the departments or agencies. The Board did not believe additional language was necessary as the broad classes of exclusions provided were sufficient. Board members noted concern with broad exclusions of board members and organizations with which they are affiliated because there may be situations where disclosures would be appropriate. Further, current practices have provided meaningful and transparent information and the Board believes this information should continue to be provided absent a change in circumstances.

A99. The Board further understood the respondent's concern that the term 'related party,' as commonly used in financial reports, may imply less than arms-length transactions. The Board believes once federal standards are issued, the term 'related parties' in the federal environment will develop its own unique meaning—that is, relationships of such significance to the reporting entity that it would be misleading to exclude information if one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions. There is a focus on exposures to risk of loss or potential gain as a result of the relationship. Additionally, the standards do not prevent an entity from referring to related parties as "affiliated institutions" or any other appropriately descriptive term. When doing so, it may be informative to explain the relationships by including information such as conflict of interest rules and other frameworks under which they operate.

[65] Therefore, intragovernmental transactions would not be considered related party transactions.

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A100. During due process, certain respondents asked for clarification regarding the difference between a disclosure entity and a related party. More specifically, the respondents had difficulty finding a distinction between the characteristics of a related party and those of a disclosure entity meeting the "misleading to exclude" inclusion principle. When considering whether the principles required clarification, the Board noted the key difference between related parties and included organizations is that related parties are not controlled or owned but are significantly influenced by or influencing the federal government. In considering whether an organization rises to “misleading to exclude” the Board believes this distinction between included organizations and related parties will be helpful. The Board did not believe there was a need to revise the standards.

A101. The Board recognizes the difficulty in applying new standards to complex relationships. However, the Board believes the standards are clear. While there is a key change in the application of principles from the government-wide perspective, central agency coordination and guidance during the implementation process will aid users in adopting this perspective.

Proposed Amendments to SFFAC 2, Entity and Display

A102. This Statement provides amendments to SFFAC 2, *Entity and Display*. This Statement provides a description of the change to SFFAC 2 and an explanation as to why the change is being made. Most of the conforming changes are rescissions that result from movement of criteria for determining what organizations are required to be included in the federal reporting entity’s GPFFR from a concepts statement to a standards statement.

A103. Paragraphs 54—77 and 79–-112 of SFFAC 2 address concepts outside the scope of this Statement and are not amended.

A104. In addition, no changes are made to paragraphs 11-37 of SFFAC 2 because the Board believes these paragraphs provide the conceptual underpinning for understanding the structure of the federal government and how this relates to reporting entities for general purpose federal financial reporting. Although there may be some small differences in terminology in those paragraphs, the Board did not believe they were significant enough to warrant amendments.

A105. Paragraphs 47-50 of SFFAC 2 identify certain organizations or types of organizations (the Federal Reserve System, Government Sponsored Enterprises, and Bailout Entities) that could be included in the government-wide reporting entity based on the SFFAC 2 concepts but that should not be included. This Statement establishes principles to provide users of GPFFRs with comprehensive financial information while recognizing the complexity of the federal government and its relationships with varied organizations. The principles can be applied to the organizations previously excluded and conclusions reached to include the organizations—either as consolidation entities or disclosure entities—or to continue to exclude the organizations. SFFAC 2 is being amended to ensure that concepts provide a framework for standards-setting but do not themselves establish standards by listing specific exclusions.

Other Unique Situations

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A106. As part of the exposure draft process, the Board also asked respondents if there were other unique situations that should be addressed within this Statement. The Board received input from respondents on several example organizations that they believe should be clarified in this Statement. The Board considered the suggestions against the goal to develop principles-based standards that could be applied to all organizations. The Board believes the standards are sufficiently clear. Therefore, the Board did not revise the proposed requirements in response to these unique circumstances.

Board Approval and Dissent

A107. This Statement was approved for issuance by 8 members of the Board. One member dissented. The written ballots are available for public inspection at the FASAB's offices. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A108 through A115.

A108. Although Mr. Steinberg believes this Statement achieves the objective of providing authoritative guidance for defining the federal government reporting entity, he dissents because he believes the Statement implies, and therefore could lead readers to conclude, that the federal government considers receiverships, conservatorships, and intervention entities to be part of the federal government. He concurs that the federal government's general purpose financial report should disclose the relationships of these organizations to the reporting entity, the nature and magnitude of their relevant activities during the period and balances at the end of the period, and the reporting entity's future exposures to financial and non-financial risks and rewards resulting from these relationships, and has pointed to the numerous accounting standards already requiring those disclosures. However, he believes there are three compelling reasons for this Statement to not imply that receiverships, conservatorships, and intervention entities are part of the federal government reporting entity, as is done in paragraphs 51 through 55.

A109. Accounting literature has traditionally followed the postulate that, for an organization to be deemed part of a larger organization, the relationship has to be other than temporary—a condition that does not exist with the receiverships, conservatorships, and intervention entities. The desire to remain consistent with this postulate was pointed out by more than one respondent to the Exposure Draft. The Board, nonetheless, maintained that organizations for which the relationships are temporary, such as receiverships, conservatorships, or intervention entities, are part of the federal government reporting entity, but modified the standards to state that they would be classified generally as disclosure entities rather than consolidation entities. Mr. Steinberg believes the purpose of the postulate is to define the relationship that should exist in order that there be reporting, and not the form of the reporting itself.

A110. The policy of the federal government is to not engage in activities that are typically conducted by the private sector. Banking is an activity that since the nation's founding, has mostly been conducted by the private sector. Although failed and failing banks are taken into receivership, it is not because the government intends to provide banking services, but only to oversee an orderly liquidation or transfer of those banks' assets, and thereby protect the depositors. Likewise, the organizations for which the government has, from time to time,

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decided to provide temporary financial support, that is, intervention entities, are in sectors of the economy that the federal government recognizes are not its function: automobile manufacturing and financing, manufacture of weapons systems, commercial insurance, banking, state and local government. Listing the receiverships, conservatorships, and intervention entities as part of the federal government reporting entity, as this Statement does, can be inferred as an expansion of the federal government into areas traditionally reserved for the private sector.

A111. Some of the most strident political arguments in recent years are about the expanding reach of the federal government into the private sector. Issuance of an accounting standard that could be read as including in the federal government reporting entity, entities normally viewed as outside the federal government (for example, automobile manufacturers, automobile financing companies, defense manufacturers, insurance companies, privately-owned banks, state and local governments) supports the position of those who claim the federal government is slowly expanding its reach and becoming increasingly socialist. Accounting standards should neither support a political position, nor give the appearance of such.

A112. Indeed, the inappropriateness of implying that receiverships, conservatorships, and intervention entities are part of the federal government reporting entity is revealed by a disavowal and apparent self-contradiction in the Statement itself. Paragraphs 51-55 identify receiverships, conservatorships, and intervention entities as one of the parts of the reporting entity that are deemed disclosure entities. Paragraph A63, on the other hand, states that the Board "wishes to avoid [the implication] that organizations owned or controlled as a result of interventions are considered 'federal government entities' when applying the Code of Professional Conduct established by the American Institute of CPAs," but then states that "this does not make the disclosure entities arising from intervention actions 'federal government entities.'" (underlining added)

A113. Mr. Steinberg agrees the accountability for receiverships, conservatorships, and intervention entities should be disclosed, but these types of organizations should not be listed in this Statement in such a way that they may be inferred by readers to be part of the federal government reporting entity. His beliefs are based on long-standing accounting postulates, the existing policy of the federal government, and the potential appearance that the accounting standards support a particular political agenda.

A114. Mr. Steinberg is also concerned with the manner in which this Statement provides for the reporting of museums, performing arts companies, and other entities partially funded by appropriations and partially by donations in the federal government's general purpose financial report. Specifically, these entities have often viewed the activities funded by donations as conducted by organizations that are separate from the organization performing activities funded by appropriations. They therefore provided the Department of the Treasury with information for only the activities funded by appropriations. Hence, the government-wide financial report often presented the financial position and results for only a portion of the museums, performing arts companies, and other entities funded partly by appropriations and partly by donations. The Board recognized the inappropriateness of financial statements presenting only a part of an entity and therefore agreed that the entirety of these entities should be included in the federal government reporting entity, whether through consolidation

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or as disclosure entities. This requirement was stated initially in two footnotes and in the Basis for Conclusions, but not in the body of the Standard. One of the footnotes was subsequently moved to the body of the Standard.

A115. Mr. Steinberg believes that while the movement of the footnote to the body of the Standard avoids the dangerous precedent of defining accounting standards in only footnotes and the Basis for Conclusions, the requirement, as stated, will enable entities to still claim that the activities funded by donations are in separate organizations that do not meet the inclusion principles of “in the budget,” “majority ownership interest,” or “control.” Therefore these portions of the entities might be inappropriately excluded from the federal government reporting entity’s general purpose financial statements.

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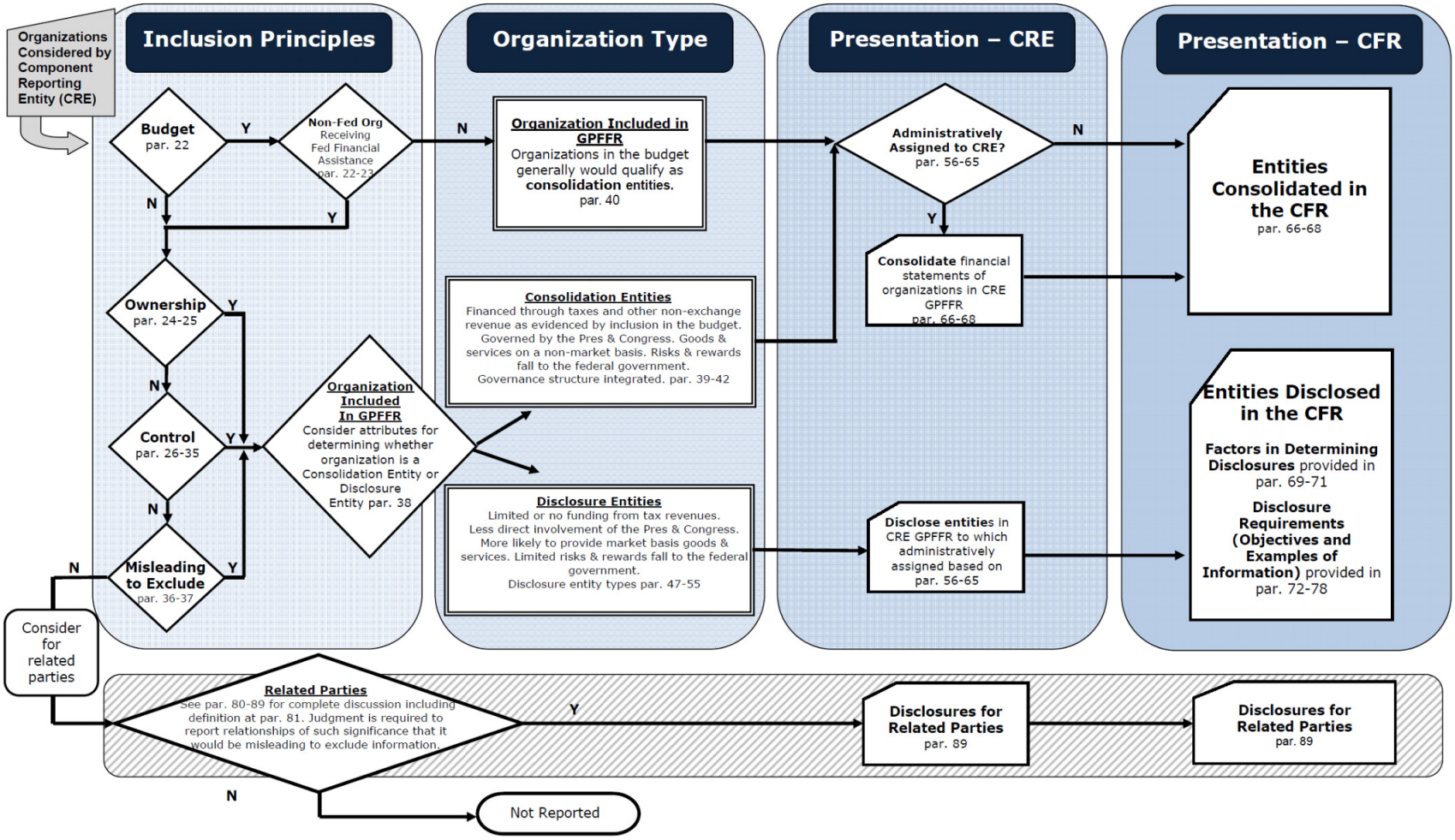
APPENDIX B: FLOWCHART



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APPENDIX C: ILLUSTRATIONS

Preamble

These illustrations demonstrate how the provisions of this Statement could be applied to organizations given simplified hypothetical circumstances. They are for illustrative purposes only and are nonauthoritative. They do not:

1. represent actual organizations,
2. provide a thorough analysis of all the facts and circumstances that are needed to reach a conclusion in practice,
3. indicate a preferred method of analyzing facts and circumstances, and
4. substitute for the application of professional judgment to actual facts and circumstances.

These illustrations follow the sequence presented in the decision flowchart in Appendix B. All tentative conclusions are based primarily on the hypothetical circumstances presented. In most illustrations, the tentative conclusions refer to consideration of other factors by management and the auditor. This reference is included to emphasize that, in practice, consideration of all relevant facts and circumstances would be needed to reach conclusions. The reader should assume that the general reference to “other factors” means that such factors, in aggregate, supported the conclusions implied by the necessarily limited assumed facts and circumstances presented in each illustration.

Application of the standards to actual organizations requires consideration of the circumstances specific to each organization and the exercise of professional judgment. Although the limited assumed facts and circumstances presented in the illustrations may be similar to situations at a particular reporting entity, they should not be used in practice as a substitute for a complete and thorough consideration of all of the relevant facts and circumstances, which may lead to a conclusion different from the tentative conclusions in these illustrations. For example, the illustrations make certain assumptions that, in practice, require judgment of the specific facts and circumstances to make appropriate determinations.

All of the illustrations discuss administrative assignments to component reporting entities where there is only one component reporting entity relationship described. In reality, more than one component reporting entity may have a relationship with the illustrative organization. In such cases, additional information would need to be considered to determine whether other administrative assignments exist.

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ABC Department

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

Congress established ABC Department (ABC), a federal organization, to promote entrepreneurship and innovation as a means to address national economic and environmental challenges. Provisions that govern ABC are generally prescribed in legislation and ABC accomplishes its mission through the activities of various bureaus, grants to research institutions, and contracts with universities and not-for-profit organizations.

The executive leadership of ABC consists of a secretary, deputy secretary, and three assistant secretaries. The President nominates and the Senate confirms each of these officials. These officials serve at the pleasure of the President. ABC is subject to all laws and regulations applicable to executive branch agencies.

ABC relies on appropriated public funds to conduct its mission and is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information. The President and the Congress consider ABC's requests for resources and determine the amount that should be budgeted to provide services. Furthermore, ABC is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that ABC should be included in the government-wide GPFFR because it (1) meets the first of the three inclusion principles (being listed in the budget) and (2) is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Entity

Further, because it is listed in the budget, ABC generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts contradicting the assumption that ABC is a consolidation entity. As a consolidation entity, ABC's financial statements should be consolidated in the government-wide GPFFR.

Administrative Assignments

The assumed facts and circumstances do not indicate ABC should be consolidated with another component reporting entity. Further consideration of ABC's relationships with other consolidation entities would be needed to determine if ABC has been administratively assigned to another component reporting entity. Further consideration would also be needed to identify any consolidation entities or disclosure entities administratively assigned to ABC.

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Epsilon Corporation

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

The Congress and the President established Epsilon Corporation as an independent government corporation to insure consumer funds placed in trust with certain types of institutions. Federal legislation established provisions that govern Epsilon's activities. Epsilon is governed by a seven member board of directors and each board member is appointed by the President and confirmed by the Senate. The Congress monitors Epsilon's activities by conducting hearings on Epsilon's programs and requesting Government Accountability Office (GAO) and Office of Inspector General (OIG) audits.

Epsilon is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Epsilon receives its funding based on legislation permitting it to receive and spend premiums from the institutions it insures. Legislation limits how Epsilon can invest proceeds from premiums and, to help ensure that Epsilon remains financially viable, legislation requires Epsilon to have a reserve fund. The board of directors determines the level of the reserve fund. If Epsilon encounters a shortfall, the organization may borrow a limited amount from the U.S. Department of the Treasury (Treasury), but any additional funding requirements must be obtained from premium assessments.

Epsilon is required to periodically report to the Congress and the President on matters such as:

- Program performance results
- Financial position, results of operations, and cash flows
- Adequacy of internal controls and systems

Furthermore, Epsilon is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumed facts and circumstances, management determined and the auditor concurred that Epsilon Corporation should be included in the government-wide GPFFR because it meets the first inclusion principle (in the budget) and is not a non-federal organization receiving federal financial assistance.

Classification as a Consolidation Entity or Disclosure Entity

Further, because it is listed in the budget, Epsilon generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that Epsilon is a consolidation entity. As a consolidation entity, Epsilon's financial statements should be consolidated in the government-wide GPFFR.

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Administrative Assignments

There is no information included in the assumed facts and circumstances indicating that Epsilon should be consolidated with another component reporting entity. Further consideration of Epsilon's relationships with other consolidation entities would be needed to determine if Epsilon has been administratively assigned to another component reporting entity or has had consolidation entities administratively assigned to it. Also, further consideration would be needed to identify any disclosure entities administratively assigned to Epsilon for which disclosures are needed.

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Sigma Association

(Control based on Persuasive Indicator—Disclosure Entity (Financially Independent))

Assumed Facts and Circumstances

The Congress and the President established Sigma Association (Sigma) as a not-for-profit, non-taxpayer funded organization to market innovative U.S. agricultural technology worldwide and to respond to any claims of damage arising from new technology. The fundamental purpose of the corporation is specified in legislation and its mission statement is "to open new markets for U.S. agricultural technology through a cooperative marketing strategy and risk-sharing approach for market participants."

Sigma is governed by a ten-member board of directors. Five members are appointed by the President and confirmed by the Senate. Four members are elected by industry members. The Secretary of Agriculture (or his/her designee) serves as a voting ex-officio member of the board. No more than three of the appointed members may be from the same political party. Board members serve seven-year terms and can only be removed for cause (meaning they may not be removed for policy decisions). Also, Congress monitors Sigma's activities by conducting hearings on Sigma's programs and requesting GAO audits.

Sigma is financed by fees imposed on industry members. Sigma's board of directors must establish an annual budget and legislation limits how Sigma can invest proceeds from fees. To help ensure that Sigma remains financially viable, legislation requires Sigma to have a reserve fund. The board of directors determines the level of the reserve fund after considering input from industry members. If Sigma encounters a shortfall, it may borrow a limited amount from the Treasury, but any additional funding requirements must be obtained from future fee assessments on industry members.

Tentative Conclusions

Based on the assumed facts and circumstances, and other considerations, management determined and the auditor concurred that Sigma should be included in the government-wide GPFFR because Sigma meets the third inclusion principle (control with expected benefits or risk of loss). Indicators that the federal government can control Sigma are that the Congress and/or the President (1) established its fundamental purpose and mission through legislation, and (2) appoint a majority of the members of its board of directors (its governing body). Each of these facts individually would be sufficient to indicate control such that Sigma would be included.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Sigma should be reported as a disclosure entity because it is a financially independent organization. Management and the auditor considered the assumed facts and circumstances presented below in the aggregate, weighed them against other considerations, and used professional judgment.

Evidence suggesting that it is a disclosure entity includes:

1. Tax revenue is not appropriated for ongoing operations.

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2. The corporation is relatively financially independent because it is primarily funded from a source other than appropriations. Its budget and fees are not subject to Congressional or Presidential approval.

3. Having seven-year terms for directors who are not subject to removal for policy decisions indicate a higher degree of autonomy than executive branch appointees. This governance structure vests greater decision-making authority with the board while insulating it from political influence. As a result, Congressional and Presidential oversight is less direct since they are not involved in decisions such as the level of reserves needed.

4. While Sigma is permitted to borrow from the Treasury, such borrowing is limited. This means risks to the federal government are limited. Instead, Sigma is expected to maintain its operations and meet its liabilities with revenues received from sources outside of the federal government.

Evidence suggesting that Sigma may be a consolidation entity includes:

1. The President and the Senate, who appoint and confirm, respectively, members of the board of directors as well as establish organizational authorities in legislation, have a governance role.

2. Sigma provides a service that is not available from market participants. Its fees are adjusted to recover losses rather than to respond to market influences. Hence, its fees are not market-based.

Administrative Assignment

Because each disclosure entity must be reported by at least one consolidation entity, management considered whether Sigma has been administratively assigned to the Department of Agriculture. Evidence suggesting administrative assignment to the Department of Agriculture includes that the secretary serves as an ex-officio member of the board.

As a result, management determined and the auditor concurred that the Department of Agriculture should disclose information regarding Sigma in its GPFFR. If Sigma is also administratively assigned to other component reporting entities, then those component reporting entities should also consider the need to disclose information in their GPFFRs.

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Scholars University

(Not Included)

Assumed Facts and Circumstances

The Congress and the President chartered Scholars University as a small, private, independent, not-for-profit educational institution and legislation describes the mission of the university. The legislation also indicates that the university is not an instrumentality of the federal government and that the federal government does not assume any liabilities of the university.

Scholars University is governed by a 29-member board of trustees. The Secretary of Education is an ex-officio member of the board and the remaining members are elected by the board for three-year terms. The board controls and directs the university's affairs such as determining the university's tuition and fee structure, adding or removing colleges within the university, and establishing new research institutions.

To support its mission, Scholars University receives most of its revenue from tuition, fees, and private contributions. The university receives appropriations to support some of its academic programs. The university is listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information under a Department of Education program because an amount is appropriated for Scholars University each year. Although the appropriations discuss limitations on how the funds may be used, the university generally has discretion over how it chooses to allocate funds for its academic programs and construction activities.

Tentative Conclusions

Based on the assumed facts and circumstances and other information, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR. Although it meets the first inclusion principle (in the budget), management asserts that Scholars University is a non-federal organization receiving federal financial assistance in the form of a grant. Any non-federal organization listed in the budget should be assessed against the other two principles. So, management must determine if the other inclusion principles are met or if it would be misleading to exclude the university.

The initial analysis is summarized below:

- Ownership—The Congress and the President chartered Scholars University as a private, independent organization. There is no evidence that the federal government has an ownership interest in the university.

- Control—-Based on the assumptions presented, the persuasive indicators of control have not been met. While the federal government chartered Scholars University, the standards provide that further indicators of control must be present to conclude that the organization is controlled. The remaining persuasive indicators—appointing or removing a majority of the governing board members, establishing financial and operating policies, and dissolving the university and having access to its assets—are not met. The available facts and circumstances suggest that Scholars is not controlled. [Note, however, for brevity this illustration does not present an analysis of indicators of control that in the

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aggregate may reveal that Scholars is controlled. Such an analysis may be needed in practice.]

- Misleading to exclude—Scholars University is a small not-for-profit that is listed in the Budget solely as a program within the Department of Education. Management determined and the auditors concurred that it is both quantitatively and qualitatively immaterial. Also, there were no other facts and circumstances that would suggest that Scholars University should be included in the GPFFR. As a result, it would not be misleading to exclude.

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that Scholars University should not be included in the government-wide GPFFR.

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Education Research Institute (ERI)

(Control based on Persuasive Indicator–-Consolidation Entity)

Assumed Facts and Circumstances

The purpose of the Education Research Institute (ERI) is to assist state and local officials in making informed decisions regarding effective education methods. ERI was established by the Congress and the President through a public law specifying the organization's:

- status as a tax exempt not-for-profit,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The public law establishing ERI requires reauthorization of its operations every five years. If the Congress and the President do not authorize continued operation, ERI must cease operations and distribute its net assets to a successor organization designated by the federal government. If ERI is unable to satisfy its liabilities prior to dissolution, the federal government will assume its liabilities.

ERI is governed by a seven-member board of directors; five of whom are voting. Two members are specific federal officials within the Department of Education who serve part-time and do not have voting rights. The remaining five serve full-time, are appointed by the Association of Local School Boards, and serve six-year terms. One of these five members is elected by the board to serve as chairperson.

The legislation creating ERI designates funding of $1 per elementary school student per year to be made available from the general fund of the U.S. Treasury to the ERI trust fund. An annual transfer to ERI is not listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information but is included in the Department of Education's Congressional Budget Justification. The board of directors is authorized to establish an annual budget not to exceed the amounts available in the trust fund. ERI may fund up to 25% of its annual budget through donations but may not use federal funds to solicit donations.

The Department of Education approves the ERI annual budget. The department also reports information related to ERI activities in its annual performance report and Congressional Budget Justification.

ERI must provide annually an audited financial report to the Department of Education and relevant Congressional committees.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that ERI should be included in the government-wide

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GPFFR because the third inclusion principle (control with risk of loss or expectation of benefit) is met. A persuasive indicator of control exists because the federal government can unilaterally dissolve the organization and have access to its assets and responsibility for its liabilities.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, ERI should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that ERI is a consolidation entity.

Evidence suggesting that ERI is a consolidation entity includes:

1. It is primarily financed by taxes.
2. Federal government has assumed the risks associated with ERI's liabilities.
3. The purpose of ERI is to assist state and local officials by providing consultation services on a non-market basis.
4. ERI's annual budget is approved by the Department of Education and the Department also provides information related to ERI activities in its annual performance report and Congressional Budget Justification. These activities show that elected officials, acting with and through politically appointed officials, make decisions regarding ERI's budget.

Evidence suggesting that ERI is a disclosure entity includes:

1. A majority of the members of the board of directors is appointed by non-federal officials.
2. ERI is able to access donations to sustain some of its operations.

Administrative Assignment

The Department of Education should consider whether or not ERI is administratively assigned to it. Evidence that indicates ERI is administratively assigned includes Education's participation in ERI's budgetary process and inclusion of information regarding ERI in its own Congressional Budget Justification. Having considered the above information and other available evidence, the Department of Education determined and its auditor concurred that it should consolidate ERI's financial statements in its GPFFR.

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Mediation Corporation

(Control based on Indicators in the Aggregate—Disclosure Entity)

Assumed Facts and Circumstances

Mediation Corporation (Mediation) was established as a 501(c)(3) non-member not-for-profit organization through a public law specifying the organization's:

- status and operating location,
- purpose and duties,
- governance structure,
- sources of financing, and
- reporting requirements.

The purpose of Mediation is to ensure that low-income individuals have access to mediation services to resolve non-criminal legal disputes. An assigned duty is to develop and maintain a network of state and local government organizations to deliver services financed by grants. Network members may raise funds to finance delivery of services through taxes, donations, and other grants without limitation.

The governing board comprises 13 members including Mediation's executive secretary. The President nominates candidates to fill the board member positions. A panel of local government officials participating in the network selects new members of the governing board from among the nominees. No more than seven members may be affiliated with the same political party. The members elect their chairperson from among the members. The President appoints the executive secretary and the Senate confirms the appointment. The executive secretary's term is fifteen years during which the President may only remove the appointee for cause.

Mediation is financed by an annual appropriation, interest earnings, and grants from any public or private grant-making organization. Grants must not finance more than 20 percent of its annual budget. The U.S. Attorney General approves the annual budget. Any liabilities incurred by Mediation must be settled from its assets and are not backed by the full faith and credit of the U.S. Government.

An annual appropriation is provided in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level for "Grants to the Mediation Corporation." The appropriation is made to the Department of Justice which transfers budget authority to Mediation. Mediation manages its cash balances similar to other not-for-profits and may retain any interest earned on unspent funds. In addition, it may apply for and receive grants from any grant making organization—public or private—subject to the 20 percent limitation.

The public law creating Mediation requires it to make annual audited financial reports publicly available. Mediation also files annual tax returns with the Internal Revenue Service. Furthermore, Mediation is considered to be a non-federal organization receiving federal financial assistance.

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Tentative Conclusions

Although Mediation meets the first inclusion principle (in the budget), it is a non-federal organization receiving federal financial assistance. To determine if Mediation should be included in the government-wide GPFFR, management considered the remaining inclusion principles—majority ownership interest and control with risk of loss or expectation of benefit.

It is unclear, based on the assumed facts and circumstances, whether Mediation is owned by the federal government and, therefore, meets the second inclusion principle. Therefore, management must consider the control indicators to determine if the third inclusion principle (control) is met. None of the persuasive indicators of control are present based on the assumed facts and circumstances so considerable professional judgment is required to determine whether—in the aggregate—the indicators provide evidence of control. The indicators suggesting federal government control over Mediation include:

1. The federal government provides significant input regarding selection of the organization's governing board members since a selection can only be made from among candidates identified by the President.

2. The President appoints a key executive—the executive secretary—and may remove him or her for cause.

3. Federal law restricts Mediation's capacity to generate revenues since only appropriations, interest earned, and grants may be used. In addition, only 20 percent of its annual needs may be met through grants.

4. The U.S. Attorney General approves the annual budget.

5. Federal law requires annual audited financial reports.

6. Federal law directs Mediation to work through a network of government agencies to provide services.

Based on the assumed facts and circumstances and other considerations, and using professional judgment, management determined and the auditor concurred that Mediation should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Mediation should be reported as a disclosure entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Mediation is a disclosure entity.

Evidence suggesting that Mediation is a consolidation entity includes:

1. It is primarily funded by taxes.

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2. Elected officials determine Mediation's budget, because at least 80 percent of its funding is appropriated to Justice. In addition, an appointed federal official, the U.S. Attorney General, approves Mediation's annual budget.

Evidence suggesting that Mediation is a disclosure entity includes:

1. Members of its governing body are selected by non-federal officials, serve longer terms than political appointees, must include members from different political parties, and may only be removed for cause. These conditions insulate the governing body from political influence.

2. Mediation has some access to non-federal funding through grants and its network of service providers is free to access non-federal funding for service delivery (subject to the 20 percent limitation).

3. Federal government has not assumed risks related to Mediation's liabilities.

Administrative Assignments

The Department of Justice should consider whether or not Mediation is administratively assigned to it. Evidence that indicates it is administratively assigned includes the Department of Justice's participation in Mediation's budgetary process. After considering the above and other factors, and using professional judgment, management at the Department of Justice determined and the auditor concurred that disclosures regarding Mediation should be presented in its GPFFR.

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Bicycle America, Inc. (Scenario A)

(Not Included)

Assumed Facts and Circumstances

Individual bicycle shop owners determined that a nation-wide network of shops and trails was needed to encourage greater reliance on bicycles for transportation and invested in a new corporation, Bicycle America (BA). BA's mission was to create a coast-to-coast network and ensure wide access to bicycling. Shares in the venture are held by local bicycle shops in all major cities.

BA is governed by a board of directors. The board controls and directs the organization's affairs and interests. Board members are elected by the shareholders to serve three-year terms.

Until recently, BA was able to finance its operations from user fees. A recent lawsuit led to serious financial challenges and cash was unavailable to meet pressing needs. Absent a cash inflow, BA was considering closing the trails. Due to exceptional citizen reliance on the trails for transportation and recreation, the federal government intervened and enacted legislation to provide funding.

The federal government provided a short-term loan to BA. The federal financial intervention to preserve BA was not separately identified in the Budget, but was part of a larger federal program within the Department of Transportation.

The funding legislation also established a temporary advisory committee to monitor BA's financial condition and inform Congress of potential issues that may warrant additional actions. In addition, the advisory committee will develop a plan to aid BA in returning to financial solvency and refinancing the short-term loan.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should not be included in the government-wide GPFFR. Specifically, BA is not listed in the Budget. Further, based on the available information and other considerations, management determined and the auditor concurred BA does not meet either the remaining ownership or control inclusion principle because BA continues to be owned by common shareholders and governed by the existing board of directors. The advisory committee offers advice to the Congress and does not have authority to direct BA to act. Management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustration, it would not be misleading to exclude BA.

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Bicycle America, Inc. (Scenario B)

(Ownership–-Disclosure Entity (Intervention))

Assumed Facts and Circumstances

Same as above except that in addition to the actions in Scenario A above, the federal government received shares that carry 51 percent of the voting rights of BA common stock and the advisory committee will develop a plan to sell the shares.

Tentative Conclusions

Based on the changed assumptions and no information to the contrary, and using professional judgment, management determined and the auditor concurred that BA should be included in the government-wide GPFFR. When the federal government holds a majority ownership interest, albeit temporary, the owned organization should be included in the government-wide GPFFR.

Classification as a Consolidation Entity or Disclosure Entity

The available facts and circumstances indicate that the federal government's involvement with BA is an intervention. Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BA should be reported as a disclosure entity because (1) separate legal identity is maintained, and (2) limited funding from general tax revenues is provided. The initial determination would need to be evaluated periodically to determine if the classification remains appropriate.

Administrative Assignments

Department of Transportation was assigned responsibility for transferring funds to BA which indicates an administrative assignment. As a result, management determined and their auditor concurred that the department should disclose information regarding BA in its GPFFR. If BA is also administratively assigned to other component reporting entities, then those component reporting entities should also disclose information in their GPFFRs.

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Chatham Laboratory

(Control based on Persuasive Indicator—Consolidation Entity (FFRDC))

Assumed Facts and Circumstances

Federal Department of ABC (ABC) organized Chatham Laboratory as a federally funded research and development center (FFRDC) to conduct specialized engineering research that supports ABC's mission related to infrastructure and leads to improved services. As specified in the agreement, ABC provides the physical capital and ongoing funding for the FFRDC and sets research goals for Chatham.

ABC selects a contractor to operate Chatham and conduct research consistent with the established goals. ABC is not involved in the day-to-day operations of Chatham. ABC routinely evaluates Chatham's performance and maintains a research office to review strategic plans, consider progress, and serve as a liaison to other federal institutions. ABC reports on Chatham's efforts in its own performance reports.

Chatham operations are funded entirely through appropriations provided to ABC. ABC identifies Chatham in its Congressional Budget Justification but Chatham is not specifically identified in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Instead, amounts for Chatham are included in a larger research program which makes payments to the contractor consistent with the terms of the contract. Chatham's contract operator must submit financial and performance reports to ABC periodically. All Chatham assets belong to the federal government and the results of Chatham research are the property of the federal government. In addition, ABC would be responsible for liabilities arising from use of the facilities to conduct research such as environmental cleanup liabilities. ABC is also responsible for employee benefits in the event Chatham operations are terminated.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Chatham should be included in the government-wide GPFFR. While contracting for the operation of Chatham, officials at ABC also act as the governing body by establishing the purpose and mission of Chatham. Further, ABC continues in this role through its involvement in Chatham's strategic planning and monitoring of performance. Establishing the purpose and mission of an organization is a persuasive indicator that control exists.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, Chatham should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that Chatham is a consolidation entity.

Evidence suggesting that Chatham is a consolidation entity includes:

1. It is primarily financed by taxes.

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2. The federal government has assumed the risks associated with Chatham's liabilities.

3. Chatham's annual budget is developed by ABC officials and information related to Chatham activities is provided in ABC's performance report and Congressional Budget Justification. This indicates that decision-making regarding the budget is exercised by elected officials through politically appointed officials and the budget process.

Evidence suggesting that Chatham is a disclosure entity includes:

1. Day-to-day operating decisions are made by a contractor.

After considering the above analysis and other factors, management determined and the auditor concurred that Chatham is a consolidation entity.

Administrative Assignment

ABC should consider whether or not Chatham is administratively assigned to it. In the example, evidence suggesting Chatham is administratively assigned includes ABC's role in Chatham's strategic planning, budgeting, and administration. Having considered the assumed facts and circumstances and other available evidence, the Department of ABC determined and its auditor concurred that it should consolidate Chatham's financial statements in its GPFFR.

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Gotham Laboratory

(Not included—Economic Dependency Insufficient to Show Control)

Assumed Facts and Circumstances

The Department of XYZ (XYZ), a department within the executive branch of the federal government, contracted with Gotham Laboratory (Gotham) to conduct specialized engineering research that fulfills a federal mission related to infrastructure and leads to improved services of XYZ. As specified in the agreement, XYZ provides funding to Gotham and Gotham's management team plans, manages, and executes the assigned research program.

XYZ serves on a panel providing input on the appointment of the board of directors for Gotham. However, the board of directors elects new members and the board manages Gotham's research. Gotham also may engage in any outside research activities approved by its board of directors.

Gotham performs services for various federal and non-federal organizations but receives 90 percent of its funding from XYZ. XYZ receives appropriated funds to support the Gotham research program. The remaining 10 percent of Gotham funding is derived from contracts with other federal agencies and private industry as well as donations. Gotham's budget is not reviewed or approved by any federal officials. Gotham is subject to the usual federal contract oversight and reporting requirements.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that Gotham should not be included in the government-wide GPFFR. Gotham is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. Further, based on the assumed facts and circumstances and other considerations, Gotham does not meet the inclusion principles of either majority ownership or control with risk of loss or expectation of benefit. Although Gotham appears to be economically dependent on the federal government, it ultimately retains discretion as to whether to accept funding or do business with the federal government. Despite the influence resulting from this dependency, the federal government does not govern Gotham's financial and operating policies. Further, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustration, it would not be misleading to exclude Gotham.

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Andromeda Prime Power Systems

(Related Party—GSE)

Assumed Facts and Circumstances

The federal government created Andromeda Prime Power Systems (APPS) as a government sponsored enterprise (GSE) to facilitate commercial space travel. APPS controls interplanetary travel among a network of commercial space stations and is subject to federal regulations regarding safety and technology transfers to other nations.

APPS is governed by a nine-member board of directors elected by common stock shareholders. Board members serve three-year terms.

APPS issued common stock and received a federal government grant to finance its initial capital and startup costs. The APPS is under no obligation to return the grant funds but is expected to promote U.S. competitive interests in the emerging space travel industry.

During the reporting period, APPS' board approved a strategic plan to expand its systems to accommodate increased commercial demands and APPS issued bonds to finance the initiative. The interest rate required by lenders indicates that the market assumes the federal government has implicitly guaranteed the payment of principal and interest. In its regulatory capacity, the federal government required APPS to establish a capital reserve and created a five-member APPS Advisory Board to monitor and advise Congress on APPS' fiscal operations.

APPS derives its revenues from fees charged to commercial organizations and receives no ongoing federal support through the Budget.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that APPS should not be reported in the government-wide GPFFR as a consolidation entity or disclosure entity. APPS is not listed in the schedule in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* that provides budget account level information and the federal government does not have a majority ownership interest in the company.

Further, management conducted a thorough assessment of control indicators and determined the federal government does not exercise control of APPS. Regulation of APPS does not, by itself, establish control.

However, based on the assumptions and other considerations, management determined and the auditor concurred that APPS should be disclosed as a related party. Related parties generally include GSEs not meeting the inclusion principles, especially those organizations for which the relationship is of such significance that it would be misleading to exclude information about it.

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U.S. Museum (Scenario A)

(In the Budget—Consolidation Entity)

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was organized to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship.

The Museum is an independent establishment of the federal government and is governed by a board of trustees, known as the Museum Council. The Council has 13 voting members and 2 nonvoting members. Of the voting members, 11 are appointed by the President and serve 10-year terms (appointments are staggered) and the other 2 are appointed from among members of Congress to serve during their term. The non-voting members are selected by the Council.

The Museum receives an annual appropriation as well as private donations. Annual appropriations account for approximately 90 percent of operations and activities, with the remaining 10 percent coming from donor activities and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. All donations are considered to be available for use unless specifically restricted by the donor or by time. Furthermore, the Museum is not considered to be a non-federal organization receiving federal financial assistance.

Tentative Conclusions

Based on the assumptions and other considerations, management determined and the auditor concurred that the Museum should be included in the government-wide GPFFR because the Museum meets the first inclusion principle (in the budget). Further, the President and the Congress appoint the Museum Council which indicates the federal government controls the Museum which meets the third inclusion principle (control with risk of loss or expectation of benefit).

Classification as a Consolidation Entity or Disclosure Entity

Because it is listed in the budget, the Museum generally would qualify as a consolidation entity assuming no information to the contrary. In this example, management determined and the auditor concurred that there were no facts rebutting or contradicting the assumption that the Museum is a consolidation entity. As a consolidation entity, its financial statements should be consolidated in the government-wide GPFFR. The financial statements included should be for the entire organization and thus include the sources and uses for both the appropriations and the donated funds.

Administrative Assignment

Based on a review by management, no other component reporting entity has been assigned administrative responsibilities for the Museum. Therefore, the Museum is consolidated only directly into the government-wide GPFFR.

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U.S. Museum (Scenario B)

(Control based on Persuasive Indicator—Disclosure Entity (Financially Independent))

Assumed Facts and Circumstances

The U.S. Museum (the Museum) was originally organized by volunteers to bring history and lessons about the United States to individuals through educational outreach, teacher training, traveling exhibitions, and scholarship. The Museum is intended to be a self supporting operation. Shortly after its founding, it entered into a cooperative relationship with the Department of Federal Museums, a department within the executive branch.

The Museum is incorporated as a not-for-profit organization governed by the Museum Council. The Council has 15 voting members referred to as trustees. The presidentially-appointed head of the Department of Federal Museums serves as the Council chairperson. Of the remaining voting trustees, nine are appointed by the President and five are selected and approved by the Council. Except for the chairperson, all trustees serve ten-year terms which are staggered. The Council selects a Board of Directors for the Museum and appoints the Chief Executive Officer.

The Museum is a public-private partnership which receives an annual appropriation as well as private donations, rental income, and sales revenue. No fees are charged for educational events or museum tours. Rental income from the Museum facilities is derived from rates competitive with other venues for similar events. Rental of the facilities is intended to support museum activities such that the museum can eventually be self supporting. Presently, annual appropriations account for approximately 15 percent of operations and activities, with the remaining 85 percent coming from donor activities, rental income, and museum sales. The museum is listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information. The funding received from donations is restricted to use by the Museum and the trustees approve the annual budget including rental income and fundraising goals.

The Museum's employees are not federal employees. The Museum is required to fully fund any deferred compensation programs and to advise its employees that the federal government has not guaranteed their deferred compensation.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred the Museum should be included in the government-wide GPFFR because it meets the third inclusion principle (control with risk of loss or expectation of benefit). Although the Museum also meets the first inclusion principle (in the budget), it is a non-federal organization receiving federal financial assistance. An assessment of the remaining inclusion principles shows that the Museum meets the third inclusion principle (control with risk of loss or expectation of benefit) because it is controlled by the federal government since a majority of the trustees are appointed by the President; a persuasive indicator of control.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, the Museum should be reported as a disclosure entity. In arriving at this conclusion,

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management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that the Museum is a disclosure entity.

Evidence suggesting that U. S. Museum is a consolidation entity includes:

1. Appointments to the Council are made by elected officials.

2. Museum services, educational events and tours, are provided on a non-market basis to the general public.

Evidence suggesting that U.S. Museum is a disclosure entity includes:

1. The Museum is a separate legal organization – a not-for-profit – and terms for a majority of Council members are ten-years. This insulates the organization from political influence. Further, day-to-day operations are governed by a board of directors whose members are not directly appointed by elected officials.

2. The Museum is intended to receive limited financing from taxes and market rates are charged for facility rentals.

3. The Museum is required to make explicit that any liability for deferred compensation of its employees is not guaranteed by the federal government. This indicates that limited risks are imposed on the federal government.

Disclosure entities should be presented by the component reporting entity to which they are administratively assigned and, if material, by the government-wide entity.

Administrative Assignment

Management determined and the auditor concurred the Department of Federal Museums should present the Museum as a disclosure entity in its GPFFR because the department is assigned administrative responsibility for the Museum based on appointment of its head to serve as chairperson of the Council.

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Firefighters' Housing Limited Partnership

(Owned and Controlled—Consolidation Entity)

Assumed Facts and Circumstances

Agency 123 has been authorized to establish pre-positioned housing and equipment storage facilities on federal land to ensure immediate and efficient deployment of firefighting resources in response to wildfires in remote areas. The enabling legislation allows Agency 123 to enter into a wide range of financial agreements with private-sector participants to provide housing and equipment storage for the firefighters.

The agency and a private developer formed a limited partnership—Firefighters' Housing Limited Partnership (FHLP)—to develop, operate, maintain, and own all housing and storage units and facilities within a designated area for 25 years. Agency 123 leased land to FHLP under a 25-year ground lease. At the end of the 25-year ground lease, the agency has the option to renew the partnership for another 25 years. If it does not renew, all structures and land revert back to Agency 123 in accordance with the agency's residual ownership interest. During the 25-year ground lease, Agency 123 will provide an annual payment to FHLP from its appropriated funds for management services, use of the housing by Agency 123 employees during the fire season, and equipment storage year-round.

The private sector partner is guaranteed a minimum payment from FHLP and has no ownership interest in FHLP properties. The private sector partner also is entitled to a share of profits from non-fire season vacation rentals of the housing so long as the facilities meet established condition requirements. Profits not distributed to the private sector partner are retained by FHLP and can be used for capital improvements including development of new housing in adjacent parks under similar terms.

As part of the partnership agreement, Agency 123 has significant authority to determine the policies governing FHLP's activities and to affect day-to-day decisions such as design and construction. Any debt incurred by FHLP must be authorized by the agency. Furthermore, capital and operating budgets require agency approval and financial transactions are monitored on a monthly basis by the agency's contract administration office. The partnership is required to produce audited financial statements annually.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that FHLP should be included in the government-wide GPFFR. A substantial ownership interest is present via the agency's continuing ownership interest. In addition, several control indicators are met as summarized in the following analysis of available information:

1. Agency 123 may be able to direct the partnership regarding the establishment and subsequent revision of financial and operating policies through its review and approval of operating budgets, designs, and condition of the facilities. If so, this would be a persuasive indicator of control. Management should weigh the impact of its role in directing the FHLP's financial and operating policies and consider how much discretion falls to the private sector partner.

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2. Other indicators in the aggregate may indicate control. Agency 123 has significant authority to:

    a. direct the ongoing use of assets,

    b. approve the budgets and business plans for FHLP,

    c. require audits, and

    d. limit borrowing and investment by FHLP.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, FHLP should be reported as a consolidation entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that FHLP is a consolidation entity.

Evidence suggesting that FHLP is a consolidation entity includes the following:

1. FHLP provides housing to firefighters as its primary function on a non-market basis.

2. It is financed by tax revenues supplemented by any retained profits from non-fire season rentals.

3. Decisions are made by organizational leaders at Agency 123 who are appointed by the President and confirmed by the Senate.

4. Funds transferred to FHLP will be approved through the usual budgetary process so that FHLP funding will be included in the budget approved by the Congress and the President.

Evidence suggesting that FHLP is a disclosure entity includes the following:

1. FHLP has a legal identity separate from Agency 123.

2. FHLP is authorized to provide vacation housing services to customers on a market basis and use the proceeds to first compensate the private sector partner and then reduce the cost of firefighter housing borne by the taxpayer.

As a consolidation entity, FHLP's financial statements should be consolidated by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred that Agency 123 should consolidate FHLP's financial statements because it is assigned administrative responsibility for FHLP based on its inclusion of FHLP funding in its budget request and its coordination and monitoring of FHLP's plans and performance.

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The Blue Mountain Observatory

(Control based on Indicators in the Aggregate—Disclosure Entity (FFRDC))

Assumed Facts and Circumstances

Agency XYZ created an FFRDC, the Blue Mountain Observatory (BMO), to provide facilities and leadership needed to conduct scientific research in a wide range of fields, including the study of black holes. Agency XYZ is BMO's primary sponsor. University Cooperative (UC) is a not-for-profit membership corporation created by 50 universities conducting research that would benefit from use of BMO facilities. UC was created to seek the role of managing, operating, and maintaining BMO under a cooperative agreement with Agency XYZ. UC subsequently entered into a cooperative agreement with Agency XYZ.

UC is governed by a board of trustees appointed to represent each of the 50 member universities. UC trustees appoint an individual to serve as president of BMO. The trustees also oversee BMO operations including providing input on strategic plans, approving the annual program plan before its submission to Agency XYZ for approval, responding to Agency XYZ input, and monitoring financial activities including establishing investment policies. UC employs staff to perform all BMO activities and these individuals are referred to as 'BMO employees.' Member universities fund any non-BMO activities of UC.

The cooperative agreement between UC and Agency XYZ ensures close coordination between Agency XYZ and BMO employees. The agreement contains requirements necessary for Agency XYZ's oversight of both BMO's programs and UC's management activities, including the following provisions:

1. Provide input to a strategic plan developed by BMO employees in collaboration with UC trustees. The strategic plan sets the overall direction and priorities for BMO.
2. Agency XYZ must approve the annual program plan and budget for use of resources.
3. UC must provide to Agency XYZ an annual scientific report and audited financial statements.
4. Agency XYZ participates in developing a five-year strategic plan.
5. BMO and Agency XYZ must meet annually to review progress and ensure that scientific and facility priorities remain consistent with those of Agency XYZ.

UC works cooperatively with Agency XYZ to ensure the effective implementation of the strategic mission of BMO to the benefit of the research community. Mid-way through the current cooperative agreement, Agency XYZ will conduct comprehensive reviews of science, facilities, and management to inform future decisions regarding recompetition of the cooperative agreement for the facility. UC is under no obligation to continue in its role in managing, operating, and maintaining BMO.

In the most recent fiscal year, BMO received $100 million in funding from Agency XYZ through its cooperative agreement with UC. Agency XYZ proposed the $100 million in funding in its Congressional Budget Justification and described how the funds would be used to support the

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research programs at BMO. In administering the funds provided by Agency XYZ for BMO programs, UC may:

1. expend funds to meet ongoing operational needs,
2. make annual cash contributions to employee benefits programs (accrued leave and pension plans),
3. make annual payments due under long-term leases, and
4. construct or purchase new assets so long as all resulting property is titled to BMO.

In the event the cooperative agreement with UC is terminated, Agency XYZ would assume management responsibility for the facility. Further, Agency XYZ would seek appropriations for termination expenses such as post-retirement benefit liabilities for BMO employees. However, Agency XYZ would be obligated to pay termination benefits only if funds were appropriated for that purpose.

Tentative Conclusions

Based on the assumed facts and circumstances and other considerations, management determined and the auditor concurred that BMO should be included in the government-wide GPFFR. BMO is not listed in the *Budget of the United States Government: Analytical Perspectives—Supplemental Materials* schedule that provides budget account level information so other inclusion principles must be considered. BMO facilities are owned by the federal government and new assets are titled to the federal government. With respect to the control inclusion principle, Agency XYZ establishes the fundamental purpose and mission of BMO through its participation in strategic planning and the overall effort to ensure BMO goals are consistent with Agency XYZ research goals. This effort includes annual actions to approve BMO's annual program plan and operating budget. These actions are persuasive indicators of control.

Classification as a Consolidation Entity or Disclosure Entity

For this illustration, management determined and the auditor concurred that, based on the assumed facts and circumstances as well as other considerations not described in the illustrations, BMO should be reported as a disclosure entity. In arriving at this conclusion, management and the auditor considered the assumed facts and circumstances presented below in the aggregate and, finding no other facts that in the aggregate contradict these, used professional judgment to determine that BMO is a disclosure entity.

Evidence suggesting that BMO is a consolidation entity includes the following:

1. BMO provides, as its primary function, research facilities and leadership to university members of UC on a non-market basis. It is financed by taxpayer funds supplemented by non-government donors.
2. Key operational decisions are made by organizational leaders at Agency XYZ who are appointed by the President and confirmed by the Senate.

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3. Funds transferred to BMO will be approved through the usual budgetary process so that use of tax revenues to support BMO is ultimately decided by the Congress and the President.

Evidence suggesting that BMO is a disclosure entity includes the following:

1. BMO has a legal identity separate from Agency XYZ.
2. The governance structure ensures that universities have substantial input regarding BMO's strategic plans and annual program plan. The significant involvement of non-governmental organizations lessens political influence.
3. BMO's liabilities are not obligations of the U.S. government.
4. BMO is authorized to accept donations from non-government organizations.

As a disclosure entity, BMO should be presented by the component reporting entity to which it is administratively assigned.

Administrative Assignment

Management determined and the auditor concurred that Agency XYZ should disclose information about BMO because it is assigned administrative responsibility for BMO based on its inclusion of BMO funding in its budget request and its coordination and monitoring of BMO's plans and performance.

Table 1: Summary Application of Standard

NAME	IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?					CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
	IN THE BUDGET	OWNED	CONTROL	MISLEADING TO EXCLUDE	IS THE ORGANIZATION INCLUDED?	A CONSOLIDATION ENTITY (CONSOLIDATED)	A DISCLOSURE ENTITY (DISCLOSED)
ABC Department	Yes				Yes	Organizations listed in the budget generally would qualify as consolidation entities.	
Epsilon Corporation	Yes				Yes	Organizations listed in the budget generally would qualify as consolidation entities.	
Sigma Association	No	No	Yes. A majority of the governing board members is appointed by the President and confirmed by the Senate and they established its fundamental purpose and mission through legislation.		Yes		Financially independent organization
Scholars University	Yes but as a non-federal organization receiving federal financial assistance.	No	No. Scholars' board of trustees elects its respective board members. Scholars' board of trustees primarily directs the university's affairs and the university seeks sources of revenue to operate virtually in a self-sustaining manner.	Management and auditor agreement based on facts and circumstances it was not misleading to exclude.	No		
Education Research Institute	No	No	Yes, the federal government can unilaterally dissolve ERI and have access to its assets and responsibility for its liabilities.	.	Yes	The ERI Trust Fund is primarily funded through taxes, elected officials establish ERI's budget, services are provided on a non-market basis, and federal government assume risk.	

NAME	IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?					CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
	IN THE BUDGET	OWNED	CONTROL	MISLEADING TO EXCLUDE	IS THE ORGANIZATION INCLUDED?	A CONSOLIDATION ENTITY (CONSOLIDATED)	A DISCLOSURE ENTITY (DISCLOSED)
Mediation Corporation	Yes but as a non-federal organization receiving federal financial assistance. Therefore, must assess against other principles.	No	Yes. Considering the control indicators in the aggregate, the federal government controls Mediation. It provides significant input on the selection of governing board members, appoints a key executive, limits Mediation's capacity to generate revenue, approves the annual budget, requires audited financial statements, and directs Mediation to work with other governments.		Yes		Mediation's governing body is insulated from political influence and risks are not assumed by the federal government.
Bicycle America, Inc. (Scenario A)	No	No. BA is owned by shareholders.	No, governing board members are elected by shareholders rather than subject to political appointment	No, Management and auditor agreement based on facts and circumstances it was not misleading to exclude.	No. Advisory committee offers advice but does not have the authority to direct BA to act.		
Bicycle America, Inc. (Scenario B)	No	Yes, the federal government acquired 51% of the voting rights in BA.			Yes		Intervention activity—separate legal entity with limited financing from general taxes
Chatham Laboratory (FFRDC)	No	The assets and research results are owned.	Yes. The federal government establishes the purpose and mission of Chatham.		Yes	Yes, Chatham is primarily funded by taxes, and governance rests with the President and Congress.	

NAME	IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?					CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
	IN THE BUDGET	OWNED	CONTROL	MISLEADING TO EXCLUDE	IS THE ORGANIZATION INCLUDED?	A CONSOLIDATION ENTITY (CONSOLIDATED)	A DISCLOSURE ENTITY (DISCLOSED)
Gotham Laboratory	No	No	No	No, Management and auditor agreement based on facts and circumstances it was not material to exclude.	No. Although it may be economically dependent, Gotham has discretion as to whether to accept funding from the government.		
Andromeda Prime Power Systems (GSE)	No	No	No, APPS' governing body is elected by common shareholders. The APPS Advisory Board advises Congress and does not direct APPS' operations.		No, Management determined and the auditor concurred APPS should be disclosed as a related party.		
U.S. Museum (Scenario A)	Yes				Yes	Yes. The Museum is in the budget and primarily funded by taxes and governance rests with the President and Congress.	
U.S. Museum (Scenario B)	Yes but as a non-federal organization receiving federal financial assistance	No	Yes. The President appoints a majority of the governing body's members.		Yes		The museum is a financially independent organization.

NAME	IS THE ORGANIZATION INCLUDED IN THE GOVERNMENT-WIDE GPFFR?					CONSOLIDATION ENTITY OR DISCLOSURE ENTITY	
	IN THE BUDGET	OWNED	CONTROL	MISLEADING TO EXCLUDE	IS THE ORGANIZATION INCLUDED?	A CONSOLIDATION ENTITY (CONSOLIDATED)	A DISCLOSURE ENTITY (DISCLOSED)
Firefighters' Housing Limited Partnership	No	Ownership of property is retained.	Yes. Agency 123 has significant authority to direct the limited partnership's activities and to affect day-to-day activities such as in design and construction and the partnership's purpose is to carry out federal missions and objectives.		Yes	Yes. Taxes fund the housing and risks have been assumed	
Blue Mountain Observatory (FFRDC)	No	Property is owned by the federal government.	Yes. The federal government establishes the purpose and mission of BMO.		Yes		BMO is a separate legal entity and UC plays a significant role in its governance without political influence.

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APPENDIX D: ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
C.F.R.	Code of Federal Regulations
CFR	Consolidated Financial Report of the U.S. Government
CRE	Component Reporting Entity
CRS	Congressional Research Service
ED	Exposure Draft
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FFRDC	Federally Funded Research and Development Center
FRS	Federal Reserve System
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPFFR	General Purpose Federal Financial Report
OAI	Other Accompanying Information
OIG	Office of Inspector General
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States
U.S.C.	United States Code

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APPENDIX E: TASK FORCE MEMBERS

Owen Barwell, Department of Energy

Lieutenant Colonel Richard Brady, United States Marine Corp, Department of Defense

Terry Bowie, (formerly of) National Aeronautics and Space Administration

James L. Chan, University of Illinois at Chicago

Naresh Chopra, Department of Labor

Wendy Calvin, Department of Transportation

Tom Daxon, Former Oklahoma State Auditor

Ann Davis, U.S. Department of Treasury

Lynda Downing, Government Accountability Office

Abe Dymond, (formerly of) Government Accountability Office

Joel Grover, (formerly of) U.S. Department of Treasury, Office of the Inspector General

Mark Hadley, Congressional Budget Office

Regina Kearney, Office of Management and Budget

Karen Kelbly, National Credit Union Administration

Dan Kovlak, (formerly of) KPMG

Andrew Lewis, KPMG

Rick Loyd, Department of Energy

Ned Maguire, (formerly of) Office of the Dir. of National Intelligence, OIG

Sam Papenfuss, Congressional Budget Office

Reginald Royster, Department of Housing and Urban Development

Fred Selby, (formerly of) U.S. Department of Treasury, Office of Financial Stability

Gary Solamon, (formerly of) Department of Commerce, Bureau of Economic Analysis

Sandy Van Booven, National Reconnaissance Office

Denise Williams, U.S. Department of Treasury, Fiscal Service

Adrienne E. Young, (formerly of) National Science Foundation

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APPENDIX F: GLOSSARY

Component Reporting Entity—"Component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity.[66] Examples of component reporting entities include organizations such as executive departments, independent agencies, government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Conservatorship—A conservatorship is the legal process in which a person or entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition. In a conservatorship, the powers of the company's directors, officers, and shareholders are transferred to the designated conservator.[67]

Control with risk of loss or expectation of benefit—Control with risk of loss or expectation of benefit is the power to impose will on and/or govern the financial and/or operating policies of another organization with the potential to be obligated to provide financial support or assume financial obligations or obtain financial resources or non-financial benefits.[68]

Disclosures—Information in notes or narrative regarded as an integral part of the basic financial statement.

Federally Funded Research and Development Center—Federally Funded Research and Development Center (FFRDC) is a government-funded entity that has a long-term contractual relationship with one or more federal agencies.[69] FFRDCs can be privately owned or government-owned, and they serve to meet the long-term research and development needs of federal agencies that could not otherwise be met as effectively in-house or through existing contractors. 49 Fed. Reg. at 14,464; 48 C.F.R. § 35.017(a). FFRDCs are established either specifically in statute or under the statutory authority of agencies to enter into contracts, which can be inherent or specific authority, and are used to perform research and development and related tasks.

General Purpose Federal Financial Reports—General purpose federal financial reports (GPFFRs) is used throughout this Statement as a generic term to refer to the report that contains the reporting entity's financial statements that are prepared pursuant to generally accepted accounting principles. In the federal government, the report for the U.S. government-wide reporting entity is known as the consolidated financial report of the U.S. Government

[66] The larger reporting entity could be the government-wide reporting entity or another component reporting entity.
[67] Federal Housing Finance Agency Fact Sheet, Questions and Answers on Conservatorship
[68] For example, a non-financial benefit would be one where the federal government benefits from a service being provided to it or on its behalf.
[69] The Office of Federal Procurement Policy (OFPP) and Federal Acquisition Regulation (FAR) policies for FFRDCs apply to executive agencies, which includes "an executive department, a military department, or any independent establishment within the meaning of 5 U.S.C. 101, 102, and 104(1), respectively, and any wholly owned Government corporation within the meaning of 31 U.S.C. § 9101." 48 C.F.R. § 2.101; see also 5 U.S.C. § 403.

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(CFR) and for component reporting entities it is usually included in the performance and accountability report, the agency financial report, or the annual management report.

Government Sponsored Enterprise—Government Sponsored Enterprise (GSE) is created by Congress with its particular attributes defined in its enabling legislation and charter. Despite this diversity, there are at least four readily observable characteristics of GSEs: (1) private sector ownership, (2) limited competition, (3) activities limited by congressional charter, and (4) chartered privileges that create an inferred federal guarantee of obligations.[70]

Receivership—Receivership is the legal procedure for winding down the affairs of an insolvent institution.[71]

Related Parties—Organizations are considered to be related parties in the GPFFR if the existing relationship or one party to the existing relationship has the ability to exercise significant influence over the other party's policy decisions. Relationship, as used in this context, refers to material transactions or events involving both parties.

Reporting Entity—Reporting entities are organizations that issue a GPFFR because either there is a statutory or administrative requirement to prepare a GPFFR or they choose to prepare one. The term "reporting entity" may refer to either the government-wide reporting entity or a component reporting entity.

Statement of Federal Financial Accounting Concepts (SFFAC) 2 provides criteria for an entity to be a reporting entity.[72] The criteria focus on whether:

a. An entity's management is responsible for controlling and deploying resources, producing outputs and outcomes, and executing the budget or a portion thereof (assuming that the entity is included in the budget), and is held accountable for the entity's performance.

b. An entity's financial statements would provide a meaningful representation of operations and financial condition.

c. An entity's financial information could be used by interested parties to help them make resource allocation and other decisions and hold the entity accountable.

[70] Congressional Research Service Report for Congress *Government-Sponsored Enterprises (GSEs): An Institutional Overview*

[71] *Managing the Crisis: The FDIC and RTC Experience*, Appendix B - List of Abbreviations and Glossary of Terms; available online at http://www.fdic.gov/bank/historical/managing/; last accessed October 11, 2012.

[72] SFFAC 2, paragraphs 29-37, provides a discussion on Identifying the Reporting Entity for General Purpose Financial Reporting.

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FASAB Board Members

Tom L. Allen, Chair

Robert F. Dacey

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Sam M. McCall

Mark Reger

D. Scott Showalter

Graylin E. Smith

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Melissa L. Loughan

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814

Mail Stop 6H19

Washington, DC 20548

Telephone 202-512-7350

FAX 202-512-7366

www.fasab.gov

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Federal Accounting Standards Advisory Board

OPENING BALANCES FOR INVENTORY, OPERATING MATERIALS AND SUPPLIES, AND STOCKPILE MATERIALS

Statement of Federal Financial Accounting Standards 48

January 27, 2016

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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SUMMARY

This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. This method is permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

This Statement is intended to provide an alternative valuation method to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3, *Accounting for Inventory and Related Property*.

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TABLE OF CONTENTS

Summary 1
Introduction 3
Standards 4
- **Scope** 4
- **Definitions** 4
- **Disclosure Requirements** 5
- **Effect on Existing Standards- Amendments to SFFAS 3, *Accounting for Inventory and Related Property*** 5
- **Effective Date** 8

Appendix A: Basis for Conclusions 9
Appendix B: Abbreviations 16
Appendix C: Amendments to SFFAS 3 17
Appendix D: Glossary 27

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INTRODUCTION

PURPOSE

1. This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials. These assets are addressed in Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*. While SFFAS 3 addresses six types of tangible property, only inventory, OM&S, and stockpile materials are required to be valued using the "initial amount" measurement approach.[1]

2. The alternative valuation method permitted by this Statement may be applied when a reporting entity is presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

MATERIALITY

3. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[1] The *measurement approach* is how an asset or liability is measured in periods after initial recording—i.e., at the historical cost or initial transaction amount (with subsequent adjustments for amortization, depreciation, or depletion, if applicable) or at an amount, such as fair value, measured at each financial statement date. A different measurement approach may be appropriate for different assets and liabilities. Amounts initially recorded are referred to as the "initial amount" and amounts measured at each subsequent financial statement date are "remeasured amounts." [Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 7a]

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STANDARDS

SCOPE

4. This Statement applies when a reporting entity is presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The application of this Statement based on the second condition is available once per reporting entity.

5. This Statement may only be applied in establishing **opening balances**[2] for the reporting period that the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

6. Reporting entities that meet either condition in paragraph 4 and elect to apply the alternative valuation method in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.

DEFINITIONS

7. **Deemed Cost**—Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

8. **Opening Balances**—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

9. **Unreserved Assertion**—An unconditional statement.

ALTERNATIVE VALUATION METHOD FOR OPENING BALANCES

10. **Deemed cost** is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials for the reporting period when the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

[2] Terms defined in the Glossary are shown in bold-face the first time they appear.
[3] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

11. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[4]

    a. Standard price (selling price)[5] or fair value[6]
    b. Latest Acquisition Cost[7]
    c. Replacement cost[8]
    d. Estimated historical cost (initial amount)
    e. Actual historical cost (initial amount)

12. Once established using deemed cost, opening balances are to be considered consistent with GAAP. No distinction or breakout of the deemed cost amount in the opening balances is required.

DISCLOSURE REQUIREMENTS

13. A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

EFFECT ON EXISTING STANDARDS- AMENDMENTS TO SFFAS 3, *ACCOUNTING FOR INVENTORY AND RELATED PROPERTY*

14. This section amends SFFAS 3, *Accounting for Inventory and Related Property,* as described in the following paragraphs.

[4] The methods are not listed in order of preference.
[5] The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.
[6] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)
[7] The Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*
[8] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

15. Paragraph 20 is replaced with the following paragraph: "**Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost."

16. Paragraph 22, the last sentence is amended by removing "(e.g., a standard cost system)."

17. Paragraphs 23-25 are rescinded to remove the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance).

18. Paragraph 26 is replaced by the following paragraph which expands the exception to valuation in SFFAS 3 to incorporate the Alternative Valuation Method for Opening Balances provided in this Statement.

"26. Valuation Method for Opening Balances and Exceptions to Valuation.

a. **Alternative Valuation Method for Opening Balances.**[9] Deemed cost[10] is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials when a reporting entity is presenting financial statements, or one or more line items addressed by Statement of Federal Financial Accounting Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, following generally accepted accounting principles (GAAP) promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in applying an alternative valuation method:

i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[11] that its financial statements, or one or more line items addressed by SFFAS 48, are presented fairly in accordance with GAAP.

ii. The application of this method based on the second condition specified above is available once per reporting entity.

iii. Reporting entities that meet either condition in paragraph 26a. and elect to apply the alternative valuation method in establishing opening balances permitted by SFFAS 48 are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21:

[9] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[10] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

[11] An unreserved assertion is an unconditional statement.

Reporting Corrections of Errors and Changes in Accounting Principles.

iv. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[12]
   (1) Standard price (selling price)[13] or fair value[14]
   (2) Latest Acquisition Cost[15]
   (3) Replacement cost[16]
   (4) Estimated historical cost (initial amount)
   (5) Actual historical cost (initial amount)

v. Disclosure requirements–A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. **Exceptions to Valuation.** An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:
   i. Units of which are interchangeable,
   ii. Units of which have immediate marketability,
   iii. Units for which appropriate costs may be difficult to obtain."

19. Paragraph 42 is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Operating Material and Supplies."

[12] The methods are not listed in order of preference.
[13] The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.
[14] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)
[15] The Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*
[16] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

20. Paragraph 44 is amended by deleting the last sentence: “In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).”

21. Paragraph 53, the first sentence is amended by adding the following after historical cost “or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Stockpile Materials.” Paragraph 53 is also amended by deleting the last sentence: In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).”

EFFECTIVE DATE

22. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas 48.pdf.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for the Board's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, provide the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request for guidance on the use of reasonable baseline estimates on the valuation of inventory, operating materials and supplies (OM&S), and stockpile materials from non-GAAP legacy systems. Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, requires valuation at historical cost (initial amounts).

A3. In the initial phase of the project, Board staff met with senior officials from DoD to develop a comprehensive list of inventory valuation methodologies in place and the status of implementation of an SFFAS 3 compliant system for each DoD component.

A4. Based on the meetings and information provided it was determined that:

a. Most DoD component legacy systems have valued inventory, OM&S, and stockpile materials at latest acquisition cost or standard cost (selling price) rather than historical cost. These legacy systems do not maintain a record of the cost of previous purchases. Therefore, DoD does not have the data necessary for revaluing inventory, OM&S, and stockpile materials at transition from a non-GAAP to a GAAP valuation (that is, historical cost).
b. DoD components transitioned from non-GAAP legacy systems to SFFAS 3 compliant systems at different times. While DoD has implemented systems that are SFFAS 3 compliant, it is difficult to determine at what point DoD inventory valuation using a historical cost methodology (for example, moving average cost) will be cleansed (eliminated through turnover) of non-GAAP values derived from legacy systems.
c. DoD components advised that they do not have the information to provide historical turnover rates for the purpose of identifying items that have turnover rates such that the non-GAAP valuation method used prior to the adoption of SFFAS 3 would approximate historical cost.
d. DoD does not have the information for revaluation and it is not practical or cost effective to develop models for revaluation.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A5. The Exposure Draft (ED), *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, was issued on June 2, 2015 with comments requested by July 20, 2015.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, FASAB News, the Journal of Accountancy, Association of Government Accountants Today, the CPA Journal, Government Executive, and the CPA Letter, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board.)

A7. This broad announcement was followed by direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations- Sub-Committee on Defense
b. House Committee on Armed Services
c. House Committee on Oversight and Government Reform
d. House Committee on the Budget
e. House Committee on Veterans' Affairs
f. Senate Appropriations- Sub-Committee on Defense
g. Senate Committee on Armed Services
h. Senate Committee on Finance
i. Senate Committee on Homeland Security and Governmental Affairs
j. Senate Committee on the Budget
k. Senate Committee on Veterans' Affairs

A8. The DoD also received the ED.

A9. Twelve responses were received from preparers, auditors, and professional associations. All respondents (with the exception of one respondent that did not specify agreement or disagreement) agreed with the proposal. The respondents identified certain issues that could be clarified within the Statement or addressed in the Basis for conclusions.

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. Two respondents requested that aspects of the scope be clarified. After considering the comments, the Board considered options and decided to state consistently the conditions that entities must meet in order to apply the provisions of this Statement rather than attempting to describe the many conditions for which the Statement does not apply. Additionally, the Board believed it should address the applicability of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles* to those reporting entities that meet the conditions and elect to apply the provisions of this Statement. Specifically, paragraph 12 states "…For the purposes of this standard, changes in accounting principles also include those occasioned

by the adoption of new federal financial accounting standards." Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13(a) – (c) for all changes in accounting principles:

> "(a) The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
>
> (b) Prior period financial statements presented for comparative purposes should be presented as previously reported; and
>
> (c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure."

A12. SFFAS 21 provides that the adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and explain that opening balances of a particular line item or group of line items were valued at deemed cost under this Statement, briefly describe deemed cost, and indicate the effect of adoption on beginning net position.

A13. In addition, changes to the basis for conclusions were made so it did not appear that references to DoD in the basis for conclusions were intended to limit the applicability of deemed cost. While the Statement resulted from a request from DoD, it may be applied to any reporting entity that falls within the scope of the Statement.

A14. During due process, two respondents noted potential confusion due to the similarities between the valuation methods identified for use in arriving at deemed cost for opening balances and with methods identified for use in SFFAS 3. Respondents questioned how the alternative valuation method differs from other valuation methods which approximate historical cost such as latest acquisition cost. They asked whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods.

A15. The Board believes all reasonable methods should be allowed for opening balances. Therefore, the list of potential deemed cost methods remains expansive. This list includes historical cost because deemed cost may be a consolidation of amounts based on historical cost methods and other methods that do not approximate historical cost. Further, some respondents were confused by the references to latest acquisition cost. The Board's intends that latest acquisition cost, without adjustment for unrealized holding gains and losses needed to approximate historical cost, be permitted under the deemed cost method; thus, this method was not a method that approximates historical cost as provided by SFFAS 3.

A16. The Board believes that amending SFFAS 3 to incorporate the alternative valuation approach for opening balances would clarify the intended application and address the concerns raised by respondents. Specifically, removing the term latest acquisition cost

(LAC) from SFFAS 3 when used to mean that LAC is equivalent to historical cost (inclusive of the valuation allowance) will avoid potential misunderstandings. The Board believes removing this discussion of LAC will prevent confusion regarding the use of LAC adjusted to approximate historical cost through an allowance for unrealized holding gains or losses as a deemed cost method (not adjusted to approximate historical cost) as provided in this Statement . To assist users, the Board is providing Appendix C: Amendments to SFFAS 3, a marked version of the relevant sections (Inventory, Operating Materials and Supplies, and Stockpile Materials) of SFFAS 3.

A17. In addition, it was suggested the term "may" as used in paragraph 11 regarding the use of valuation methods presents an auditability challenge and respondents recommended it be changed to "should." The Board's intent was to be permissive regarding methods; however, after considering the suggestion that an unacceptable method could be used the language was changed. The Board still believes the standards should provide for all methods, including those that are allowable under SFFAS 3, because this provides flexibility and a cost-effective approach for large and complex organizations to include several valuation methods because the reporting entity may have components using different methods and/or adopting methods permitted under SFFAS 3 at different times.

A18. In addition, four respondents requested clarification on the disclosure requirements. Based on the comments, language was added to the disclosure paragraph to clarify that financial statements of subsequent periods need not repeat this disclosure unless the statements to which deemed cost was applied in establishing opening balances are presented for comparative purposes. One respondent requested clarification on what is meant by first reporting period in relation to interim reporting. The first reporting period would be the first financial statement year end that an unreserved assertion is made. The Board does not believe this would include interim financial statements that presently are unaudited and do not include note disclosures. One respondent requested that the Board consider adding a requirement for the amount of the deemed cost to be disclosed. The Board considered carefully the disclosures that would provide the most meaningful information when developing the Statement. Considering the intent and purpose of this Statement, the Board does not believe such a disclosure would add sufficient value to warrant the significant effort and costs.

A19. During due process, three respondents requested the term "unreserved assertion" be defined. The Board revised the Statement to include a definition of the term. Additionally, a respondent suggested that certain entities' management (such as DoD) may be required to make assertions regarding its financial information. An example is management assertions that DoD financial statements are validated as ready for audit by not later than September 30, 2017. This Statement refers to an unreserved assertion that the reporting entity's "financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP." Other assertions – such as being ready for an audit - may or may not accompany such an assertion. Other minor changes were made to the Statement as suggested by respondents that improved the clarity of the document and terms.

ALTERNATIVE VALUATION METHOD

Consideration of Other Accounting Standards

A20. During deliberation on the project, the Board considered the recently issued International Public Sector Accounting Standards (IPSAS) No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board (IPSASB) reached several relevant conclusions with IPSAS No. 33:

a. Use of deemed cost facilitates the introduction of IPSASs in a cost effective way.
b. Multiple options for deemed cost are appropriate.
c. The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.
d. Use of deemed cost does not affect fair presentation.

A21. The Board believes that it should take an approach similar to the IPSASB standard. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for inventory, OM&S, and stockpile materials. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances.

Alternative Valuation Method for Opening Balances

A22. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for inventory, OM&S, and stockpile materials addressed in SFFAS 3 for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

A23. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances. Therefore, most often deemed cost will be based on the reporting entity's valuation method or system used for managing inventory, OM&S, and stockpile materials prior to the adoption of SFFAS 3.

A24. Large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 3 at different times prior to establishing opening balances. Deemed cost may be one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 3.

A25. Opening balances in this Statement are the balances at the beginning of the first reporting period when the entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are fairly presented in accordance with GAAP. Once established using deemed cost, opening balances are to be considered consistent with historical cost requirements of SFFAS 3.

A26. Opening balances, established by application of this Statement, should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had a GAAP valuation method been used. Further, no distinction or segregation of amounts arising from the opening balances is required. For example, cost of goods sold using deemed cost need not be distinguished from cost of goods sold at historical cost under a first-in first-out approach. The purpose of this Statement is to provide an alternative valuation method for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of individual types of inventory, OM&S, and stockpile materials, acceptance of non-GAAP values at the transition point to SFFAS 3 compliant systems is the most cost-effective approach.

A27. However, all activity after the opening balances for inventory, OM&S, and stockpile materials are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.

Implementation by Component Reporting Entities

A28. As stated above, complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Further, reporting entity components may have transitioned to an SFFAS 3 valuation method at different times; however, some components established balances for existing inventory, OM&S, and stockpile materials at the time of transition using methods that were not in accord with SFFAS 3. Therefore, given the timing of the transition to an SFFAS 3 valuation methodology, opening balances for the reporting entity may be based on transitional values based on one of the other methods listed in paragraph 11 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.

A29. A component reporting entity that is in the process of implementing systems that are SFFAS 3 compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A30. Using the DoD example, certain DoD components may have transitioned at an earlier date to SFFAS 3 compliant systems; this allows them to assert independently of the larger DoD. DoD would make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

A31. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election

since it may only be made once. A complex entity should work with its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities should ensure issues such as supporting documentation for opening balances established are addressed and validated through sampling or other means, including consideration of any audit findings or conclusion affecting the reliability of the valuation, prior to making the unreserved assertion. The importance of a reporting entity being prepared to make the unreserved assertion is critical because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the FY 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for FY 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to:

a. continue in subsequent years to correct or support the valuation as of the beginning of FY 2018, or

b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 3 (as amended), in all material respects.

DISCLOSURE REQUIREMENTS

A32. The election to apply the provisions of this Statement (deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials) should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required.

A33. The Board discussed that, with time, the valuation of inventory, OM&S, and stockpile materials will not be materially different than historical cost because the older inventory may be consumed. If reporting entities are able to document that turnover rates for inventory, OM&S, and stockpile materials are such that the opening balance valuation is at historical cost, a reference to deemed cost would not be required. This Statement, however, does not impose a requirement that reporting entities engage in an effort to conclude that the use of deemed cost is no longer necessary.

BOARD APPROVAL

A34. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at www.fasab.gov/pdffiles/handbook_sffas 48.pdf.

APPENDIX B: ABBREVIATIONS

DoD	Department of Defense
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
LAC	Latest Acquisition Cost
OM&S	Operating materials and supplies
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

This is the original Standard file; please check for the most recent update in the FASAB Handbook
at www.fasab.gov/pdffiles/handbook_sffas 48.pdf.

APPENDIX C: AMENDMENTS TO SFFAS 3

INVENTORY

17. **Definition.** "Inventory" is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. The term "held for sale" shall be interpreted to include items for sale or transfer to (1) entities outside the federal government, or (2) other federal entities. The principal objective of the sale or transfer of inventory is to provide a product or service for a fee that generally recovers full cost or an identified portion of the cost. "Other federal entities" may include entities within the same organization/agency. Sales transactions may be executed through transfer of funds between federal entities; it is not essential that the transaction be an exchange of goods for cash or cash equivalents. In addition, inventory may be acquired through donation or barter. Inventory excludes some other assets held for sale, such as (1) stockpile materials, (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; however, the purpose of acquiring them is not to provide a product or a service for a fee.

18. Inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. These categories are defined in paragraphs 17, 27, 29, and 32 respectively.

19. **Recognition.** Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or the goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

~~20.~~ **Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost. ~~Valuation. Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost.~~

21. ~~(1)~~ Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

22. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those

of one of the above historical cost methods~~(e.g., a standard cost system)~~.

~~23. (2) The latest acquisition cost method provides that the last invoice price[17] (i.e., the specific item's actual cost used in setting the current year stabilized standard [sales] price) be applied to all like units held including those units acquired through donation or nonmonetary exchange. The inventory shall be revalued periodically but at least at the end of each fiscal year. Revaluation results in recognition of unrealized holding gains/losses[18] in the ending inventory value. Upon adjustment for unrealized holding gains/losses, the latest acquisition cost method then results in an approximation of historical cost.~~

~~24. An allowance for unrealized holding gains/losses in inventory shall be established to capture these gains/losses. The ending balance of this allowance shall be the cumulative difference between the historical cost, based on estimated or actual valuation, and the latest acquisition cost of ending inventory. The balance shall be adjusted each time the inventory balance is adjusted. The adjustment necessary to bring the allowance to the appropriate balance shall be a component of cost of goods sold for the period as described below.~~

~~25. The cost of goods sold for the period shall be computed as follows:~~

~~Beginning inventory at beginning-of-the-period latest acquisition cost~~
~~less: beginning allowance for unrealized holding gains/losses~~
~~plus: actual purchases~~
~~Cost of Goods Available for Sale~~
~~less: ending inventory at end-of-the-period latest acquisition cost~~
~~plus: ending allowance for unrealized holding gains/losses~~
~~Cost of Goods Sold~~

26. **Valuation Method for Opening Balances and Exceptions to Valuation.**

~~27. **Exception to Valuation.** Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine approximate costs, (2) immediate marketability at quoted prices, and (3) unit interchangeability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.~~

a. **Alternative Valuation Method for Opening Balances.**[19] Deemed cost[20] is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials when a reporting entity is presenting financial statements, or one or more line items addressed by

~~[17] This unit value is referred to as the latest acquisition cost for the remainder of this standard.~~

~~[18] Holding gains (or losses)" result from holding assets in periods of changing prices. Under historical cost methods, holding gains (or losses) are not separately recognized even though they exist. Under the latest acquisition cost method, holding gains (or losses) will be recognized in the valuation of inventory since that value is adjusted periodically to present the more current latest acquisition costs. These gains or losses are unrealized holding gains or losses. "Unrealized" refers to any gain or loss associated with inventory still held by the entity. "Realization" of the holding gain or loss occurs only when an item of inventory is sold.~~

[19] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[20] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

Statement of Federal Financial Accounting Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, following generally accepted accounting principles (GAAP) promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in applying an alternative valuation method:

vi. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[21] that its financial statements, or one or more line items addressed by SFFAS 48, are presented fairly in accordance with GAAP.

vii. The application of this method based on the second condition specified above is available once per reporting entity.

viii. Reporting entities that meet either condition in paragraph 26a. and elect to apply the alternative valuation method in establishing opening balances permitted by SFFAS 48 are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.

ix. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods: [22]
   a) Standard price (selling price)[23] or fair value[24]
   b) Latest Acquisition Cost[25]
   c) Replacement cost[26]
   d) Estimated historical cost (initial amount)
   e) Actual historical cost (initial amount)

[21] An unreserved assertion is an unconditional statement.
[22] The methods are not listed in order of preference.
[23] The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.
[24] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)
[25] The Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*
[26] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

x. Disclosure requirements–A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items are presented fairly in accordance with GAAP. Financial statements, or as applicable, reports on line items, of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. Exceptions to Valuation. An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:

i. Units of which are interchangeable,
ii. Units of which have immediate marketability,
iii. Units for which appropriate costs may be difficult to obtain.

OTHER CATEGORIES OF INVENTORY

27. **Inventory Held in Reserve for Future Sale.** Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

28. The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. **Examples** of factors to be considered in developing the criteria are all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage, and (5) the likelihood that a supply of the items will be available in the future. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.

29. **Excess, Obsolete, and Unserviceable Inventory.** "Excess inventory" is inventory stock that exceeds the demand expected in the normal course of operations because the amount on hand is more than can be sold in the foreseeable future and that does not meet management's criteria to be held in reserve for future sale. "Obsolete inventory" is inventory that is no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable inventory" is damaged inventory that is more economical to dispose of than to repair. The category "excess, obsolete and unserviceable inventory" shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in

footnotes or (2) shown as a separate line item on the face of the financial statements.

30. Such inventory shall be valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. Any subsequent adjustments to its net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain). The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected not realizable value.

31. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.

32. **Inventory Held for Repair.** Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.
(1) Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established The annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.

33. (2) Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.

34. Transition to either of these two methods may result in recognizing an accumulated amount of needed repairs that were not previously accounted for. To avoid overstating repair expense for the first period that repair expense is accrued, prior period amounts are to be separately identified or estimated. The estimated amount to repair inventory that is attributable to prior periods shall be credited to the repair allowance under the repair allowance method or to the inventory account under the direct method and reported as an adjustment to equity.

DISCLOSURE REQUIREMENTS

35.

- General composition of inventory.
- Basis for determining inventory values; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods; if any.
- Balances for each of the following categories of inventory; inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial

statements.

- Restrictions on the sale of material.
- The decision criteria for identifying the category to which inventory is assigned.
- Changes in the criteria for identifying the category to which inventory is assigned
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

The provisions of this statement need not be applied to immaterial items.

OPERATING MATERIALS AND SUPPLIES

36. **Definition.** "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

37. Operating materials and supplies shall be categorized as (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies. These categories are defined in paragraphs 36, 45, and 47 respectively.

38. **Recognition.** The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and supplies shall be recognized and reported as assets when produced or purchased. "Purchased" is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

39. The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.

40. If (1) operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

41. An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user.

42. **Valuation Under the Consumption Method.** Operating materials and supplies shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Operating Material and Supplies.

43. Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

44. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed. ~~In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).~~

OTHER CATEGORIES OF OPERATING MATERIALS AND SUPPLIES

45. **Operating Materials and Supplies Held in Reserve for Future Use.** Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.

46. The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

47. **Excess, Obsolete, and Unserviceable Operating Materials and Supplies.** "Excess operating materials and supplies" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management's criteria to be held in reserve for future use. "Obsolete operating materials and supplies" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs,

or operations. "Unserviceable operating materials and supplies" are operating materials and supplies that are physically damaged and cannot be consumed in operations. The category "excess, obsolete and unserviceable operating materials and supplies" shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

48. Such operating materials and supplies shall be valued at their estimated net realizable value. The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete or unserviceable and their estimated net realizable value shall be recognized as a loss (or gain) and either reported separately or disclosed. Any subsequent adjustments to their estimated net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).

49. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies.

DISCLOSURE REQUIREMENTS

50.

- General composition of operating materials and supplies.
- Basis for determining operating materials and supplies values; including valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods, if any.
- Balances for each of the categories of operating materials and supplies described above.
- Restrictions on the use of material.
- Decision criteria for identifying the category to which operating materials and supplies are assigned.
- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

The provisions of this statement need not be applied to immaterial items.

STOCKPILE MATERIALS

51. **Definition.** "Stockpile materials" are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business. The following items are specifically excluded from stockpile materials: (1) items that are held by an agency for sale or use in normal operations (see proposed standards for inventory and operating materials and supplies), (2) items that are held for use in the event of an agency's operating emergency or

contingency (see proposed standard for operating materials and supplies), and (3) materials acquired to support market prices (see proposed standard for goods held under price support and stabilization programs).

52. **Recognition.** The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. "Purchase" is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.

53. **Valuation.** Stockpile materials shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Stockpile Materials. Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of stockpile materials. ~~In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).~~

54. **Exception to Valuation.** The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss or an expense[27] in the period in which it occurs.

55. **Held for Sale.** When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price.

DISCLOSURE REQUIREMENTS

56.

- General composition of stockpile materials.
- Basis for valuing stockpile materials; including valuation method and any cost flow

[27] The decline in value shall be considered an expense if it is an expected decline in the normal course of operations.

assumption.

- Changes from prior year's accounting methods, if any.
- Restrictions on the use of materials.
- Balances of stockpile materials in each category described above (i.e., stockpile materials and stockpile materials held for sale).
- Decision criteria for categorizing stockpile materials as held for sale.
- Changes in criteria for categorizing stockpile materials as held for sale.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

The provisions of this statement need not be applied to immaterial items.

APPENDIX D: GLOSSARY

Deemed Cost—Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

Opening Balances—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[28]

Unreserved Assertion—An unconditional statement.

[28] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

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FASAB Staff

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Melissa L. Batchelor

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

PUBLIC-PRIVATE PARTNERSHIPS DISCLOSURE REQUIREMENTS

Statement of Federal Financial Accounting Standards 49

April 27, 2016

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
www.fasab.gov

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SUMMARY

This Statement establishes principles to ensure that disclosures about Public-Private Partnerships (P3s) are presented in the reporting entity's general purpose federal financial reports (GPFFRs). The principles guide financial reporting by establishing a P3 definition and identifying risk-based characteristics that need to exist before considering the P3 arrangement or transaction for disclosure.

This Statement exempts certain arrangements or transactions from the P3 disclosure requirements contained herein. Such exempt arrangements or transactions are subject to existing disclosure requirements in other Statements of Federal Financial Accounting Standards (SFFAS) applicable to such arrangements or transactions.

This Statement provides for first determining those arrangements or transactions that are exempt from the provisions of this Statement before proceeding to the P3 definition. Federal P3s are defined as "risk-sharing[1] arrangements or transactions lasting more than five years between public and private sector entities." Arrangements or transactions meeting the P3 definition are then evaluated against risk-based characteristics referred to as "Conclusive Characteristics." Should the arrangement or transaction not meet any one of the Conclusive Characteristics required for disclosure, the arrangement or transaction should then be evaluated against the "Suggestive Characteristics" before concluding whether disclosure is required. If an arrangement or transaction warrants reporting, the disclosures should be provided.

Disclosure requirements comprise quantitative and qualitative information to assist users in understanding the nature of P3s such as the relative benefits/revenues being received in exchange for the government's consideration, the contractual terms governing payments to and from the government, and related risks including those deemed remote. Disclosures can be provided by individual P3 or summarized; for example, by an entity's strategic objectives, departmental or bureau categorizations, or program budget classifications.

This Statement helps achieve the operating performance and budgetary integrity objectives outlined in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, by making P3s more understandable. P3 information is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. Moreover, because P3s are a form of investment, they should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are being managed and (b) the identification of risks.

This Statement is effective for periods beginning after September 30, 2018. Earlier implementation is permitted.

[1] Risk-sharing exists when a public sector entity shares risks and rewards with a private sector entity whenever the benefits of the arrangement or transaction accrue to both the private sector entity and the public sector entity and (1) the public sector entity is at risk of loss, or (2) the private sector entity's ability to perform is at risk and success of the arrangement or transaction depends upon the public sector's intervention.

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TABLE OF CONTENTS

Summary 3

Introduction 5

Standards 8

- **Scope** 8
- **Definition** 9
- **Identification of P3's Requiring Disclosure** 10
- **Disclosure Requirements** 14
- **Effective Date** 16

Appendix A: Basis for Conclusions 17

Appendix B: Flowchart 33

Appendix C: Abbreviations 34

Appendix D: Glossary 35

This is the original Standards file; please check for the most recent update in the FASAB Handbook at: http://files.fasab.gov/pdffiles/handbook_sffas_49.pdf

INTRODUCTION

PURPOSE

1. To meet challenges such as those brought about by limited budgetary resources governments are increasingly establishing risk-sharing arrangements or transactions[2] with the private sector. Some of these arrangements or transactions may also involve private financing and enable governmental agencies to fulfill their missions to their constituents that would otherwise not be possible without such arrangements or transactions.

2. These risk-sharing arrangements or transactions are commonly referred to as **Public-Private Partnerships (P3s)**[3] but may also be referred to as Alternative Financing Arrangements, or Privatization Initiatives, some of which are extremely complex. For example, P3s may involve the use of appropriated funds, non-appropriated funds, third-party financing, or significant amounts of private capital or investment. Furthermore, P3s can (1) be so long-term in nature that costs along with the accompanying benefits may not be distributed equitably across generations, (2) exclude contractual protections afforded the government by the Federal Acquisition Regulation (FAR) such as, but not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability, and (3) require the government to provide resources or absorb losses greater than other alternative procurement methods or competing in-house[4] performance. Lastly, P3s may involve the transfer of government assets, including intellectual property, into private hands for extended periods of time.

3. As a result, the Board recognizes that the accounting and reporting issues related to risk-sharing can also be extremely complex, involving a wide array of assets and liabilities. P3s by their very design transfer or share various forms of risk among the P3 partners. Such risk allocation strategies are in essence the very incentives that serve as the foundation or building blocks for P3s. Therefore, an entity should understand how much (total) risk resides in an arrangement or transaction and how much of that risk has been (1) transferred to the private partner, (2) shared with the private partner, and (3) retained by the entity (that is, the government sponsor). Such an understanding relies on a thorough analysis of the underlying contractual agreements, guarantees, insurance, and indemnification strategies as well as the existence and nature of any underlying private party capital buffer that might exist; that is, the extent of any debt (for example, bonds, loans and notes) and equity (for

[2] Risk-sharing can be either structural or transactional. P3 Structural Arrangements are external to the government entity's operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP). For example, military base housing. P3 Transactional Arrangements are internal to the government entity's operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP.

[3] Terms defined in the Glossary are shown in bold-face the first time they appear.

[4] In-house refers to using government facilities and personnel as opposed to relying on commercial sources to supply the products and services the government needs.

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example, stocks, and other securities representing an ownership interest) participation.

4. Entities can execute P3s via **structural arrangements** through the use of **special purpose vehicles (SPV's)** and/or directly as **program transactional arrangements**. Furthermore, many P3s are either discrete (long-term) leases or involve aspects of leasing.

5. The Board has previously addressed various types of long-term arrangements or transactions in which the government participates (for example, leases or guarantees). As such, accounting standards exist that provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. This Statement supplements existing guidance to help ensure adequate disclosure of those arrangements/transactions that either form the basis of or are part of a P3. Therefore, existing accounting standards that govern the various types of long-term arrangements/transactions continue to apply.

6. To that end, the Board notes that there are risks associated with P3s. For example, risks (1) where actual costs will be greater than budgeted costs, (2) the entity may have to absorb part or all of the project's private debt, (3) the entity will not achieve expected returns on its investments in limited partnerships, (4) conditions may lead to a government-acknowledged event where an entity assumes financial responsibility for the event, and (5) the public purpose or public value will not be fulfilled or achieved. Because of the risks involved in entering into such long-term agreements, some of which involve government assets, specific disclosures regarding P3s are needed. Such disclosures foster accountability and improve understanding of (1) the general risks inherent in P3 arrangements by revealing their purpose, objective, funding, operational and financial structures; and (2) contractual risks of loss such as early termination requirements. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements.

7. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. Some risks associated with P3s may result in the incurrence of losses and applying Statement of Federal Financial Accounting Standards 5 (SFFAS 5): *Accounting for Liabilities of the Federal Government* would be appropriate. For recognition of losses, SFFAS 5 requires that a past event has occurred for which a future outflow or other sacrifice of resources is probable and measurable. Disclosure should be provided for reasonably possible losses and probable losses that are not measureable.

8. Due to their very nature, P3s are used to manage risks, some of which may be risks of loss included in the terms of the contractual P3 arrangements or transactions that are deemed remote but are nonetheless material and may require disclosure. For example, excluding contractual protections afforded the government by the FAR[5] inherently increases the entity's risk as does a

[5] For example, contractual protections afforded the government by the FAR include but are not limited to: termination rights and obligations, contract by negotiation, cost accounting administration, and contract cost allowability.

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relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. It is the Board's opinion that remote risks of loss included in the terms of the contractual P3 arrangements or transactions that are material should be disclosed. Therefore, consideration should be given to those risks that management does not expect to be likely yet could represent a risk of loss to the entity. With this being said, the Board also recognizes that (1) certain remote risks may have a reasonably high materiality threshold and (2) not all individual remote risks in a P3 arrangement or transaction need to be disclosed to satisfy the requirements of this Statement. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

9. Disclosures comprise quantitative and qualitative information and not all P3 risks can be readily or sufficiently measured. However, federal financial reports are most likely to meet reporting objectives and, therefore, user's needs when disclosures help readers understand complex arrangements or transactions and the associated risk. To this end, qualitative disclosures are as important as quantitative disclosures. Further, both quantitative and qualitative factors should be considered in assessing materiality as well as the nature and content of information to be disclosed.

10. Because the Board has identified the need for clarity with respect to questions that arise concerning the full costs including risk of these complex arrangements or transactions, this Statement is a first step toward developing principles-based guidance and identifying potential gaps in existing guidance. The Board is working and will continue to work closely with stakeholders interested in improving the accounting and reporting of these complex arrangements or transactions. By addressing disclosure issues as a first step, the Board will facilitate continued cooperation and greater interest in identifying areas requiring attention while minimizing preparer burden. It should be noted that the Board also plans to address measurement, recognition, and reporting issues through continued consultation with stakeholders. This could lead to the issuance of additional guidance.

MATERIALITY

11. The provisions of this Statement need not be applied to immaterial items. However, materiality should be applied cumulatively or in the aggregate by the entity. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. Refer to paragraphs 8 and 9 above for related comments.

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SCOPE

12. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board*.

13. This Statement is applicable to public-private partnerships (P3s) and this term is used to refer to a wide variety of service, management, operating, and research and development arrangements or transactions meeting the definition of P3s presented in paragraphs 16 through 18.[6] Such arrangements and transactions may include contracts, grants, reimbursable agreements, alternative financing arrangements, privatization initiatives, and other arrangements or transactions.

14. Some P3s can result in risk of loss and therefore should be assessed against the risk based (conclusive and suggestive) characteristics at paragraphs 20 and 21 to identify those that should be disclosed.

15. The following arrangements and transactions are not subject to the provisions of this Statement:

    a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

    b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend

[6] For purposes of this Statement, the private sector refers to individuals and entities acting in their private capacities outside of the authority and control of federal, state, or local governments and encompasses for-profit businesses and non-profit organizations that are outside of the authority and control of federal, state or local governments.

[7] The term leases includes enhanced use leases and both capital and operating leases, as defined under current FASAB standards.

[8] A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, software updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered “bundled” with the underlying lease agreement.

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existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

c. Acquisition of supplies and services, including construction, research and development, and commercial items, made pursuant to the FAR *Simplified Acquisition Procedures* (FAR Part 13)

d. Formal and informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, or coordinate and integrate strategic initiatives

e. Grants to state, local, and Indian tribal governments and other public institutions and arrangements or transactions with foreign governments

f. Arrangements or transactions in which private entities voluntarily contribute nominal resources or provide incidental resources without expectation of compensation or government indemnification for any possible risk of loss

DEFINITION

16. Subject to the exclusions noted in paragraph 15 and for the purposes of this Statement, federal public-private partnerships (P3s) are risk-sharing[9] arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

17. A public sector entity shares risks and rewards with a private sector entity whenever the benefits of the arrangement or transaction accrue to both the private sector entity and the public sector entity and (1) the public sector entity is at risk of loss, or (2) the private sector entity's ability to perform is at risk and success of the arrangement or transaction depends upon the public sector's intervention.

18. The expected life of a P3 is the term or period for which the entity, including consideration of economic incentives, is likely to participate in the P3. The expected life is initially determined at the inception of the P3 arrangement when the economic incentives are identified and considered in the formation of the P3. Economic incentives considered may include expected significantly reduced costs or increased efficiencies if contracts are renewed or if the P3 approach is continued realization of return on investment, continuity of mission critical services, flexibility, and significant

[9] Risk-sharing can be either structural or transactional. P3 Structural Arrangements are external to the government entity's operations and often involve the creation of a Special Purpose Vehicle (SPV), Trust, or Limited Partnership (LP); for example, military base housing. P3 Transactional Arrangements are internal to the government entity's operations; for example, work-share programs not involving the creation of a SPV, Trust, or LP.

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costs associated with nonrenewal, such as required payments at the end of the contract to compensate the private party for significant capital investments. Typically, expected life is documented in budget justifications, cost benefit or value for money analyses, or other analyses. Expected life may extend beyond the current contract period (including options or renewals). Expected life is re-evaluated as P3 contracts are renewed and when the entity identifies significant changes in circumstances during the contract period that may affect the expected life.[10]

19. Arrangements or transactions which are not excluded by paragraph 15 and meet the definition in paragraphs 16 through 18 should be assessed against the risk based characteristics in paragraphs 20 and 21.

IDENTIFICATION OF P3'S REQUIRING DISCLOSURE

20. The following risk characteristics are conclusive evidence that P3s possess risk of loss indicating that disclosures should be provided. If any one of the following conclusive risk characteristics is met, the P3 arrangement or transaction should be disclosed.

Conclusive Risk Characteristics	Risk Rationale[11]
1. The arrangement or transaction results in the conveyance or creation of a long-lived asset or long-term financing[12] liability.	Not all P3s result in the conveyance or construction of an asset. However, in those that do, the government's risk may be significantly increased because of costs that accompany asset ownership or control. Further, financing may be provided in whole or shared in part by private sector entities. Note that some private partners may incur substantial financing liabilities in preparation for delivering services even if an asset is not created.
2. The federal entity participates in, helps sponsor, or is party to a Special Purpose Vehicle (SPV), partnership, trust, and other such arrangements.	Entities such as SPVs, partnerships, trusts, and other such arrangements can be established for a variety of strategic and/or tactical reasons. Generally speaking, they are commonly considered risk-containment vehicles and are more often than not, purposefully not included in

[10] The Basis for Conclusions (BFC) paragraph A41 provides examples regarding determination of a P3's expected life.

[11] The rationale presented herein explains why the Board believes there is or may be risk of loss when the characteristic is present. The rationale discusses risk broadly and is not intended to create specific disclosure requirements. The disclosures are articulated in paragraph 23. Please refer to BFC paragraphs A37 through A44 for related comments.

[12] Contractors routinely finance operations while awaiting payment of invoices. Such routine financing is not indicative of a P3 in and of itself.

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Conclusive Risk Characteristics	Risk Rationale[11]
	budgets or balance sheets. P3s employing SPVs, partnerships, trusts, and other such arrangements can be or most often become borrowing arrangements/transactions or alternative financing mechanisms. Therefore, the risk rests in the fact that because SPVs, partnerships, trusts, and other such arrangements can facilitate funding/financing, an agency's explicit or implicit long-term debt or promise to pay the established entity is not appropriately recognized in either budget or financial reports.
3. The arrangement or transaction covers a significant portion of the economic life of a project or asset.	Those P3 procurement or contract arrangements/transactions that cover a significant portion of the economic life of a project or asset pose greater risk to the federal entity because there is often no re-procurement or re-negotiation opportunity for the agency. As a result, changed conditions that could warrant a fair and reasonable re-negotiation or re-competition cannot be exercised and increased costs that would otherwise be avoided are incurred for the duration of the arrangement/transaction.
4. The principal arrangement or transaction is exempt from: a. if a contract, the FAR; or b. if a grant, Office of Management and Budget (OMB) requirements (2 C.F.R. Title 2, Part 200).	The FAR for contracts and OMB requirements for grants govern the administrative framework and include procurement, accounting, and legal requirements to help safeguard taxpayer dollars. Therefore, those P3s exempt from such requirements are at an increased-risk because well-established safeguards and contract resolution mechanisms are absent.

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21. The following risk characteristics are evidence that P3s may possess risk of loss and require disclosure. The following suggestive risk characteristics should be considered in the aggregate. Each suggestive risk characteristic will require entity judgment as each characteristic is analyzed in connection with the other suggestive risk characteristics.

Suggestive Risk Characteristics	Risk Rationale[11]
1. A **Value for Money**[13] (VfM) analysis is performed.	The term VfM is commonly used in connection with P3 arrangements or transactions. VfM analyses are broader in scope emphasizing qualitative factors, as opposed to the more traditional quantitatively based cost-benefit analyses most often performed. If an entity conducts a VfM analysis it may indicate that the project in question is a P3. VfM's are typically more subjective than traditional cost-benefit analyses and are sometimes prepared ex-post facto, thus increasing potential risk to the agency.
2. The consideration or items given up in an arrangement/transaction or their value are not readily apparent.	Generally under common law, consideration from both parties is required in order to have what constitutes a binding contract. Some courts have ruled that in those cases where the exchange appears excessively one sided, no quid-pro-quo exists and the contract may be void by law. Therefore, in those cases where consideration or its value from either party is not readily apparent, such cases could lead to recourse or remedies that have adverse financial ramifications to the agency.
3. Significant work force duties, activities, or knowledge are cross-shared between public and private sector P3 parties.	As federal entities face under-utilization and skill retention issues, with Congressional approval, some entities are entering into P3 arrangements/transactions to put both infrastructure and government personnel to

[13] In its publication "The Value for Money Analysis: A Guide for More Effective PSC and PPP Evaluation," the National Council of Public Private Partnerships adopted the United Kingdom's, Her Majesty's Treasury Value for Money definition as contained in Her Majesty's Value Assessment Guide:

> VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be.

Suggestive Risk Characteristics	Risk Rationale[11]
	heightened work. However, there is a concern that the analyses used to justify these arrangements or transactions often exclude government personnel costs, including associated legacy costs (for example, pension and OPEB). Therefore, increased risk exists in those cases where such costs are excluded from cost-benefit or VfM analyses because the government (1) is left absorbing these costs with no related activity base, (2) is exposed to potential liabilities arising from union and/or employee litigation, and (3) may lose governmental skill-sets that would lead to costlier procurement options.
4. The focus is more on collaboration and informal, real-time, resolution processes than on formal, contractual, administrative processes.	Due to their very nature, P3 arrangements or transactions involve risk-sharing and in some cases, issues such as contract disputes are resolved informally. However, such informal resolution processes could lead to potential liability when contracting, procurement, or legal personnel are not involved. Therefore, the risk rests in the potential liability arising from informal resolution of what otherwise would require more formal contractual administrative processes.
5. The government relies on either the private sector partner's or a third party's determination of a P3's performance or return on investment/equity without performing its own verification of performance or return on investment/equity.	Agencies often rely on 3rd party experts to assist in performing various types of analyses. It has been noted that conflicts of interest often exist because there are only a few firms who practice in this highly sophisticated area. As a result, some firms have provided advisory services to both the private partner and government sponsor of a P3 arrangement/transaction. In addition, fees are often based on the dollar volume of the arrangement/transaction creating what some believe are self-serving incentives. Therefore, the risk in those P3 arrangements/transactions rests where an agency does not or cannot perform its own independent analysis, thus relying solely on either the private partner or a third party determination of a P3's performance or return on investment/equity without performing its own verification. Such analyses may belie the significant risk the government has or will incur.

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DISCLOSURE REQUIREMENTS

COMPONENT REPORTING ENTITY DISCLOSURES

22. The P3 disclosures at paragraph 24 below specify the inclusion of qualitative and quantitative information and may be aggregated or grouped by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, or other means.

23. Disclosures should generally accompany the related asset and/or liability display contained within the financial statements. Depending on the circumstances, some of the required information may be disclosed due to other requirements. The resultant disclosures should be integrated so that concise, meaningful, and transparent information is provided and information is not repetitive.

24. Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a P3 arrangement/transaction. The following information should be disclosed:

    a. The purpose, objective, and rationale for the P3 arrangement or transaction and the relative benefits/revenues being received in exchange for the government's consideration, monetary and non-monetary; and the entity's statutory authority for entering into the P3.

    b. A description of federal and non-federal funding of the P3 over its expected life, including the mix and, where available, the amounts of such funding. For any amounts that are not available, the disclosures should indicate such.

    c. The operational and financial structure of the P3 including the reporting entity's rights and responsibilities, including:

        i. A description of the contractual terms governing payments to and from the government over the expected life of the P3 arrangement or transaction to include:

            1. explanation of how the expected life was determined

            2. the time periods payments are expected to occur

            3. whether payments are made directly to each partner or indirectly through a third-party, such as, military housing allowances

            4. in-kind contributions/services and donations

ii. The amounts received and paid by the government during the reporting period(s) and the amounts estimated to be received and paid in aggregate over the expected life of the P3

d. Identification of the contractual risks of loss the P3 partners are undertaking

i. Identification of such contractual risks of loss should include a description of (1) the contractual risk and (2) the potential effect on cash flows if the risks were realized (for example, early termination requirements including related exit amounts and other responsibilities such as asset condition (hand-back) requirements, minimum payment guarantees, escalation clauses, contingent payments, or renewal options).

ii. Disclosure of remote risks of loss should be limited to those included in the terms of the contractual P3 arrangements or transactions. If remote risks of loss are disclosed, an explanation should be included that avoids the misleading inference that there is more than a remote chance of a loss.

e. As applicable:

i. Associated amounts recognized in the financial statements such as gains or losses and capitalized items

ii. Significant instances of non-compliances with legal and contractual provisions governing the P3 arrangement or transaction

iii. Whether the private partner(s), including any Special Purpose Vehicle (SPV), have borrowed or invested capital contingent upon the reporting entity's promise to pay whether implied or explicit

iv. Description of events of termination or default

Financial Report of the US Government Disclosures

25. The U.S. government-wide financial statements should disclose:

a. a general description of P3 arrangements or transactions

b. the consolidated amounts the government received and paid during the reporting period(s) and estimated to be received and paid in aggregate over the expected life of the P3s

c. a reference(s) to applicable component entity report(s) for additional information

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EFFECTIVE DATE

26. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Early adoption is permitted.

The provisions of this Statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. This project was added to the FASAB's technical agenda in April 2012 because federal agencies have increasingly turned to public-private partnerships to accomplish goals and in light of budget pressures likely to further increase their use. Although federal generally accepted accounting principles are fairly robust, the Board noted that due to the complex nature of P3s significant study would be required regarding a host of issues dealing with the definition, measurement, and recognition of P3s. In December 2012, the project plan was adopted with the overall goal of recognizing the full costs of P3s in the financial statements. In addition, a P3 task force was formed and held its first meeting in February 2013.

A2. Final standards or guidance were expected to follow a three year effort. Specific project objectives include:

a. Defining terms

b. Providing guidance (that is, identifying gaps) for the recognition and measurement of:

   i. assets and liabilities

   ii. revenues and expenses

   iii. establishing disclosure requirements

c. Considering guidance for other arrangements/transactions related to P3s (for example, sale-leaseback or other long-term arrangements)

A3. Early in its deliberations the Board was clear that forthcoming guidance must be consistently applied and covered by an overarching principle(s). The Board noted its concern is with the risks to which the government is exposed and related disclosures. As a result, members decided that because P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements, these complexities necessitate the establishment of disclosure requirements as a first step to (1) developing uniform, principles-based guidance, and (2) identifying potential gaps in existing guidance. To that end, the Board decided that a broad P3 definition accompanied by risk-based characteristics should be pursued to establish a framework for determining which P3s should be disclosed. The Board believes that the resulting disclosures will inform the need for and development of future standards providing recognition

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and measurement guidance specific to P3s. Therefore, any further work will be undertaken after these disclosures become effective.

A4. P3 task force meetings for this phase of the project were held between February 2013 and May 2014. All meetings were well attended with representation from federal agencies, commercial sector(s), and citizens. Participants came from diverse disciplines such as accounting, auditing, facilities management, financial reporting, housing, information technology (IT), commercial and investment banking, procurement, and program management. To best meet the project goals and objectives, staff, in addition to engaging in task force discussions, initiated fact-finding meetings with experts and practitioners both within and external to government. Staff met with federal agency representatives, public policy experts, consultants, private equity participants, and a private IT/Cloud/Software development firm.

Common Themes and Other Matters

A5. The most common themes arising from task force and fact finding meetings considered in developing the Statement include:

a. At a minimum, participants expect continued use if not growth in P3s.

b. Government employee legacy & relocation costs are not presently considered in Value for Money (VfM)[14] analyses.

c. Long-term nature of P3s is accepted, but concerns include

i. lack of transparency in the solicitation and award processes along with the lack of competition hinders accountability and fair and reasonable pricing,

ii. not applying the Federal Acquisition Regulation[15] (FAR) increases government risk, and

iii. some P3s circumvent procurement administration.

[14] VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability. The VfM concept has drawn criticisms not only because of its subjectivity and lack of rigor in application, but because in some cases (1) cash flows can be easily managed to meet desired expectations and (2) VfM results are used as ex-post facto justifications for qualitatively made project and/or award decisions. It is important to note that the same criticisms can be made of the more traditional cost-benefit analyses used in management decision making.

[15] The FAR is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services with appropriated funds. It became effective on April 1, 1984, and is issued within applicable laws under the joint authorities of the Administrator of General Services, the Secretary of Defense, and the Administrator for the National Aeronautics and Space Administration, under the broad policy guidelines of the Administrator, Office of Federal Procurement Policy, Office of Management and Budget.

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d. In-kind contributions are difficult to value or are overvalued and not always reported.

e. P3 financial reporting is generally supported but agencies and participants vary in the what, how, and where of disclosures. For example, relative to significant and material P3 arrangements or transactions, some believe that property, plant, and equipment (PP&E) note disclosure would be sufficient whereas others believe that MD&A discussion is more appropriate because of the SFFAS 15, *Management's Discussion and Analysis,* requirement to address the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends, while others suggest reporting in both locations.

A6. Other matters arising during task force and fact finding meetings included:

a. **Increased Risk to Citizens.** A few participants noted that P3s erode (1) the notion of public service (for example, what is inherently governmental) and (2) in many cases, belief in good government. This increased risk is evidenced by those entities that:

i. purposefully avoid capital acquisition budgeting requirements

ii. absorb "availability" risk[16] absent sufficient private partner consideration

iii. lose control of assets

iv. lock into long-term arrangements/transactions that cannot be re-competed or re-negotiated

v. are constrained by contract modification restrictions

vi. are constrained by proximity and/or right-to-compete restrictions

vii. ignore government employee personnel (legacy) costs

b. **Financing costs.** To enable private financing to work, P3's must be longer-term in nature to allow for sufficient time to liquidate debt and achieve return on investment targets. This is significantly different than traditional procurement contract periods that are typically 5 years or less.

c. **Performance Metrics.** Financial reporting would be enhanced by incorporating performance metrics that could point to both risks and potential liabilities as they arise.

[16] Availability risks or project completion risks exist when for example, defects in construction or quality shortfalls within the control of the private partner occur that preclude the asset or service from being available for its intended use requiring the government sponsor to intervene.

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Summary of Outreach Efforts

A7. The ED was issued October 1, 2014 with comments requested by January 2, 2015. Upon release of the exposure draft, notices and press releases went to the following organizations:

a. The Federal Register

b. *FASAB News*

c. *The Journal of Accountancy, AGA Today, the CPA Journal, Government Executive and the CPA Letter*

d. The CFO Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network; and members of both the Federal Real Property Council and Federal Facilities Council

e. Committees of professional associations generally commenting on exposure drafts in the past

A8. This broad announcement was followed by electronic mailings of the exposure draft followed up by several reminder notices.to:

a. Relevant congressional committees

i. House Committee on Oversight and Government Reform

ii. Senate Committee on Homeland Security and Governmental Affairs

b. Public interest and labor union groups

i. In the Public Interest

ii. American Federation of State, County and Municipal Employees

A9. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

A10. The exposure draft was issued with an alternative view that expressed concerns over the (1) breadth of the general definition, (2) disclosures related to certain remote risks, and (3) clarity of "significant exposure." Specific comments regarding respondent concerns and Board re-deliberations are noted in the following paragraphs as appropriate.

Definition: Public-Private Partnerships

A11. In consultation with constituents to include respondent comments received and related outreach concerning the breadth and scope of the definition, the Board has further developed and refined the definition proposed in the exposure draft. The Board desired establishing a definition that (1) reflected actual federal P3 practices, (2) covered the wide breadth and diverse scope of federal assets, and (3) focused on the risk-sharing or risk transfer strategies that are the very essence of these complicated arrangements or transactions. The definition is intended for general application to be applied uniformly across the federal government.

A12. In reviewing the P3 definitions of other standard-setters, the Board notes that their guidance is largely focused on service concession arrangements (that is, a sub-set of P3s) that directly benefit the general public. The definition contained in this Statement is much broader given the wide breadth and diverse scope of federal assets being managed. It is important to note that (1) federal preparers and auditors have identified accounting topics that extend beyond those typically found in service concession arrangements, (2) oversight entities such as the Congressional Budget Office, GAO, and inspectors general have defined and identified P3 arrangements or transactions to be more than just service concessions, and (3) service concession accounting guidance primarily reflects economic development initiatives such as new roads, toll roads, highways, airports, railways, and hospitals, whereas federal initiatives extend well beyond economic development such as the common defense and general welfare of the nation thus necessitating accounting guidance to best fit these federal initiatives.

A13. In developing the definition, the Board primarily relied on (1) the task force's review of existing definitions from several authoritative sources, (2) various respondent comments to the definition contained in the exposure draft, and (3) an ad-hoc working group comprised of selected respondents. The task force identified the more common characteristics of P3s which are believed to exist in the federal government. Some of the more common P3 characteristics identified include: existence of very long-term contractual agreements (for example, anywhere from five to 99 years), shared or transferred financing, agreements covering a significant portion of the project's or asset's life, shared risks, shared rewards, shared skills and expertise, conveyance or creation of real and personal property, and the use of SPVs. Those respondents specifically commenting on the definition as well as the ad-hoc working group primarily suggested better linkage between the definition and the risk-based characteristics. Accordingly, the broad definition contained in the exposure draft was further refined and is as follows:

> Subject to the exclusions noted in paragraph 15 and for the purposes of this Statement, federal public-private partnerships (P3s) are risk-sharing[17] arrangements or transactions with

[17] A public sector entity shares risks and rewards with a private sector entity whenever the benefits of the arrangement or transaction accrue to both the private sector entity and the public sector entity and (1)

expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

Scope, Applicability and Exclusions

Scope

A14. The Board recognizes that establishing a P3 definition reflecting the breadth and diverse scope of entity missions, operational strategies, available leasing authorities, and other variables might capture activities which are already being recognized or disclosed in the entity's financial statements. Specifically, this is because the Board has previously addressed various types of long-term arrangements/transactions in which the government participates (for example, leases and guarantees). As such, existing accounting standards provide for recognition and measurement of assets/liabilities and revenues/expenses as well as disclosures of certain risks in these long-standing types of arrangements or transactions. However, the Board believes that there is a need for disclosure requirements specific to the risks existing in P3s for which there is no current accounting guidance. The requirements herein do not replace existing disclosure requirements in other SFFASs for similar arrangements or transactions such as leases. P3s are complex arrangements/transactions and an entity would apply all applicable standards to report relevant information in the notes.

Applicability

A15. To help ensure achievement of the federal reporting objectives while minimizing unwarranted disclosure of P3 arrangements or transactions, the Board has established filters at several decision points to aid preparers in this regard. The filters are categorized as follows:

a. Definitional Features Indicative of Risk – After careful study the Board initially identified four major features of federal P3 arrangements or transactions that were embodied in the proposed definition: (1) agreements covering a significant portion of the economic life of a project or asset, and/or lasting more than five years, (2) financing provided in whole or shared in part by the private partner, (3) conveyance or transfer of real property, personal property, or multi-sector skills and expertise, and (4) formation of SPV's. However, as a result of respondent comments concerning linkage between the definition and the risk-based characteristics and a working group recommendation, the Board (1) realigned the four major features by incorporating them directly into the risk-based characteristics and (2) within the definition, specifically excluding arrangements or transactions which are not more than 5 years in duration.

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the public sector entity is at risk of loss, or (2) the private sector entity's ability to perform is at risk and success of the arrangement or transaction depends upon the public sector's intervention.

b. Risk-based Characteristics – The Board has identified and refined during its re-deliberations certain key characteristics discussed later that reflect varying degrees of risk that exist in federal P3s. Therefore, should these characteristics be absent in a P3, the disclosure requirements of this Statement would generally not apply.

c. Materiality – As is the custom with all Statements issued by the Board, only those P3s that are material (qualitatively and quantitatively) in nature, more thoroughly discussed later, should be subject to the requirements of this Statement. The Board notes that because materiality assessments require both qualitative and quantitative judgments, specific guidance limiting preparer and auditor considerations of information would not be appropriate.

Exclusions

A16. As a result of respondent comments concerning the breadth of the proposed definition, the ad-hoc working group recommended and the Board adopted three additional exclusions. The three additional exclusions are:

a. grants to state, local, and Indian tribal governments and other public institutions,

b. arrangements or transactions with foreign governments, and

c. arrangements or transactions sharing nominal or incidental resources.

The first two exclusions identified above reflect that this Statement only applies when a federal entity is in a risk-sharing arrangement or transaction with the private sector[18] and not a public sector institution. Risks associated with public-to-public partnerships (for example, federal to state or federal to local) and those associated with foreign governments (1) are significantly different when compared to risks arising in public-private partnerships and (2) warrant extensive research far beyond the scope of this Statement. Moreover, arrangements or transactions with Indian tribal governments or foreign governments are closely governed by selected agencies and Congressional committees and are also beyond the scope of this Statement. Lastly, arrangements or transactions in which private entities voluntarily contribute nominal resources or provide incidental resources without expectation of compensation or government indemnification for any possible risk of loss are also excluded from the requirements of this Statement.

A17. In summary, the following arrangements or transactions are excluded from the requirements of this Statement:

[18] For purposes of this Statement, the private sector refers to individuals and entities acting in their private capacities outside of the authority and control of federal, state or local governments and encompasses for-profit businesses and non-profit organizations that are outside of the authority and control of federal, state or local governments.

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a. non-lease acquisitions of property, plant, and equipment that are subject to the FAR and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction,

b. leases meeting certain conditions,

c. acquisitions made using Simplified Acquisition Procedures (FAR Part 13),

d. formal and informal arrangements or transactions that do not share risks or rewards and are solely designed to foster goodwill, encourage economic development, promote research and innovation, or coordinate and integrate strategic initiatives,

e. grants to state, local, and Indian tribal governments and other public institutions and those with foreign governments, and

f. arrangements or transactions sharing nominal or incidental resources.

A18. Concerning leases, in consultation with the P3 Task Force and after careful consideration, the Board concluded:

a. to exclude leases[19] that meet the following two conditions: a) they are not bundled and b) they are entered into using GSA delegated authority. Such leases (1) have no significant P3 risk of loss, (2) are already subject to existing FASAB guidance, (3) have well defined FAR-based contractual processes and remedies in place to address risks associated with landlord-tenant relationships, (4) have contractually capped payments for termination liabilities, and (5) have termination payments that are indemnified by GSA's Building Fund. The Board believes that if a lease is either bundled or not entered into using GSA delegated authority, the provisions of this Statement should apply.

b. to not broadly exclude Enhanced Use Leases (EULs) except for those meeting the two conditions cited above because they are more oriented towards P3s as a result of (1) possessing special authorities and not being subject to the FAR, (2) often operating under a risk-reward model as opposed to those entity leases that are basically a landlord-tenant relationship and not a risk-sharing partnership, and (3) possibly including ancillary services and in-kind consideration as part of the arrangement or transaction. Because the Board believes that EULs could be encompassed by this Statement, a

[19] The term leases includes enhanced use leases (EULs) which are typically long-term lease agreements that allow public or private entities to use an agency's property. Agency EUL programs have allowed entities to develop or occupy federal properties such as power plants, housing and healthcare facilities, office space, and parking facilities, and in return, federal agencies receive cash or in-kind consideration. Please note that there is no government-wide definition of EULs. Source: GAO-13-14 Federal Real Property: Improved Cost Reporting Would Help Decision Makers Weigh the Benefits of Enhanced Use Leasing, December 2012).

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determination should be made as to whether disclosures are required via the application of the risk-based characteristics.

Risk-based Characteristics

A19. Although federal P3s are varied and complex, the Board believes there are some common characteristics that can be used to identify those P3s that create risk of loss and should be disclosed. Because the Board is aware of the administrative burdens agencies face day-to-day and that some P3 portfolios might be voluminous, in addition to identifying those P3s that create risk of loss, the risk-based characteristics can also be applied to assist a federal entity in determining which P3 arrangements or transactions do not require disclosure.

A20. The risk-based characteristics have been developed, refined, and categorized from an initial comprehensive list of characteristics that distinguishes federal P3s from traditional procurement actions. With the assistance of the task force, the Board further analyzed and then selected risk-based characteristics which indicate significant P3 risk of loss. These risk-based characteristics are intended to: (1) apply to all types of P3s: construction, housing, utilities, military depots, and others, and (2) assist a federal entity in ascertaining which P3 arrangements or transactions should be disclosed. Once a P3 is identified for disclosure, such arrangements or transactions would then be evaluated in light of the entity's materiality considerations including quantitative and qualitative threshold(s).

A21. As a result of respondent comments concerning linkage between the definition and the risk-based characteristics, the working group recommended and the Board adopted an additional risk-based characteristic for grants and other arrangements. Specifically, OMB requirements (2 C.F.R. Title 2, Part 200) for grants govern the administrative framework and include requirements to help safeguard and protect taxpayer dollars. Therefore, those P3s exempt from such requirements are at an increased-risk because well-established safeguards and resolution mechanisms are absent.

Conclusive and Suggestive Characteristics

A22. The majority of respondents agreed with the risk-based characteristics, their related classification, and their proposed application. However, as mentioned above, the working group recommended and the Board adopted an additional risk-based characteristic for grants and other arrangements. Moreover, the Board clarified the two categories of risk-based characteristics (conclusive and suggestive) pursuant to respondent concerns. Conclusive characteristics are those that existence of any one characteristic means the P3 arrangement or transaction should be disclosed. However, existence of any one of the suggestive characteristics is evidence that the P3 arrangement or transaction may possess risk of loss and require disclosure. Such a suggestive characteristic should be considered in the aggregate with all the other suggestive characteristics before a final decision is made. Each conclusive characteristic is meant to be definitive whereas each suggestive characteristic requires entity judgment as each one is analyzed in connection with the other suggestive characteristics.

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A23. If a P3 arrangement or transaction is subject to disclosure, it should be further evaluated in light of materiality considerations that include both qualitative and quantitative assessments. Additionally, materiality should be applied cumulatively or in the aggregate by the entity.

Materiality

Considering User Needs

A24. As the standards-setting body for the federal government, the Board has stated that there are two fundamental values that provide the foundation for governmental accounting and financial reporting: "accountability" and its corollary, "decision usefulness."[20] Concepts explain that "Because a democratic government should be accountable for its integrity, performance, and stewardship, it follows that the government must provide information useful to assess that accountability." The Board believes that P3 disclosures are an essential element in establishing accountability.

A25. In applying the concept of materiality,[21] the needs of the users of the annual financial report should be considered. Specific to P3s for example, users are interested in: (1) assessing the costs and related risks of entering into such long-term agreements; (2) assessing the efficiency and effectiveness of these risk-sharing agreements as well as the government's management of its assets and liabilities; and (3) determining how financial resources, budgetary or otherwise, have been obtained and used and whether their acquisition and use were in accordance with the entity's legal authorization. As a result, the Board believes that the P3 disclosures required by this Statement will help answer these questions while achieving the associated reporting objectives.

Qualitative and Quantitative Assessments Require Judgment

A26. In connection with concerns over the breadth and scope of the definition, some respondents suggested that the Board develop a clear and objective materiality standard that would limit the disclosure requirement to those transactions that present substantial financial risk to the government. The Board believes that refining the definition and adding additional exclusions best addresses respondent concerns in this regard. Respondents are reminded that "materiality" has not been formally defined in the accounting community; rather, it is a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The determination of whether an item is material:

[20] SFFAC 1, par. 105 states, "The federal government derives its just powers from the consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. …Providing this information to the public, the news media, and elected officials is an essential part of accountability in government."

[21] The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

a. requires the exercise of considerable judgment, based on consideration of specific facts and circumstances, and

b. depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

A27. The Board believes that preparers and auditors are in the best position to exercise this judgment predicated on their direct knowledge of the specific facts and circumstances and user needs. Furthermore, the Board believes that specific guidance concerning materiality assessments would limit preparer and auditor considerations and are therefore inappropriate.

A28. The Board notes that while a P3 arrangement or transaction might not be considered material from a quantitative standpoint, it may be considered qualitatively material and subject to this Statement's disclosure requirements if the disclosures would influence or change the judgment of the financial statement user. Exclusive reliance on certain quantitative benchmarks or thresholds to assess materiality should be avoided.

Materiality Includes Probability Assessments

A29. Decisions whether to recognize or, in the case of this Statement, disclose a P3 arrangement or transaction may take into account considerations that include uncertainties. Uncertainties can be expressed as a measurement of an appropriate attribute (for example, historical cost, fair value, *expected value*, or some other attribute) which may include an assessment of the probability of future flows of economic benefits or services (emphasis added). Furthermore, uncertainties are often subjected to assessments of the materiality of the item, and the benefit versus the cost of recognition or, in this Statement's case, disclosure.

A30. Statement of Federal Financial Accounting Standards 5 (SFFAS 5), *Accounting for Liabilities of the Federal Government,* states that "probable" refers to that which

a. can reasonably be expected, or

b. is *believed to be more likely than not* on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.

A31. The Board notes that the concept of probability is imprecise and may be difficult to apply with respect to certain P3 activities such as economic stabilization payments, in addition to other matters that could arise during the life of the P3 arrangement or transaction. However, the "more likely than not" phrase in SFFAS

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5 accommodates the assessment of the probability of those uncertainties often associated with P3s due to their long-term nature and project variability.

A32. Historically, some studies including work done by GAO suggest that, in practice, preparers and auditors in the private sector often interpret "probable" to mean a subjective assessment of probability considerably in excess of 50%. However, FASAB has defined "probable" as "more likely than not," that is, a subjective assessment of probability greater than 50% (51% or more).

Risks that are Deemed Remote

A33. Most of the respondents agreed with the Alternative View that stated (1) disclosure of remote contingencies is not limited to the terms of contractual arrangements, (2) the concept of "significant exposure" is not sufficiently clear to result in consistent disclosures, and (3) risks related to entity operations or performance (referred to in the Alternative View as business risks) would be included in the risk disclosure. As such, respondents were concerned that such additional disclosures could overwhelm or mislead users. The Board believes that it has addressed respondent concerns in this regard by refining the definition contained in the Exposure Draft, adding additional exclusions, eliminating references to "significant exposure," and in emphasizing at paragraph 24d that remote risks of loss should be limited to those that are included in the terms of the contractual P3 arrangements or transactions. The Board is of the opinion that remote risks can and should be reported where appropriate as explained below.

A34. SFFAS 5 provides that contingencies deemed remote (that is, the chance that a loss has been incurred is slight) are not recognized as a contingent liability or disclosed.[22] However, SFFAS 5 requires that a contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred.

A35. The Board believes that some risks of loss associated with P3s may be consistent with contingencies in SFFAS 5 that arise because of an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity, including the concepts of probable, reasonably possible, and remote. It is this uncertainty, or risk in other words, that prompts entities to seek private partners who can best manage and/or contain the effects of the uncertainty that could ultimately lead to a loss. In applying SFFAS 5 some contingencies may be

[22] Per SFFAS 5, paragraph 38, a contingent liability should be recognized when all of these three conditions are met:

- A past event or exchange transaction has occurred (for example, a federal entity has breached a contract with a nonfederal entity).
- A future outflow or other sacrifice of resources is probable (for example, the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is likely to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (for example, the federal entity's management determines an estimated settlement amount).

identified for which the degree of uncertainty is so great that no reporting (that is, recognition or disclosure) is required by that Statement. However, the Board notes that (1) reporting such contingencies is not inconsistent with the provisions of SFFAS 5 and (2) as discussed above at paragraph A32, because FASAB has defined "probable" as "more likely than not," the FASAB framework suggests that "reasonably possible" and "remote" risks be assessed for disclosure at the remaining (more narrow) band.

A36. Due to their very nature, P3s can also possess risks of loss that may be considered remote but material. For example, excluding contractual protections afforded the government by the Federal Acquisition Regulation (FAR) inherently increases the entity's risk as does a relationship with an industry or private partner that may require the government to provide resources or absorb losses beyond what was contemplated. The Board believes such P3 arrangements or transactions should be disclosed, subject to materiality, even though the risks of loss included in the terms of the contractual P3 arrangements or transactions may be deemed remote. The Board further notes that enterprise risk management frameworks often focus on remote risks because of the magnitude of any potential adverse effects that might arise. Therefore, consideration should be given to those risks that management does not expect to be likely, but represent a material risk of loss to the government if they were to occur. With this being said, the Board also notes that such remote risks may have a reasonably high materiality threshold balanced by whether the omission is such that it is probable that the judgment of a reasonable person would have been changed or influenced by the disclosure. As such, remote risks should not be dismissed from disclosure without further consideration of user needs and the qualitative and quantitative characteristics when applying materiality.

Disclosure Requirements of P3s

A37. The task force conducted research and identified examples of disclosures surrounding P3s from a variety of international and national authoritative sources which address P3 information needs for different types of users. Additionally, the task force considered fact-finding meetings with public and private representatives regarding the types of information that diverse users believe are important. As a result, the task force overwhelmingly agreed with requiring disclosures concerning (1) why the government selects a P3 model to conduct business, (2) the solicitation and procurement processes used, (3) how the P3 is structured, (4) the expected benefits, and (5) the total amounts expected to be paid. Although it was noted that requiring a description of the solicitation and procurement processes is unusual in financial reporting, the task force reached that conclusion because P3s fall outside the routine way governments procure services and such disclosures reveal the potential risk that governments assume, which can ultimately lead to liability recognition.

A38. In analyzing the task force's recommendations the Board considered the federal financial reporting objectives. Of the four objectives outlined in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal*

Financial Reporting, the operating performance and budgetary integrity objectives are identified as being most important for P3 reporting. The Board agreed that P3 reporting is important to meeting these objectives because the federal government is accountable to citizens for the proper administration of its resources. As such, the Board agreed with the majority of the task force's recommendations. However, requiring disclosure of an entity's solicitation and procurement processes falls outside the realm of financial reporting. Furthermore, the Board questioned the informational value of such a disclosure and concluded that its cost also exceeded potential benefits identified by the task force.

A39. P3s are a form of investment and they should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are being managed and (b) whether the government's financial position improved or deteriorated over the period of the P3. P3s often involve innovative operational and complicated accounting practices, accompanied by sophisticated financing agreements. These complexities necessitate the establishment of disclosure principles as a first step to (1) developing uniform principles-based guidance, and (2) identifying potential gaps in existing guidance.

A40. Respondents were mixed regarding disclosures with some stating that the disclosures are onerous and burdensome and the others in agreement with the proposed disclosures or seeking additional disclosures. As a result of considering the overall financial reporting objectives, and in light of certain respondent comments regarding administrative burden, the Board decided to not require disclosure of amounts estimated to be received and paid during each of the succeeding five years. That is, only the amounts received and paid by the government during the reporting period(s) and the amounts estimated to be received and paid in aggregate over the expected life of the P3 need be reported. In determining the expected life of the P3 arrangement or transaction the entity's economic incentives (that is, its risks and/or rewards) should be considered.

A41. The Board offers two examples regarding the determination of a P3s expected life. First, consider an infrastructure arrangement containing a master ground lease of 50 years where in exchange for an up-front payment the entity out-leases (government-owned) land for the construction of an office building and at the same time enters into an occupancy lease which can be renewed for up to 75 years. The expected life of the P3 should be limited to 50 years given the fact that the entity's economic incentive at year 50 changes due to the master ground lease's expiration. That is, at such time the entity may decide to renew the master ground lease and renegotiate its occupancy lease or sell the land and not renew the occupancy lease. As a result, the amounts estimated to be received and paid in aggregate over the 50 years would be reported. Second, consider a spare parts sustainment program where an entity partners with an inventory logistics firm to handle the entire supply chain management function of a major weapons system expected to remain in service for the next 25 years. Although by statute the entity can only enter into a 5 year (for example, base year with 4 renewable options) contract, it has an economic incentive to maintain the relationship beyond 5 years. This is primarily due to the fact that the private partner is likely to incur a

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substantial investment to manage the supply chain and the investment will need to be recovered over time. As a result, the amounts estimated to be received and paid in aggregate over the 25 years would be reported.

Aggregation

A42. Due to the relative complexity and potential voluminous nature of P3s that an entity might be party to, the Statement permits entities to aggregate disclosures by providing broad and summarized information instead of unique or discrete arrangement or transaction detail. However, entities are permitted to disclose information related to individually significant P3 arrangements or transactions separately if entity management believes that such disclosure would better meet user needs.

A43. For example, disclosures of P3 arrangements or transactions could be aggregated by an entity's strategic objectives, departmental or bureau categorizations, program budget classifications, or other means. In this way users are presented with information that is comprehensive and material to an entity's financial statements without placing an undue burden on preparers to provide P3 specific or granular level information. Respondents generally supported the aggregation of information.

Reporting Period

A44. Disclosures should be provided for the initial period and all annual periods thereafter where an entity is party to a material P3 arrangement/transaction.

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BOARD APPROVAL AND DISSENT

A45. This Statement was approved for issuance by 8 members of the Board. One member dissented. The written ballots are available for public inspection at the FASAB's offices. The dissent of the member who opposed the issuance of this Statement is presented in paragraphs A46 and A47.

A46. Ms. Ho dissents to the issuance of this Statement. She believes that the increased use of P3s in the federal government makes the need for clarity in the accounting for P3s vitally important. Ms. Ho acknowledges that the taxpayer has the right to know what obligations the government has agreed to and what the total cost is for a P3 project. Ms. Ho commends FASAB for their thorough examination of the issue, which encompassed several years.

A47. Ms. Ho strongly supports more transparency in financial reporting of federal taxpayers' dollars. However, she shares the concerns voiced by many agencies in response to the exposure draft that the disclosures required by this Statement will create a burden that does not justify the cost required to collect, analyze, report and audit the information needed to comply with this Statement's requirements. In particular, Ms. Ho feels that the expected life requirement will result in inconsistent application by agencies throughout government, which is contrary to the goal of the Statement.

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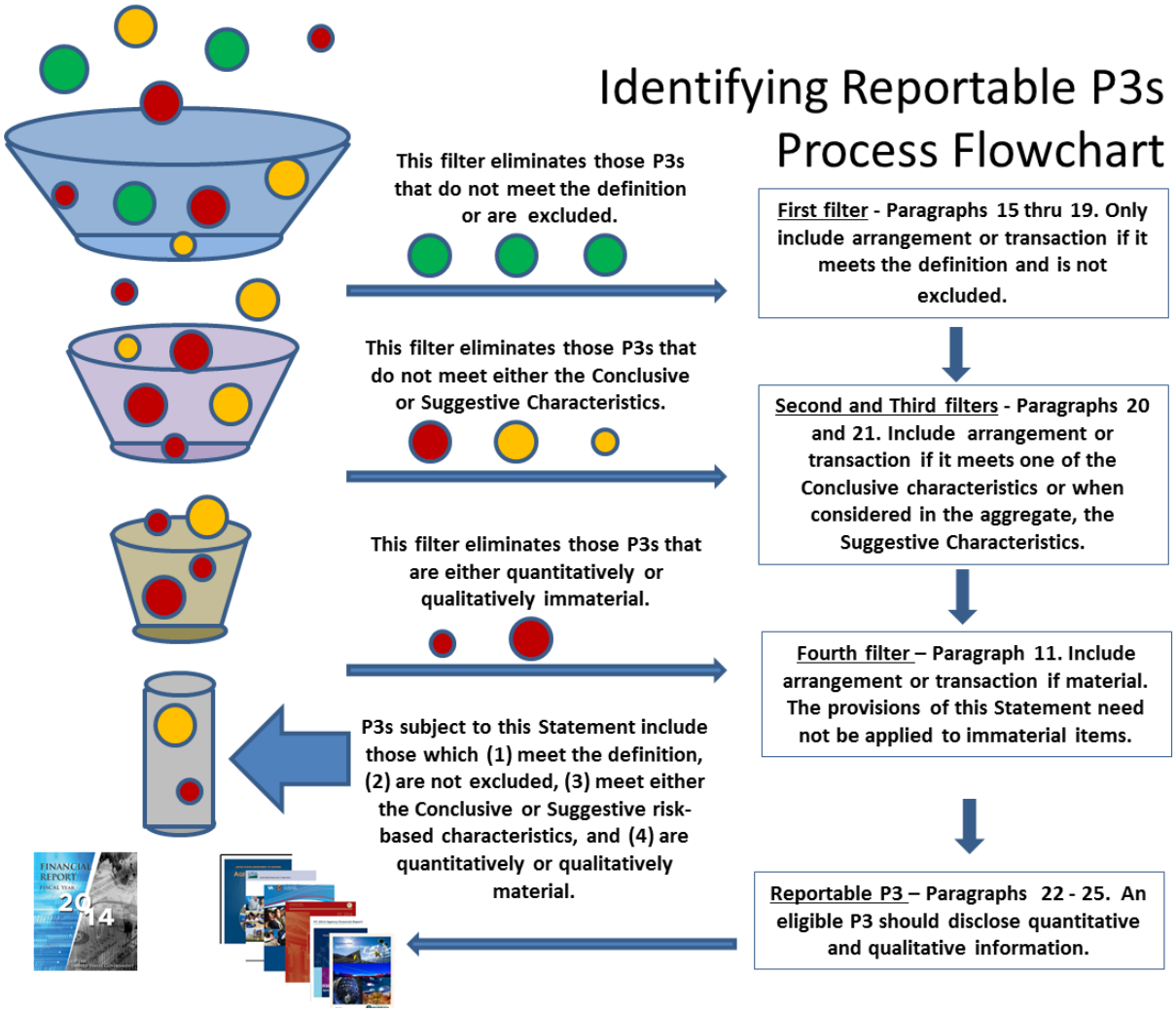
APPENDIX B: FLOWCHART[23]



[23] The standards enunciated in this Statement and not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

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APPENDIX C: ABBREVIATIONS

AGA	Association of Government Accountants
BFC	Basis for conclusions
CFR	Consolidated financial report of the U.S. government
C.F.R.	Code of federal regulations
CPA	Certified public accountant
ED	Exposure draft
EUL	Enhanced Use Lease
FAR	Federal Acquisition Regulation
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPFFR	General purpose federal financial reports
GSA	General Services Administration
IRR	Internal rate of return
IT	Information Technology
LP	Limited Partnership
MD&A	Management's discussion and analysis
OMB	Office of Management and Budget
OPEB	Other postemployment benefits
P3	Public-Private Partnership
PP&E	Property, Plant, and Equipment
PPP	Public-Private Partnership
PSC	Public Sector Comparator
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SPV	Special Purpose Vehicle
U.S.	United States
VfM	Value for Money

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APPENDIX D: GLOSSARY

The standards enunciated in this Statement not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

Public-private partnerships - Federal public-private partnerships (P3s) are risk-sharing arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions.

P3 Structural Arrangement - P3s that are external to the government sponsor's or entity's operations and often involve the creation of an SPV, Trust, or Limited Partnership (LP), and other such arrangements. For example, military base housing.

P3 Program Transactional Arrangement - P3s that are internal to the government sponsor's or entity's operations. For example, work-share programs not involving the creation of a SPV, Trust, or LP, etc.

Special Purpose Vehicles (SPVs) - also commonly called Special Purpose Entities (SPEs), are entities created for a specific, limited and normally temporary purpose. An SPV can be a corporation, trust, partnership, limited-liability company or some type of Variable Interest Entity (VIE). They are often an integral part of public private partnerships because of their risk-containment nature of isolating participating entities from financial risk.

Value for Money (VfM) - VfM is defined as the optimum combination of whole-of-life costs and quality (or fitness for purpose) of the good or service to meet the user's requirement. VfM is not the choice of goods and services based on the lowest cost bid. To undertake a well-managed procurement, it is necessary to consider upfront, and at the earliest stage of procurement, what the key drivers of VfM in the procurement process will be. In other words, VfM is a much broader concept than typical cost-benefit analysis because it emphasizes "value" in more of a qualitative than quantitative manner. Quantitatively, some VfM models use a project's Internal Rate of Return (IRR) to help determine project acceptability.

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Sam M. McCall
Mark Reger
D. Scott Showalter
Graylin E. Smith
Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Project Staff

Domenic Nicholas Savini

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

ESTABLISHING OPENING BALANCES FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT:

AMENDING STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS (SFFAS) 6, SFFAS 10, SFFAS 23, AND RESCINDING SFFAS 35

Statement of Federal Financial Accounting Standards 50

August 4, 2016

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6H19
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement provides implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment. It amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.* The alternative methods include (1) using deemed cost to establish opening balances of general property, plant, and equipment, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

The alternative methods are permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

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TABLE OF CONTENTS

Summary 1

Introduction 3

Standards 5

- **Scope** 5
- **Definitions** 5
- **Amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*** 6
- **Amendments to SFFAS 10, *Accounting for Internal Use Software*** 9
- **Amendments to SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*** 12
- **Rescission of SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*** 13
- **Effective Date** 13

Appendix A: Basis for Conclusions 14

Appendix B: Abbreviations 33

Appendix C: Glossary 34

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_50.pdf.

INTRODUCTION

PURPOSE

1. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* by providing implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E).[1]

2. The alternative methods permitted by this Statement may be applied when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

3. This Statement provides implementation guidance to allow a reporting entity to apply an alternative valuation method (deemed cost) in establishing opening balances for general PP&E in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. It also allows an exclusion of land and land rights from the opening balances with disclosure of acreage information and expensing of future acquisitions. It also provides for selecting between deemed cost and prospective capitalization of internal use software (IUS) in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that was valued under an alternative method.

4. As a result of these amendments and rescission, all implementation guidance for general PP&E, with the exception of specific provisions applicable to IUS, will be incorporated into SFFAS 6. The Board believes providing implementation guidance for general PP&E other than IUS in SFFAS 6 will provide a comprehensive guide for users in a single Statement.

[1] For a complete discussion of the definition, characteristics, recognition, and measurement principles for general PP&E, see SFFAS 6, par. 21-39. For the definition, recognition, and measurement principles for internal use software, see SFFAS 10, par. 9-34.

MATERIALITY

5. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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STANDARDS

SCOPE

6. This Statement applies when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement. This Statement also is applicable to the financial report of the U. S. Government for purposes of consolidating a component reporting entity meeting the above conditions.

7. The alternative methods provided in this Statement may be applied in establishing **opening balances**[2] for the reporting period in which the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general property, plant, and equipment (PP&E) that were valued under an alternative method.

8. A reporting entity that meets either condition in paragraph 6 and elects to apply the alternative methods in establishing opening balances permitted by this Statement is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

DEFINITIONS

Definitions in paragraphs 9 – 10 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

9. **Opening Balances—**Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring

[2] Terms defined in the Glossary are shown in bold-face the first time they appear.

disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

10. **Unreserved Assertion—**An unreserved assertion is an unconditional statement.

AMENDMENTS TO SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

11. This paragraph amends SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 25 by adding the following language at the end of the first sentence: "unless the reporting entity made the election to implement the provisions of paragraph 40.f.i."

    The revised paragraph 25 of SFFAS 6 is:

    25. Land and land rights acquired for or in connection with other general PP&E[29] shall be included in general PP&E unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.

12. This paragraph amends SFFAS 6, paragraph 26 by adding the following language as the second sentence: "Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein."

    The revised paragraph 26 of SFFAS 6 is:

    26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include…

13. This paragraph amends the implementation guidance provided in SFFAS 6 by replacing paragraph 40.

    Paragraph 40 of SFFAS 6 is replaced with:

    40. Alternative Methods for Establishing Opening Balances.[44A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial

[3] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

[29] "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

[44A] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[44B] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

b. The application of these alternative methods based on the second condition specified in paragraph 40 is available to each reporting entity only once per line item.

c. A reporting entity that meets either condition in paragraph 40 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources.*

d. Alternative Valuation Method. **Deemed cost**[44C] is an acceptable valuation method for opening balances of general PP&E. Because the reporting entity may have multiple component or subcomponent reporting entities[44D] using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[44E]

   i. **Replacement cost**[44F]
   ii. Estimated historical cost (initial amount). Reasonable estimates may be based on:
      a) cost of similar assets at the time of acquisition;

[44B] An unreserved assertion is an unconditional statement.
[44C] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.
[44D] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.
[44E] The methods are not listed in order of preference.
[44F] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life (Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46).

b) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or
c) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

iii. **Fair value**[44G]

e. Establishing in-service dates.
   i. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.
   ii. It is not necessary to separately identify the in-service date for material improvements[44H] included in the opening balances of a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.

f. Alternative methods for land and land rights. A reporting entity should choose among the following alternative methods for establishing an opening balance for land and land rights. Because a reporting entity may have multiple component or subcomponent reporting entities selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

   i. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative method is applied, the reporting entity should expense future land and land right acquisitions.

   ii. Land and land rights may be recognized in opening balances based on the provisions of the alternative valuation method (deemed cost) provided in paragraph 40.d.

g. Once established using alternative methods, opening balances are considered consistent with GAAP.

h. Component Reporting Entity Disclosures:

   i. A component reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as

[44G] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale (SFFAC 7, par. 38).
[44H] Material improvements are costs which either extend the useful life of existing general PP&E or enlarge or improve its capacity.

applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 40.f.i. to land and land rights should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures. In the event different alternative methods are applied to land and land rights (as permitted by paragraph 40.f.) by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

i. Financial Report of the U.S. Government Disclosures

i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

ii. When a component reporting entity elects to apply the provisions of paragraph 40.f.i. to land and land rights, the U. S. government-wide financial statements should disclose this fact, the number of acres held at the end of each reporting period, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

AMENDMENTS TO SFFAS 10, *ACCOUNTING FOR INTERNAL USE SOFTWARE*

14. This paragraph amends SFFAS 10, *Accounting for Internal Use Software,* paragraph 16 by adding the following first sentence: "Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally

developed software, in accordance with the asset recognition and measurement provisions herein."

The revised paragraph 16 of SFFAS 10 is:

16. Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein. For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.[6] Such cost should be limited to costs incurred after…

15. This paragraph amends the implementation guidance provided in SFFAS 10 by replacing paragraph 36.

Paragraph 36 of SFFAS 10 is replaced with:

36. Alternative Methods for Establishing Opening Balances.[9A] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or the line item addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative methods. The following should be considered in establishing opening balances:

a. The alternative methods for establishing opening balances may be applied for the reporting period in which the reporting entity, taken as a whole, makes an unreserved assertion[9B] that its financial statements, or the line item addressed by this Statement, are presented fairly in accordance with GAAP. The alternative methods provided in this Statement should also be applied to correct subsequently discovered errors in general PP&E that were valued under an alternative method.

b. The application of these alternative methods based on the second condition specified in paragraph 36 is available only once to each reporting entity.

c. A reporting entity that meets either condition in paragraph 36 and elects to apply any of the alternative methods available in establishing opening balances is subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in*

[6] For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995), pars. 90-92. Also see, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, pars. 94-95.

[9A] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[9B] An unreserved assertion is an unconditional statement.

Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources.

d. Alternative Methods. A reporting entity should choose among the following alternative methods for establishing an opening balance for internal use software. Because a reporting entity may have multiple component or subcomponent reporting entities[9C] selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

   i. Alternative Valuation Method. Deemed cost[9D] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40.d. for implementation guidance regarding deemed cost.

   ii. Prospective capitalization. The reporting entity may choose prospective capitalization of internal use software. If the reporting entity elects prospective treatment, the reporting entity should choose between the following acceptable alternative methods at the opening balance date:

      (a) Exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance.

      (b) Exclude internal use software in service from the opening balance, but include amounts related to internal use software under development at the opening balance date. Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 through 27 or on the alternative valuation method (deemed cost) provided in paragraph 36.d.i.

e. Once established using alternative methods, opening balances are considered consistent with GAAP.

f. Component Reporting Entity Disclosures:

   i. A component reporting entity electing to apply deemed cost in establishing opening balances for internal use software should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this

[9C] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

[9D] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

disclosure, unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

ii. A component reporting entity electing to apply the provisions of paragraph 36.d.ii. should disclose this fact and describe the alternative methods used in the first reporting period in which the component reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternative methods are applied by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which the alternative method was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of internal use software included in the opening balance is required.

g. Financial Report of the U.S. Government Disclosures:

i. When a component reporting entity elects to apply deemed cost, the U.S. government-wide financial statements should disclose this fact, the identity of the component reporting entity, and a reference to the component reporting entity's financial report. Subsequent financial statements need not repeat this disclosure unless the financial statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of the amount of deemed cost of internal use software included in the opening balance is required.

ii. When a component reporting entity elects to apply the provisions of paragraph 36.d.ii.,the U.S. government-wide financial statements should disclose this fact, an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

AMENDMENTS TO SFFAS 23, *ELIMINATING THE CATEGORY NATIONAL DEFENSE PROPERTY, PLANT, AND EQUIPMENT*

16. This section amends the implementation guidance provided in SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* as described in the following paragraphs.

17. Paragraph 10 is replaced with:

    10. See SFFAS 6 for implementation guidance applicable to all general PP&E.

18. Paragraphs 11-18 of SFFAS 23 are rescinded.

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RESCISSION OF SFFAS 35, *ESTIMATING THE HISTORICAL COST OF GENERAL PROPERTY, PLANT, AND EQUIPMENT: AMENDING STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS 6 AND 23*

19. This paragraph rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* in its entirety. Provisions from SFFAS 35 were incorporated into the implementation guidance of SFFAS 6 and SFFAS 10 as applicable.

EFFECTIVE DATE

20. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for FASAB's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, by providing the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is issued in response to DoD's request for guidance on establishing opening balances for general property, plant, and equipment (PP&E). Accounting for the federal government's general PP&E is complex and continues to be a challenge for large federal departments. This topic has been addressed in numerous Statements of Federal Financial Accounting Standards (SFFASs) and Interpretations as well as guidance issued by the Accounting and Auditing Policy Committee. SFFAS 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software*, SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* address the accounting and reporting requirements for general PP&E.

A3. During the project, the Board's staff met with DoD officials, as well as members of the audit community, to develop an understanding of the issues faced by DoD in establishing their baseline for general PP&E. This included discussing valuation methodologies employed, management assertions and the completion of audits, and the status of implementation of a system compliant with general accepted accounting principles (GAAP) for the DoD components.

A4. Based on the meetings and information provided it was determined that:

a. DoD's financial systems and many aspects of DoD's accounting policy for general PP&E have not been in accordance with GAAP.
b. Many DoD organizations that maintain several different accounting and property systems are involved in acquiring general PP&E assets.
c. DoD has not had consistent procedures related to general PP&E acquisitions or document retention.

d. All major systems DoD has utilized for acquisitions of general PP&E have either never been audited or, when audited, had significant deficiencies or material weaknesses.
e. Capital improvement projects have not been reliably tracked, so DoD was unable to determine the date the improvements were placed in service or to establish a valuation baseline.
f. DoD has approximately 440,000 separate real property assets, and many real property assets were built more than 40 years ago.
g. DoD records related to land values are not in a structured, searchable system. The records are not digitized and accessing them involves searching boxed records. Also, source documents, such as deeds, may not be complete, and court records often have gaps given the length of time involved.
h. DoD does not have a complete inventory of its internal use software (IUS), and costs of IUS have not been captured consistently.
i. General equipment is a broad category that includes military equipment and consists of hundreds of thousands of assets.

A5. After considering the status of DoD's efforts and the fact that DoD has had numerous years to implement the standards and has shown little progress, the Board discussed the merits of the project. Specifically, one member had concerns regarding the Board's role and potentially undermining the Board's own credibility by acting to offer relief to DoD (because the department has been unable to adopt GAAP requirements). The Board acknowledges that appearance is a concern. However, the Board has been tasked with establishing standards for which the benefits exceed the cost.

A6. The Board noted that while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when FASAB issued many of these standards, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of this Statement is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed), but for which the current use is limited to accountability and assessing the cost of current services. The Board proposed less costly alternatives that will support this objective.

A7. The Board believes assisting DoD with establishing a baseline benefits all parties. Providing a starting point will enable DoD to focus on needed improvements to systems and controls to process transactions going forward and thereby establish and maintain reliable financial information regarding future PP&E acquisitions. Establishing a sound financial management system is of primary importance.

A8. The Board also acknowledges that other standard-setters have provided guidance for organizations implementing an entire body of standards for the first time. The challenge of establishing opening balances for large public sector entities warrants the flexibilities provided in this Statement.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A9. FASAB issued the exposure draft (ED) *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* on December 22, 2015, with comments requested by February 4, 2016.

A10. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News,* the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal, Government Executive,* the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A11. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations—Subcommittee on Defense
b. House Committee on Armed Services
c. House Committee on Oversight and Government Reform
d. House Committee on the Budget
e. House Committee on Veterans' Affairs
f. Senate Appropriations—Subcommittee on Defense
g. Senate Committee on Armed Services
h. Senate Committee on Finance
i. Senate Committee on Homeland Security and Governmental Affairs
j. Senate Committee on the Budget
k. Senate Committee on Veterans' Affairs

A12. FASAB received 22 responses from preparers, auditors, users of federal financial information, and professional associations. The majority of respondents agreed with the proposals to: (1) permit opening balances of general PP&E to be valued based on deemed cost and require the related disclosures, (2) allow a reporting entity to choose among alternative methods in establishing an opening balance for IUS and require the related disclosures, and (3) rescind SFFAS 35.

A13. However, approximately one-half of the respondents disagreed with the proposal to allow exclusion of land from the opening balances of general PP&E. They also disagreed with the proposal to require a reporting entity electing to exclude land from its general PP&E opening balances to exclude future land acquisition amounts.

A14. The respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A15. The Board did not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

Land

A16. When developing the ED, the Board proposed options for land that were different from those for other general PP&E. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, focuses on relating costs to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance, both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in determining resource allocation. General PP&E is capitalized and depreciated to provide this information. Because land is not depreciated due to its infinite useful life, the benefits of capitalizing land are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and capitalized. In doing so, the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

A17. The Board carefully considered those aspects of the land category, along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board determined the most practical and cost-beneficial approach to establishing an opening balance for land would be to permit the reporting entity to exclude land from the opening balance of general PP&E and to support accountability through disclosures. The Board proposed that the reporting entity disclose, with a note reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land from its general PP&E opening balance would continue to exclude amounts for future land acquisitions. Accordingly, the reporting entity would provide the disclosures each year thereafter.

A18. Some members who supported excluding land expressed concern regarding the resulting inconsistency in reporting and suggested the Board begin a project on land in the near future to review existing standards, to explore options to improve reporting on land, and to seek a consistent approach. Other members wanted to explore valuing existing land holdings based on deemed cost (consistent with general PP&E) or on a set amount per acre of land. The Board asked respondents whether they agreed or disagreed with the proposal to allow exclusion of land from the opening balances of general PP&E even though other component reporting entities would report the cost of certain land in general PP&E. The Board also requested feedback regarding three alternative approaches: (1) to value general PP&E land holdings based on historical cost, a set amount per acre of land, deemed cost, or another valuation method, (2) to defer any changes in the current requirements until the Board completes a reexamination of the appropriate basis of accounting for land, or (3) to adopt another option.

A19. Approximately one-half of the respondents disagreed with the ED to allow exclusion of land from the opening balances of general PP&E. Nearly all respondents supported a land project to reexamine standards for reporting on land. In addition, the majority of the respondents preferred that the Board defer changes to the current land requirements, such as exclusions of land from the balance sheet or other actions that may affect future acquisitions, until the Board completes the re-examination.

A20. As part of due process, the Board carefully considered the following:

a. respondents' comments regarding land,
b. DoD feedback regarding implementation challenges and options, and
c. FASAB's land project plan entitled *Accounting and Reporting of Government Land*.

A21. Respondents' key reasons for disagreeing with the proposal to allow exclusion of land were (1) inconsistent accounting treatment that would be consolidated at the government-wide level and (2) the potential that a temporary change may lead to added cost for reporting entities electing to implement the Statement. Consistent with the support for permitting opening balances of general PP&E to be valued based on deemed cost, respondents agreed that deemed cost and/or existing standards could be used to value opening balances of land.

A22. The Board considered DoD's feedback because DoD would most likely elect to implement the Statement. DoD conveyed the following important factors to the Board:

a. DoD reports that it owns considerable land qualifying as general PP&E. DoD would have to expend significant financial and personnel resources to determine the valuation of land.
b. In contrast to the information used to establish deemed cost for other general PP&E, information that would be necessary to establish deemed cost for land would not be used for DoD management purposes.
c. DoD supports reporting acreage information until the land project is completed. The potential for future valuation requirements was not viewed as more costly than requiring deemed cost and later changing the valuation requirements. DoD noted there are current accountability requirements, and it is actively working on obtaining acreage information.

A23. Although respondents' conveyed that inconsistency was a concern, the Board notes that current standards are not consistent because they differentiate between stewardship land and land acquired in connection with development or construction of an item of general PP&E. Stewardship land is not capitalized, but disclosures of information regarding use of the land and physical measures are required (see SFFAS 29, *Heritage Assets and Stewardship Land*). Land classified as general PP&E is capitalized at historical cost. Stewardship land can be used in development or construction of general PP&E but is not capitalized.

A24. The land project is being initiated to address such inconsistencies, and Board members showed a strong commitment to moving forward and expediting the project to resolve inconsistencies. At the February 2016 Board meeting, the Board approved a project plan entitled *Accounting and Reporting of Government Land*. The requirements in SFFASs 6 and 29 have resulted in significant differences in accounting treatment for land holdings. The land project will consider additional research and factors to determine how best to account for and to report land. However, the Board does not believe decisions to be made in the land project should delay the exclusion of land from opening balances as provided in this Statement. This Statement is of limited scope and seeks cost beneficial options for opening balances. If the exclusion was not available, component reporting entities would be required to adopt one of the valuation methods available under deemed

cost. The land project may reach conclusions that make such valuation methods obsolete, and the costs incurred to adopt deemed cost would have been unnecessary.

A25. Further, the Board has expressed a commitment to complete the land project quickly to resolve inconsistencies. The Board has also communicated to those parties most likely to be impacted that decisions made regarding land are subject to change as a result of the land project.

A26. As noted above, consistent with the support for opening balances of general PP&E to be valued based on deemed cost, respondents expressed that deemed cost could be used to value opening balances of land. Therefore, the Board believes deemed cost should also remain an option for establishing opening balances for land. As a result, a larger component reporting entity may establish an opening balance for land based on a combination of multiple subcomponent reporting entities' alternative methods, which may or may not be the same. This is permitted by the Statement. However, application of a particular alternative method must be consistent within each subcomponent reporting entity prior to its consolidation into a larger component reporting entity.

A27. One area that Board members believe needs transparency and additional clarification is the potential for inconsistent accounting treatment at the government-wide level, with some land reported in dollars and some in acres. The issue is further complicated by the fact that stewardship land is also included as a note reference on the balance sheet and reported in physical units, which may be different than acres. Without additional information to explain what is included at the consolidated level, this situation would not be clear to readers at the government-wide level. Therefore, the Board added a narrative disclosure requirement for the government-wide financial report. The disclosure requires a narrative explanation of any election made by component reporting entities regarding land. Each component reporting entity electing to exclude land should be identified with a reference to the component reporting entity's financial report.

A28. After considering all of the above factors, the Board considered the pros and cons of deferring significant action on land until the completion of the land project, as requested by the respondents who disagreed with the proposal. While the respondents are correct that land will be treated inconsistently, the Board believes it has a responsibility to weigh the cost of developing deemed cost for vast land holdings against the possibility that the land project will conclude that such deemed costs are not useful. Therefore, the Board adopted its proposal to permit land to be excluded from the opening balance of general PP&E and to support accountability through disclosures.

A29. Although some land rights[4] may not have an indefinite useful life, the Board proposed in the ED (similarly to what it did with respect to land) that an exclusion of land rights from the opening balances with disclosure of acreage information and expensing of future acquisitions. The Board recognizes that land rights are diverse, situation specific, and may not always result in disclosures required by this Statement. In fact, SFFAS 6 provides that land rights that are for a specified period of time shall be depreciated or amortized over that time period. The Board believes this is a cost effective approach for

[4] "Land rights" are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

opening balances of land rights and completion of the land project would more fully research the issues and provide comprehensive standards. The Board reiterates that decisions made within this Statement regarding land and land rights are subject to change based upon the results of the land project.

SFFAS 35 Rescission

A30. Although the majority of respondents agreed with the proposal to rescind SFFAS 35 and to permit reasonable estimates in the preparation of financial statements, this provision of the Statement generated many comments from respondents.

A31. A common suggestion provided by respondents was that reporting entities would benefit from the inclusion of language from paragraph 19[5] of the ED in SFFAS 6 and SFFAS 10 to clarify that the Board intended reasonable estimates to be applicable to any general PP&E versus just opening balances. Although the Board believes the broad statement provided in the paragraph should be sufficient to address the matter, members agreed including the provisions of paragraph 19 of the ED in SFFASs 6 and 10 may be clearer. Specifically, SFFAS 6, paragraph 26, and SFFAS 10, paragraph 16, were amended to specify that although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used.

A32. Respondents who disagreed with the proposal to rescind SFFAS 35 primarily cited audit concerns and the valuable guidance provided in SFFAS 35 as their reasoning. However, many of the detailed concerns expressed by respondents are addressed through existing guidance. The Board reiterates (as explained in the ED) that Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*, remains in effect regardless of these amendments and that each significant provision of SFFAS 35 was incorporated in the amendments—including the ability to use estimates in the future. In addition, SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* establishes a requirement for cost accounting that acknowledges the use of cost finding techniques and the allocation of costs on a reasonable and consistent basis. The Board also believes it important to point out the Statement provides for the use of deemed cost to correct errors in the opening balances. Reporting entities should consider all available GAAP guidance when implementing new accounting standards.

Internal Use Software (IUS)

A33. While the majority of respondents agreed with the proposal to allow a reporting entity to choose among alternative methods in establishing an opening balance for IUS, several respondents expressed their concerns to the Board. Five respondents expressed concern with prospective capitalization of IUS, but agreed with deemed cost as an alternative method. The respondents did not believe component reporting entities should be able to adopt inconsistent alternative methods when establishing an opening balance for IUS. In contrast, one respondent believed prospective capitalization of IUS should be the only option because this would enhance consistency while also appropriately balancing the value and cost of the information in the financial statements.

[5] "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35."

A34. The Board recognizes the concerns raised by respondents and considered them during the development of the Statement. While the Board understands the importance of consistency and comparability in financial reporting, the Board believes users of federal financial statements often have different objectives and may not necessarily compare asset values among various reporting entities in the way that users of financial statements do in a commercial setting.

A35. The Board considered the fact that there may be component reporting entities (such as working capital funds that charge rates) for which the prospective treatment would be undesirable. The Board determined it would be best to provide optimum flexibility by providing for the option of deemed cost for IUS. Therefore, the Board agreed the Statement should allow for the alternative methods in establishing opening balances for IUS.

A36. The Statement requires the application of a particular alternative be consistent within each of the subcomponent reporting entities[6] prior to consolidation. In the event different alternative methods are applied by subcomponent reporting entities, the alternative method applied by each significant sub-component reporting entity should be disclosed. The Board believes the disclosure requirements regarding the different alternative methods for establishing opening balances for IUS, if applicable, will support sufficient analysis for users of federal financial statements.

A37. The Board believes a reporting entity should be allowed to choose among alternative methods in establishing an opening balance for IUS. Concerns regarding inconsistencies will resolve quickly due to the short useful life of IUS.

Other Areas

A38. Certain respondents requested clarifying language be added to expand upon the phrase "one or more line items addressed by this Statement," to define line items as being line items on the financial statements or line items within the note disclosures. The Board acknowledges the term line item is quite broad, especially in relation to general PP&E. The preparer can use judgment to decide upon the line items to present either on the face of a financial statement or in related disclosures. Therefore, the Board believes line items may be based on a class of general PP&E, such as those currently included in the required disclosures, or on other reasonable means of disaggregation on the face of the statement or in the notes.

A39. A respondent asked for clarification whether the standards apply to the government-wide reporting entity. It is the intention of the Board that all standards apply to any entity—component or government-wide unless otherwise stated. SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, states that SFFASs "apply to all federal entities, that is, to the Government as a whole and to component entities … unless provision is made for different accounting treatment in a

[6] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

current or subsequent SFFAS." Because this Statement applies to first-time adopters as well as entities making an unreserved assertion for the first time, this Statement is applicable to the government-wide reporting entity for purposes of consolidating component reporting entities at any time.

A40. Several respondents provided comments regarding "*in-service dates*," questioning whether the in-service dates for material improvements are the same as the base unit and if reporting entities should disregard the in-service dates for material improvements. The Board notes the Statement is permissive. Material improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service, but this treatment is not required.

ALTERNATIVE VALUATION METHOD AND IMPLEMENTATION GUIDANCE

A41. During deliberation on the project, the Board considered the recently-approved SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.* SFFAS 48 permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. Deemed cost, or the amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances, was the alternative valuation method for valuation of opening balances (in accordance with SFFAS 3, *Accounting for Inventory and Related Property,* as amended by SFFAS 48).

A42. The Board based part of its decision to select deemed cost in SFFAS 48 on International Public Sector Accounting Standard (IPSAS) 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board reached several relevant conclusions in IPSAS 33:

a. Use of deemed cost facilitates the introduction of IPSASs in a cost-effective way.
b. Multiple options for deemed cost are appropriate.
c. The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.
d. Use of deemed cost does not affect fair presentation.

A43. Consistent with the decisions in SFFAS 48, the Board believes a similar approach is appropriate with this project. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for general PP&E. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 6, as amended, where historical records and systems do not support such balances.

A44. The Board determined permitting a reporting entity to apply alternative methods in establishing opening balances for general PP&E would be most appropriate through implementation guidance. The implementation guidance for general PP&E currently resides in several Statements. Accordingly, this Statement amends SFFAS 6, SFFAS 10, and SFFAS 23, and rescinds SFFAS 35 by providing implementation guidance to allow a reporting entity, under specific conditions, to apply alternative methods in establishing opening balances for general PP&E. Further, based on these amendments and

rescission, all implementation guidance for general PP&E, with the exception of specific provisions applicable to IUS, will be in SFFAS 6. The Board believes providing implementation guidance for all general PP&E in SFFAS 6 will provide a more inclusive approach and a comprehensive guide for users versus reviewing multiple Statements that relate to this topic.

AMENDMENTS TO STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS

Amendments to SFFAS 6, Accounting for Property, Plant, and Equipment

A45. This Statement amends SFFAS 6 implementation guidance to include alternative methods for establishing opening balances. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for general PP&E for the reporting period in which the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The presentation of line items may vary in detail. For example, components of general PP&E, such as land, may be a separate line item, or there may be a single line item for all general PP&E. Further, a reporting entity may determine it would like to make an unreserved assertion on classes of general PP&E disclosed in the notes to the financial statements.

A46. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 6, where historical records and systems do not support such balances. Accordingly, this Statement provides flexibility by permitting use of several measurement attributes and estimates. Deemed costs should be based on one, or a combination, of the following valuation methods: replacement cost, estimated historical cost, reasonable estimates, or fair value. The Board believes application of deemed cost is the most cost-effective option.

Plant Replacement Value (PRV)

A47. DoD currently estimates plant replacement value (PRV), which is based on cost factors such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. PRV is inclusive of capital improvements. While PRV has not been used for financial reporting purposes, DoD officials have stated it is used for decision making and management purposes. This Statement allows for PRV to be used as a starting point in establishing replacement cost for real property.

A48. SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 47, explains there may be several ways of arriving at an estimate of replacement cost:

> Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an

approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

A49. Although the PRV can be used as a starting point in establishing replacement cost for real property, adjustments would be needed. Further, the preparer would need to substantiate the PRV data used.

Government Property in the Hands of Contactors

A50. Government property in the hands of contactors has been a challenging area for reporting entities. This may include government-furnished equipment and contractor-acquired equipment. Previous Boards believed the accounting treatment for such assets should be consistent with that of other assets because there is no conceptual difference. Further, most would agree there should be accountability over government-owned assets in the hands of others.

A51. SFFAS 6, paragraph 18 provides that PP&E includes “property owned by the reporting entity in the hands of others (for example, state and local governments, colleges and universities, or Federal contractors)” and paragraph 34 (along with the footnote to paragraph 34) elaborates that PP&E should be recognized when title passes or is delivered to the acquiring entity or to an agent of the entity. For PP&E acquired by a contractor on behalf of the entity (for example, the entity will ultimately hold title to the PP&E), PP&E should also be recognized upon delivery, or constructive delivery, whether to the contractor for use in performing contract services or to the entity.

A52. During the due process deliberation of SFFAS 23 in 2003, this issue also surfaced. A respondent, unaware of existing standards, encouraged the Board to develop standards that address this type of property because the respondent believed that “accounting control over this property is deplorable.” As discussed in the Basis for Conclusions to SFFAS 23, the previous Board found that “despite the existence of standards for contractor held assets since late 1995, little progress has been made in resolving the issue. The Board does not believe that deferral of standards related to vast amounts of PP&E will facilitate resolution of the contractual and administrative details needed to reasonably comply with generally accepted accounting principles.”

A53. The Board understands that certain reporting entities may have long-standing contracts lacking the contractual terms and systems needed to accumulate the necessary information. The alternative valuation method—deemed cost—is applicable to general PP&E in the hands of others. The Board considered other alternatives, including those proposed by DoD, to mitigate the cost of properly reporting such PP&E. DoD’s proposal intended to take a prospective approach for establishing completeness and accountability for government property in the hands of contactors. Much of DoD’s

rationale was based on the belief that government property in the hands of contactors is immaterial and that the equipment has a short useful life. However, existing data have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. DoD also based the proposal on the fact that they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. DoD has other accountability obligations and a management need for complete records to support decision making.[7]

A54. The Board concluded that the current DoD process of including improved contract clauses in new or modified contracts should continue. As existing contracts expire or are modified, this issue should be resolved. Based on preliminary estimated information presented by DoD, 77% of the current contracts expire in 2016 and 12% expire in 2017. Hence, assuming that these estimates are reasonably accurate, processes would be in place to capture government property in the hands of contactors by 2018 through issuance of new contracts with required clauses. Considering that much of the information and data indicates the contracts for government property in the hands of contactors will expire soon and the assets may be immaterial or fully depreciated, with time, DoD may be in a position to support that this line item is not materially misstated. This supports that accounting treatment for government property in the hands of contactors should continue to be consistent with general PP&E.

A55. The Board conducted outreach on this topic prior to issuing the ED. Feedback from the audit community conveyed that the issues DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to DoD's proposal, there were noted audit challenges due to gray areas, such as no established cut-off date, the need for clarity with definitions, and complexities with implementation. In addition, there were noted existence and completeness challenges. There was also a belief that challenges will remain until the necessary contractual improvements are fully implemented.

Combination of Methods Permitted

A56. The Board recognizes that large and complex reporting entities, such as DoD, may have used a variety of valuation methods prior to the adoption of a GAAP-compliant method. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6 at different times prior to establishing opening balances. Deemed cost should be based on one, or a combination, of the accepted valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

A57. The purpose of this Statement is to provide alternative methods for reporting entities meeting the scope conditions set forth in paragraph 6 of this Statement. Absent a reliable record of transactions related to hundreds of thousands of records and related assets,

[7] In a May 13, 2014, statement to the U. S. Senate Committee on Homeland Security and Governmental Affairs, then DoD Comptroller Robert Hale acknowledged the importance of completeness when he explained, "Our audit strategy focuses first on the elements of our business that most often influence our decision making—namely budgetary dollars and the existence and completeness of property records."

this is the most cost-effective approach for determining opening balances while reporting entities, such as DoD, finalize a sound GAAP-compliant financial management system. All activity after the opening balances for general PP&E are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

Amendments to SFFAS 10, Accounting for Internal Use Software

A58. SFFAS 10 provides accounting standards for IUS used by federal entities. Previously, IUS had been addressed in SFFAS 6. Because certain questions remained, the Board decided to review the issues and to develop a separate Statement.

A59. IUS addressed by SFFAS 10 includes purchased commercial "off-the-shelf" software, contractor-developed software, and internally-developed software. Under the provisions of SFFAS 10, IUS is classified as general PP&E as defined in SFFAS 6. With the issuance of SFFAS 10, the section on IUS in SFFAS 6 was rescinded. SFFAS 10 provided guidance regarding the definition of IUS, the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, as well as other guidance.

A60. When SFFAS 10 was issued, the previous Board in effect provided for prospective implementation of SFFAS 10 in paragraph 36 by stating that "cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred."

A61. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains that some entities have not had or do not have systems that can provide the information necessary; therefore, the conditions remain that existed when many of these standards were issued. The Board considered certain unique aspects to this category of general PP&E that justify a similar treatment that was provided when SFFAS 10 was established. Specifically, the Board believes it would be cost-beneficial to allow prospective treatment of IUS because it typically has a shorter useful life than other assets and is a soft asset that is harder to inventory when compared to tangible assets. These facts make the cost of implementation higher than for other general PP&E and the benefit lower due to the shorter time the IUS would be reported as an asset for amortization.

A62. Therefore, the Board believes the most appropriate path is to amend the implementation guidance provided in SFFAS 10 to provide for prospective application of IUS if the reporting entity elects to do so. Considering the various stages of implementation within reporting entities, the Board determined this Statement should provide flexibility. Therefore, the guidance also provides for an alternative valuation method consistent with general PP&E. Considering IUS is classified as general PP&E, the Board believes it is appropriate to allow use of deemed cost and to refer users to the deemed cost implementation guidance in SFFAS 6. Together, these amendments allow the preparer to elect:

a. to establish opening balances for existing IUS based on deemed cost,

b. to establish an opening balance of zero and to capitalize costs consistent with SFFAS 10 prospectively, or

c. to establish an opening balance of zero for IUS in service, and to establish an opening balance for IUS in development based on deemed cost, and to capitalize costs consistent with SFFAS 10 prospectively.

A63. Based on the flexibility offered for establishing opening balances for IUS, a larger reporting entity may establish an opening balance for IUS based on a combination of multiple component reporting entities' alternative methods, which may or may not be the same. Therefore, a larger reporting entity may have multiple component reporting entities[8] that selected different alternative methods. This is permitted by the Statement; a larger reporting entity may establish an opening balance based on a combination of alternative methods. Application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger reporting entity.

Amendments to SFFAS 23, Eliminating the Category National Defense Property, Plant, and Equipment

A64. The purpose of SFFAS 23 was to amend specific standards with regard to national defense (ND) PP&E. More specifically, SFFAS 23 rescinded the term "ND PP&E."

A65. SFFAS 23 also provided implementation guidance for assets reclassified as general PP&E. Much of that guidance referred to the requirements in the implementation guidance provided in SFFAS 6. SFFAS 23 was effective for periods beginning after September 30, 2002, with earlier implementation encouraged. The Board believes it appropriate to rescind the implementation guidance in SFFAS 23 and to refer users to the implementation guidance in SFFAS 6 that applies to all general PP&E, including general PP&E assets previously considered ND PP&E.

A66. By rescinding the paragraphs in SFFAS 23, the Board ensured the appropriate relevant guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board chose not to rescind SFFAS 23 in its entirety because the standards provide other amendments, such as rescinding the term ND PP&E as discussed above, which must be maintained.

[8] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Rescission of SFFAS 35, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23

A67. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data's historical cost may be used to value general PP&E. It was to establish a cost-effective method to comply with SFFAS 6 by allowing reasonable estimates determined in accordance with SFFAS 6, as amended. While rescinding SFFAS 35 in its entirety, the Board ensured any pertinent guidance was included in the amendments to the SFFAS 6 implementation guidance.

A68. The Board also reiterates the conclusions of the previous Board. As explained in SFFAS 35, Basis for Conclusions, paragraph A12:

> The Board stresses to federal entities that the measurement basis for G-PP&E remains historical cost; however, reasonable estimates are allowed. The Board believes entities should use judgment regarding the decision to use estimated historical cost in lieu of original transaction based data. The Board also notes that estimates are widely used throughout the financial statements. In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.

A69. When SFFAS 35 was issued, the Board believed that allowing or encouraging estimates as reporting entities worked towards implementing systems and processes that could capture historical data would be beneficial. However, it appears this has not occurred at all departments, and there has been an overreliance that was unintended. The language in SFFAS 35 has often been misinterpreted to mean something other than reasonable estimates is in accordance with SFFAS 6.

A70. Therefore, the Board believes it is appropriate to rescind SFFAS 35. The Board acknowledges that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35. As noted in paragraph A17 of SFFAS 35, "estimates that do not lead to material misstatements are acceptable without guidance from the Board."

A71. Prior to the issuance of the ED, DoD raised concerns with the Board's proposal to rescind SFFAS 35 based on the time it would take for DoD to become full cost compliant. DoD requested the Board consider retaining SFFAS 35 or providing transitional guidance in this area. The Board believes current standards provide flexibility and there are resources other than SFFAS 35 within the GAAP hierarchy to assist in this area. For example, there is guidance (Technical Releases) to assist in accumulating, allocating, and reporting the cost of general PP&E when there is no detailed cost accounting system.

A72. Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the general PP&E lifecycle, as well as decisions regarding the granularity of cost information and acceptable methods for recognizing those costs. This implementation guidance is not dependent on SFFAS 35 and remains applicable even if SFFAS 35 is rescinded.

A73. Additionally, SFFAS 4 established a requirement for cost accounting that acknowledges the use of cost finding techniques. The requirement is:

> Each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

A74. Management has discretion in applying the cost assignment methods identified in SFFAS 4, *Managerial Cost Accounting Standards and Concepts* to accumulate acquisition costs. Of particular importance is the emphasis on economic feasibility with regard to direct tracing of costs to outputs. SFFAS 4, paragraph 124, provides that "[in] principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

a. Directly tracing costs wherever economically feasible;
b. Assigning costs on a cause-and-effect basis; and
c. Allocating costs on a reasonable and consistent basis."

DISCLOSURES

A75. The disclosures required for component reporting entities and the government-wide reporting entity are also included in the amendments to the implementation guidance in SFFAS 6 and 10. Specifically, the election to apply the provisions of this Statement should be disclosed in the financial statements in the first reporting period in which the component reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The first reporting period would be the first year-end financial statement that an unreserved assertion is made. The Board does not believe the first reporting period should be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures.

A76. The Board notes that the term “unreserved assertion” may be used in other contexts. For example, certain entities’ management (such as DoD) may be required to make management assertions regarding their financial information and that their financial statements are validated as ready for audit by no later than September 30, 2017. This Statement refers to an unreserved assertion that the reporting entity’s “financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.” Other assertions—such as being ready for an audit—may or may not accompany such an assertion.

A77. The component reporting entity disclosures (in the amendments to SFFAS 6) address both component reporting entities that may have elected to only apply deemed cost in establishing the opening balances for general PP&E as well as component reporting entities that elected to apply the provision to exclude land and land rights from opening balances. For those component reporting entities only applying deemed cost, the component reporting entity should disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is

required. This disclosure need not be repeated unless the financial statements or, as applicable, reports on line items are presented for comparative purposes.

A78. A component reporting entity electing to exclude land and land rights should disclose this fact and describe the alternative method used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP and continue to be so as long as an amount is not reported on the balance sheet. In addition, those reporting entities electing to exclude land and land rights from its general PP&E opening balances must also disclose, with a note reference on the balance sheet, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. The Board believes requiring these disclosures would meet accountability requirements and ensure appropriate measures continue to be taken for existence and completeness requirements. As discussed above, the Board determined that a larger component reporting entity may establish an opening balance for land and land rights based on a combination of multiple subcomponent reporting entities' alternative methods, which may or may not be the same. However, application of a particular alternative method must be consistent within each subcomponent reporting entity prior to its consolidation into a larger component reporting entity.

A79. The component reporting entity disclosures (in the amendments to SFFAS 10) address that component reporting entities may have elected to apply different alternative methods in establishing the opening balance of internal use software. This Statement provides for an alternative valuation method of deemed cost that is consistent with general PP&E and prospective capitalization of IUS. A component reporting entity electing to apply the alternative methods should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternative methods are applied by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

A80. Further, the government-wide reporting entity should disclose when a component reporting entity elects to apply deemed cost along with a reference to the component reporting entity's financial report. In addition, when a component reporting entity elects to exclude land and land rights, this also should be disclosed, along with an explanation of the election, the number of acres with a reference to the component reporting entity's financial report. The government-wide reporting entity should disclose when a component reporting entity elects to apply deemed cost in establishing opening balances for internal use software. In addition, when a component reporting entity elects to apply prospective capitalization, an explanation of the election and reference to the component reporting entity's financial report should be disclosed.

APPLICATION OF THIS STATEMENT

A81. A component reporting entity in the process of implementing systems that are GAAP-compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A82. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP-compliant systems; this allows them to assert independently of the larger DoD. It is anticipated DoD will make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be the DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements, or one or more line items, addressed by this Statement.

A83. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election because it may only be made once. A complex entity should work with its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities should ensure issues, such as supporting documentation for opening balances, are addressed and validated through sampling or other means, including consideration of any audit findings or conclusion affecting the reliability of the valuation, prior to making the unreserved assertion. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation in all material respects. If the audit for fiscal year 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to continue in subsequent years to correct or to support the valuation as of the beginning of fiscal year 2018.

A84. Reporting entities that meet the conditions specified in paragraph 6 and elect to apply the alternative methods in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Specifically, paragraph 12 of SFFAS 21 states, "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards."

A85. Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13.a. – 13.c. for all changes in accounting principles:

(a) The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
(b) Prior period financial statements presented for comparative purposes should be presented as previously reported.
(c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure.

A86. SFFAS 21 provides that the adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and explain that opening balances of a particular line item or group of line items were valued at deemed cost under this Statement, then briefly describe deemed cost and indicate the effect of adoption on beginning net position.

A87. In addition, the alternative methods provided in this Statement should also be applied in correcting subsequently discovered errors in general PP&E that was valued under an alternative method.

BOARD APPROVAL

A88. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_50.pdf.

APPENDIX B: ABBREVIATIONS

DoD	Department of Defense
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IUS	Internal Use Software
ND	National Defense
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
PRV	Plant Replacement Value
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Deemed Cost—Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

Fair Value—Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Opening Balances—Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[9]

Replacement Cost—Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life.

Unreserved Assertion—An unreserved assertion is an unconditional statement.

[9] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

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FASAB Board Members

D. Scott Showalter, Chairman

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Christina Ho

Sam M. McCall

Mark Reger

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Melissa L. Batchelor

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814

Mail Stop 6H19

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov

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Federal Accounting Standards Advisory Board

INSURANCE PROGRAMS

Statement of Federal Financial Accounting Standards 51

January 18, 2017

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement establishes accounting and financial reporting standards for insurance programs. It provides standards to ensure that insurance programs are adequately defined and report consistent information about the liabilities for losses incurred and claimed as well as expected losses during remaining coverage. These standards replace the insurance and guarantee program standards provided in paragraphs 97-121 of Statement of Federal Financial Accounting Standards 5, *Accounting for Liabilities of The Federal Government.*

To support consistency, this Statement identifies three categories: 1) exchange transaction insurance programs other than life insurance, 2) nonexchange transaction insurance programs, and 3) life insurance programs. Insurance programs are categorized based upon the type of revenue received as defined by Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

This Statement provides guidance as to how and when insurance programs should recognize revenue, expenses, and liabilities according to the aforementioned categories. The recognition, measurement, and disclosure guidance provides for concise, meaningful, and transparent information regarding the operating performance of insurance programs.

Insurance Programs is the first phase in a multiple phase project entitled *Risk Assumed.* Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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TABLE OF CONTENTS

Summary 1

Standards 3

- **Scope** 3
- **Definitions** 4
- **Exchange transaction insurance programs other than life insurance** 7
- **Nonexchange transaction insurance programs** 11
- **Life Insurance Programs** 13
- **Disclosures Applicable to the Consolidated Financial Report of the U.S. Government** 17
- **Effective Date** 17

Appendix A: Basis for Conclusions 18

- **Project history** 18
- **Summary of outreach efforts and responses:** 19
- **Key areas of improvement** 20

Appendix B: Abbreviations 30

Appendix C: Glossary 31

This is the original Standard file; please check for the most recent update in the FASAB Handbook at
http://files.fasab.gov/pdffiles/handbook_sffas_51.pdf

STANDARDS

SCOPE

1. This Statement applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement provides general principles that should guide preparers of GPFFRs in accounting for and reporting on exchange and nonexchange insurance transactions, related claims and liabilities, losses, and costs of insurance programs. Other items related to insurance program activities such as revenue classification that are not addressed in this Statement should be reported in accordance with other standards.

3. This Statement rescinds the Insurance and Guarantees section in SFFAS 5, *Accounting for Liabilities of The Federal Government,* paragraphs 97-121.

4. This Statement establishes three categories of insurance and related guidance: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs. In addition, there is a section providing government-wide disclosure requirements.

DEFINITIONS

Definitions in paragraphs 5 through 21 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

5. **Insurance Program**—"insurance program" is a general term used to refer to a program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

6. The following are excluded from insurance programs:

    a. Programs that administer direct loans and loan guarantees[1]

    b. Programs that qualify as social insurance[2]

    c. Programs authorized to engage in disaster relief activities[3]

    d. Programs that provide grants

    e. Programs that provide benefits or assistance based on an individual's or a household's income and/or assets

    f. Programs that assume the risk of loss arising from federal government operations[4]

    g. Programs that pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency[5]

    h. Programs that indemnify contractors, agreement partners, and other third parties for loss or damage incurred while or caused by work performed for a federal agency[6]

    i. Workers' or occupational illness compensation programs that compensate current or former employees (or survivors) and certain third parties for injuries and occupational diseases obtained while working for a federal agency

[1] SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*

[2] SFFAS 17, *Accounting for Social Insurance (*including unemployment insurance)

[3] The Robert T. Stafford Disaster Relief and Emergency Assistance Act (Public Law 100-707), commonly referred to as the Stafford Act, is the act that authorizes and regulates disaster relief programs.

[4] For example, see Government Accountability Office (GAO)-05-265R, *Catalogue of Federal Insurance Activities, Enclosure IV: Description of Accounts With Federal Self-Insurance Activity*

[5] An example may include an administrative settlement or tort claim resulting from military events.

[6] These are administrative settlements for transactions with contractors under the Federal Acquisition Regulation's authorized indemnification clauses, as well as authorized indemnification clauses within other legally binding arrangements. First responders within programs that do not have a statutory insurance or guarantee mission are also within this scope.

7. **Adverse Event**—an "adverse event" may be a single-occurring event or a series of events that cause losses to the beneficiary or beneficiaries as identified in the insurance arrangement.

8. **Cash Surrender Value**—the "cash surrender value" is the sum of money that will be returned to the policyholder on a life insurance policy if the policy is canceled before its maturity or the insured event (death) occurs.

9. **Claim Adjustment Expenses (CAE)**—"claim adjustment expenses" (CAE) are incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

10. **Arrangement Period**—"arrangement period" is the period over which adverse events that occur are covered.

11. **Exchange Transaction Insurance Programs Other Than Life Insurance**—"exchange transaction insurance programs other than life insurance" cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions with the federal government as defined in SFFAS 7.[7]

12. **In-Force**—"in-force" refers to arrangements that are unexpired as of a given date.

13. **Incurred But Not Reported (IBNR)**—claims "incurred but not reported" (IBNR) are estimated claims from events that have occurred as of the end of the reporting period but have not yet been reported for settlement.

14. **Insurance Claim**—an "insurance claim" is a formal request for payment for losses as authorized under the insurance arrangement.

15. **Insurance Arrangement (Arrangement)**—an "insurance arrangement" (arrangement) is a general term used for a contract or other agreement between an insurance program and specific parties, such as but not limited to individuals, state, local, or foreign governments, other federal agencies, or businesses. An arrangement may include and/or identify:

    a. the term the insurance arrangement is in-force,

    b. the insurance program's responsibilities,

    c. the risk assumed by the insurance program, such as:

        i. all risk for covered losses,

        ii. partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance,

[7] SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

iii. a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid, or

iv. risks shared with a third party.

d. the adverse event,

e. the insured party or parties and their premium requirements,

f. the beneficiary or beneficiaries and their responsibilities for filing claims, and/or

g. the financial compensation.

16. **Insurance Portfolio**—an "insurance portfolio" is a grouping of insurance programs or arrangements that have some meaningful relationship based on arrangement period/duration, shared risks, management, customers, geographic regions, or other factors.

17. **Liability for Losses on Remaining Coverage**—the "liability for losses on remaining coverage" is an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open arrangement period.

18. **Life Insurance Programs**—"life insurance programs" cover the risk of loss from death of individuals.

19. **Nonexchange Transaction Insurance Programs**—"nonexchange transaction insurance programs" cover the risk of loss from adverse events through nonexchange transactions, as defined in SFFAS 7.

20. **Premiums**— "premiums" is a general term used to refer to exchange revenue[8] billed by insurance programs. Programs may refer to their exchange revenue by various terms, including but not limited to premiums, assessments, and/or fees.

21. **Recoveries**—"recoveries" include monies:

a. returned from another agency through an indemnification agreement,

b. returned from a third party or commercial insurance company to repay all or part of a loss originally paid for by the program,

c. recouped from the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or

d. received from adjustments made to previously paid insurance claims.

[8] See SFFAS 7, par. 33, for the exchange revenue definition and Appendix B: Guidance for the Classification of Transactions, par. 284, for the classification of exchange revenue insurance programs.

EXCHANGE TRANSACTION INSURANCE PROGRAMS OTHER THAN LIFE INSURANCE

22. Exchange transaction insurance programs other than life insurance collect premiums through arrangements to cover the risk of loss from adverse events other than death of individuals.

23. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

RECOGNITION AND MEASUREMENT

REVENUE AND LIABILITY FOR UNEARNED PREMIUMS

24. Premiums should be recognized as revenue when earned over the period of the arrangement in proportion to insurance protection provided.

25. A liability for unearned premiums should be recognized for the amount of premiums collected and/or due by the end of the reporting period that have not yet been earned in proportion to the insurance protection to be provided during the remaining arrangement period.

LIABILITY FOR UNPAID INSURANCE CLAIMS

26. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

27. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid

        ii. claims incurred but not reported (IBNR)

            (1) A single-occurring event or a series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[9]

            (2) Management should use judgment to determine if an adverse event causes claims IBNR prior to the reporting date.

[9] If a series of events causing loss begins prior to the reporting date and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for claims IBNR.

b. related estimated CAE, and

c. estimated inflows from recoveries not realized at the end of the reporting period.

i. If estimated recoveries exceed the related claims for an insurance portfolio then recognition is limited to the amount of the related claims.[10]

ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

28. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

29. Guidance from SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards,* applies to subsequent events relating to unpaid insurance claims.

LIABILITY FOR LOSSES ON REMAINING COVERAGE

30. The liability for losses on remaining coverage as of the end of the reporting period represents the estimated amounts to be paid to settle claims (including CAE) for the remaining open arrangement period in excess of the sum of both:

a. related unearned premiums as of the end of the reporting period and

b. premiums due after the end of the reporting period that relate to the remaining open arrangement period.

31. Estimates should be determined by considering insurance portfolios rather than individual arrangements.

32. The liability should be estimated using methods designed to address uncertainties concerning future events.

33. The objective of such methods is a reasonable estimate of expected cash flow. While there are various ways to determine expected cash flow, methods using Actuarial Standards of Practice[11] are generally appropriate.

34. No specific method is required. An entity must use judgment based on the risk inherent in the insurance portfolio, sensitivity to external factors, and the availability of relevant information to select a method. A reporting entity should consider all relevant information at the balance sheet date. This information may include:

[10] Any amount expected to be recovered in excess of the recognized claim, which will result in a gain, should not be recognized until any contingencies relating to the recovery have been resolved because a contingent gain cannot be recognized until realized.

[11] See http://www.actuarialstandardsboard.org/standards-of-practice/ (last accessed October 18, 2016).

a. historical experience;

b. adjustments to historical experience for differences in current conditions;

c. current conditions;

d. trends;

e. assumptions about future events;

f. risk factors;

g. uncertainties about possible variations in the amount or timing of the potential settlement of claims; and

h. as appropriate, data, projections, and supporting analysis supplied by independent expert(s).

35. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to losses on remaining coverage should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.

36. If the effect of the time value of money is significant, for example, when settlement may occur over several years, then the estimated settlement amount should be discounted. (See SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates,* par. 28-32 for guidance on selecting discount rates.)

37. Adjustments to the liability for losses on remaining coverage should be recognized as a component of claims expense.

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

38. Materiality is an overarching consideration in financial reporting for information that should be presented regarding exchange transaction insurance programs other than life insurance. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

39. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR, such as the Debt Note to the Financial Statements.

Disclosures Applicable to Component Entity Reports

40. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program

    b. Full costs,[12] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

    c. Investing activities, such as buying treasury securities

    d. Arrangement duration and renewal characteristics, such as non-cancelable or guaranteed renewals

    e. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums and any requirements to set premium prices that do not cover the full estimated cost to settle claims

    f. The nature and magnitude of uncertainty of estimated amounts to be paid to settle future claims, including:

        i. the basis and estimation method

        ii. significant risk assumptions and factors, including relevant trend information

        iii. how much risk, if any, is shared by third parties

    g. The total amount of coverage provided through insurance in-force as of the end of the reporting period[13]

    h. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

41. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

[12] See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

[13] An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

b. Claims expense

c. CAE[14]

d. Payments to settle claims

e. Recoveries and other adjustments

f. Ending balance

NONEXCHANGE TRANSACTION INSURANCE PROGRAMS

42. Nonexchange insurance programs collect funds on demand and/or receive appropriations to cover the risk of loss from certain adverse events.

43. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

RECOGNITION AND MEASUREMENT

REVENUE

44. Nonexchange transaction insurance programs should apply general revenue recognition standards as found in SFFAS 7 (as amended).

LIABILITY FOR UNPAID INSURANCE CLAIMS

45. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

46. The estimated settlement amount includes:

a. outflows to liquidate:

i. claims that have been reported but not paid

ii. claims IBNR

(1) A series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[15]

[14] Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

(2) Management should use judgment to determine if an adverse event causes claims IBNR prior to the reporting date.

b. related estimated CAE, and

c. estimated inflows from recoveries not realized at the end of the reporting period.

i. If estimated recoveries exceed the related claims for a specific portfolio then recognition is limited to the amount of the related claims.[16]

ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

47. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

48. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

49. Materiality is an overarching consideration in financial reporting for information that should be presented regarding nonexchange transaction insurance programs. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

50. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

[15] If a series of events causing loss begins prior to the reporting date and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for claims IBNR.

[16] Any amount expected to be recovered in excess of the recognized claim which will result in a gain should not be recognized until any contingencies relating to the recovery have been resolved; a contingent gain cannot be recognized until realized.

Disclosures Applicable to Component Reporting Entities

51. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program

    b. Full costs,[17] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

    c. Investing activities, such as buying treasury securities

    d. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

52. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

    b. Claims expenses

    c. CAE[18]

    d. Payments to settle claims

    e. Recoveries and other adjustments

    f. Ending balance

LIFE INSURANCE PROGRAMS

53. Life insurance programs collect premiums for life insurance arrangements to cover the risk of loss from death of individuals.

RECOGNITION AND MEASUREMENT

REVENUE

[17] See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, paragraphs 80 -104.

[18] Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

54. Premiums should be recognized as revenue when due from policyholders.

LIABILITY FOR UNPAID INSURANCE CLAIMS

55. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

56. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid

        ii. claims IBNR

    b. related estimated CAE, and

    c. estimated inflows from recoveries, such as monies recovered from improper payments, not realized at the end of the reporting period.

        i. If estimated recoveries exceed the related claims for a group of arrangements then recognition is limited to the amount of the related claims.[19]

        ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

57. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.

58. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

LIABILITY FOR FUTURE POLICY BENEFITS

59. The liability for future policy benefits represents the expected present value of future claims to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders.

60. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to the liability for future policy benefits should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.

[19] Any amount expected to be recovered in excess of the recognized claim which will result in a gain should not be recognized until any contingencies relating to the recovery have been resolved; a contingent gain cannot be recognized until realized.

61. Estimates should be determined by considering insurance portfolios rather than individual arrangements.

62. The liability is estimated using appropriate financial and/or actuarial methods that include assumptions, such as estimates of expected investment yield, mortality, morbidity, terminations, and expenses. (For more information, see SFFAS 33.)

63. Changes in the liability for future policy benefits that result from periodic re-estimations should be recognized as an expense during the period in which the changes occur.

64. The effects of changes in relevant law or policy should be recognized when those changes occur.

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

65. Materiality is an overarching consideration in financial reporting for information that should be presented regarding life insurance programs. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

66. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

67. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:

    a. The type of life insurance and specific characteristics of those products, such as when and how benefits are paid and what other government agencies or commercial insurance programs administer and/or assume risk for any part of the program

    b. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums and requirements to set premium prices that do not cover the full estimated cost to settle claims

c. Full costs,[20] premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

d. Investing activities, such as buying treasury securities

e. The nature and magnitude of uncertainty to estimate the amounts to be paid to settle future claims, including the basis and estimation method

   i. Significant risk assumptions and factors, including relevant trend information

   ii. How much risk, if any, is shared by third parties

f. The total value of life insurance policies issued—insurance in-force—at the end of the reporting period, which represents the maximum risk exposure[21]

g. The net cash surrender value of policies at the end of the reporting period, including appropriate information to aid in avoiding the misleading inference that there is a more than remote likelihood that 100% of all policies will cancel at the end of the reporting period

h. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

68. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

a. Beginning balance

b. Claims expenses

c. CAE[22]

d. Payments to settle claims

e. Recoveries and other adjustments

f. Ending balance

[20] See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

[21] An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

[22] Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

DISCLOSURES APPLICABLE TO THE CONSOLIDATED FINANCIAL REPORT OF THE U.S. GOVERNMENT

69. The CFR should disclose the following information:[23]

    a. A broad description of insurance programs

    b. A general reference to relevant component reporting entity reports[24]

    c. The balance for insurance program liabilities

    d. A narrative discussion of programs' ability or inability to repay any borrowing

    e. The total amount of coverage provided through insurance in-force as of the end of the reporting period[25]

EFFECTIVE DATE

70. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018.

The provisions of this Statement need not be applied to immaterial items.

[23] Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statements."

[24] The term "component reporting entity" is used to distinguish between the U.S. federal government and its components. The U.S. federal government is composed of organizations that manage resources and are responsible for operations. These include major departments and independent agencies, which are generally divided into sub organizations, for example, smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations.

[25] Include an explanation about the insurance in-force amount that avoids the misleading inference that there is more than a remote likelihood that claims equal to this maximum risk exposure will be paid at the same time.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at
http://files.fasab.gov/pdffiles/handbook_sffas_51.pdf

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors. The guidance enunciated in the Statement—not the material in this appendix—should govern the accounting for specific transactions, events or conditions.

PROJECT HISTORY

A1. The Federal Accounting Standards Advisory Board (FASAB or "the Board") undertook a project to improve the accounting and reporting of all significant risks assumed by the Federal Government. Due to the breadth of the *Risk Assumed* project, the Board decided to break it into multiple phases. These standards address the first phase – *Insurance Programs.* Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.

A2. FASAB undertook insurance programs as phase I of the *Risk Assumed* project because while paragraphs 97-121 in SFFAS 5 include a requirement to report risk assumed for insurance programs, the resulting information as reported by various agencies is not comparable. Further review found that it is challenging to determine the operational results and financial position of insurance programs.

A3. In addition, the Board's conceptual framework now provides a definition of liability and describes measurement attributes that were not available when FASAB developed SFFAS 5. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, defines liability as "a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording,* defines attributes of elements that may be measured. This Statement adopts the most current concepts so that the accounting principles for insurance liabilities provide comprehensive guidance for consistent reporting.

A4. Project goals are to:

a. define federal insurance programs and related terms,

b. ensure consistent reporting for all insurance programs implemented by the federal government,

c. address measuring uncertainty regarding estimating losses on open arrangements as of the end of the reporting period,

d. ensure disclosures address uncertainties and risk factors, and

e. provide for reporting on significant risks assumed in order to meet the stewardship and operating performance objectives of federal financial reporting.

A5. The Board formed a task force to assist in developing the proposed standards for insurance programs. Task force members included accounting, budget, and insurance subject matter experts from federal agencies and independent public accounting firms.

A6. The task force met several times over the course of the project, delivered an education session to the Board, and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the proposed standards and this Statement.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES:

A7. FASAB issued the ED, titled *Insurance Programs*, on December 30, 2015, with comments requested by March 30, 2016.

A8. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A9. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Agriculture Committee
b. House Appropriations Committee
    i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
    ii. Subcommittee on Oversight and Government Reform
    iii. Subcommittee on Homeland Security
c. House Budget Committee
d. House Committee on Veterans' Affairs
e. House Committee on Homeland Security—Subcommittee on Emergency Preparedness, Response, and Communications, Majority
f. House Committee on Financial Services
g. Senate Agriculture Committee
h. Senate Appropriations Committee
    i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
    ii. Subcommittee on Homeland Security
i. Senate Committee on Banking, Housing, and Urban Affairs—Subcommittee on Securities, Insurance, and Investment
j. Senate Budget Committee
k. Senate Committee on Finance
l. Senate Committee on Health, Education, Labor & Pensions

m. Senate Committee on Homeland Security and Governmental Affairs
n. Senate Committee on Veterans' Affairs

A10. FASAB received 18 responses from preparers, auditors, professional associations, and citizens. The majority of respondents agreed with proposals for new definitions and exclusions; they also agreed with the three categories: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs for reporting insurance programs.

A11. However, the auditors and accounting associations disagreed with the proposals for how to estimate the settlement of future claims for the liability for losses on remaining coverage.

A12. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A13. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized in the following section.

KEY AREAS OF IMPROVEMENT

A14. SFFAS 5 resulted in inconsistent reporting among insurance programs due to the absence of definitions and use of terms like possible loss, probable future events, measurable, and uncertainty. The Board considered existing concepts and standards for similar circumstances such as loan guarantees to identify options for improvement. The Board also considered task force testimony that insured events are often hard to project due to their high impact yet low probability nature and the lack of available data to predict them. As a result, the Board determined that current reporting could be improved through:

a. definitions of relevant terms,
b. clarity for what programs are excluded,
c. guidance for revenue recognition and unearned premiums,
d. consistent recognition of liabilities including future loss estimates, and
e. structured disclosure requirements.

Definitions of Relevant Terms and Excluded Activities

A15. During the initial phase of the project, the Board determined that definitions of relevant terms would be necessary for consistent reporting. Staff worked extensively with the task force to develop these definitions. The Board decided to use general terms to include all current insurance and future insurance programs in this Statement. The Board determined that the following provided the foundation for the definitions developed for this project.

a. Insurance Program—while most respondents did agree with the definition, programs that were not structured like commercial insurance programs with

actual contracts requested clarification. In addition, respondents found inclusion of the term “non-loan guarantee” in the definition confusing; this was subsequently removed. Therefore, the Board defined a federal insurance program by its fundamental nature. The substance—and not the name—of a program determines if it is an insurance program and therefore subject to these standards.

i. Exclusions—a number of respondents requested clarification on what activities were excluded from this Statement. One respondent requested that the Board expand upon the exclusion of entitlement programs to avoid excluding insurance programs that perform entitlement-like activities but are actually insurance programs.

ii. One respondent recommended including fiduciary funds, workers’ compensation programs, and programs established to pay claims on adverse events that occurred in the past.

iii. A number of respondents requested that the Board provide context to explain the exclusions in this proposed standard.

b. Therefore, the Board amended the wording of certain exclusions to aid in assessing the programs and activities that should be excluded.

c. Each of the activities and programs excluded involve risk and, therefore, share a characteristic of insurance programs. The Board concluded that judgment is required in applying the exclusions and that providing context may aid in making such judgments. The rationale for each exclusion is presented below:

i. Programs that administer direct loans and loan guarantees are excluded because standards for these programs are provided in SFFAS 2, *Accounting for Direct Loans and Loan Guarantees.*

ii. Programs that qualify as social insurance are excluded because standards for these programs are provided in SFFAS 17, *Accounting for Social Insurance (*including unemployment insurance).

iii. Programs authorized to engage in disaster relief activities are excluded because while benefits are based on losses from adverse events, coverage is available broadly to the population and benefits may not be as clearly defined as in insurance programs. These aspects make it more challenging to apply the recognition and measurement provisions of this Statement. Disaster relief activities will be addressed in a later phase of risk assumed.

iv. Programs that provide grants are excluded because while grants may be based on losses from adverse events, other criteria make it more challenging to apply the recognition and measurement provisions of this Statement.

v. Programs that provide benefits or financial assistance based on an individual's or a household's income and/or assets are excluded because

while an adverse event may be a cause of the income/asset criteria, it is the criteria that determine the benefits or assistance and not the event behind it.

vi. Programs that assume the risk of loss arising from federal government operations; workers' or occupational illness compensation programs; programs that pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency; and programs that indemnify contractors, arrangement partners, and other third parties for loss or damages incurred while or caused by work performed for a federal agency are excluded. The Board updated these exclusions by removing a reference to self-insurance and missions because these terms were unclear to respondents. The Board determined that the cost incurred for such activities and programs are part of the full cost of doing business. For example, a program with fleet vehicles that pays for damage from accidents out of funds designated as operation and maintenance would include such costs in the overall program cost.

d. Adverse Event—each insurance program is responsible for settling losses that result from specific adverse events. The Board learned through an education session with the Federal Crop Insurance Corp that an adverse event may be a single event or a series of events. Therefore, an adverse event has not occurred until all of the events in a series occur.

e. Insurance Arrangement—while most respondents agreed with the term "contract" some respondents noted that they do not have formal contracts and may then be excluded from this Statement. The task force provided information that exchange transaction insurance programs and life insurance programs engage in an explicit agreement or arrangement. The Board decided to change the term from "insurance contract" to "insurance arrangement" to capture the nature of the arrangement as defined by law or regulation. Therefore, the definition of an insurance arrangement includes the elements that insurance programs agree upon to provide settlement of losses to beneficiaries.

f. Insurance Portfolios—one respondent requested that the Board define insurance portfolios and refer to that term consistently throughout the Statement. The Board agreed and added a definition for insurance portfolios.

g. Insurance Program Categories—the Board determined that an insurance program will fit into one of three categories. Each category processes different types of transactions that settle losses from specific adverse events. The categories are as follows:

i. Exchange transaction insurance programs other than life insurance cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined by SFFAS 7.

ii. Nonexchange transaction insurance programs cover the risk of loss from adverse events through nonexchange transactions as defined by SFFAS 7.

iii. Life insurance programs cover the risk of loss from death of individuals.

h. A number of respondents requested additional information for better understanding of the exchange and nonexchange transaction categories other than life insurance. In particular, respondents wanted to know (1) how to determine if a program should be classified as a nonexchange transaction insurance program and (2) how to classify a program if it receives both exchange and nonexchange revenue.

i. The Board's intention for the exchange transaction insurance programs other than life insurance and nonexchange transaction insurance programs is to define these categories in relation to the revenue standards in SFFAS 7.

ii. Some respondents were confused by the Board's reference to only SFFAS 7 and not SFFAS 5 in defining these categories. SSFAS 7 and SFFAS 5 each define exchange transactions as occurring when "each party to the transaction sacrifices value and receives value in return."[26] The Board determined that classifying the programs based on the type of revenue received would be straightforward and that no other substantive difference would result.

iii. This Statement addresses revenue recognition that is unique to each category, but does not reiterate the revenue recognition standards. To address this, the Board added a general statement in the Scope section that refers the preparer to other standards when necessary.

iv. The Board notes that some insurance programs may be funded with both exchange and nonexchange revenue. The Board concluded that a program other than life insurance that receives any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

v. Nonexchange transaction insurance programs cover the risk of loss from adverse events through nonexchange transactions, such as collection of nonexchange revenue or use of appropriations. For example, some levy:

(1) excise taxes which, like other taxes, are determined by the government's power to compel payment and are classified by SFFAS 7, paragraph 243 as nonexchange revenue;

(2) surcharges which, like excise taxes, are determined by the government's power to compel mandatory recoupment of the federal share of pay for losses.

[26] See SFFAS 5, par. 22, and SFFAS 7, par. 33.

Revenue Recognition and Liability for Unearned Premiums

A16. Exchange transaction insurance programs other than life insurance recognize revenue in proportion to the insurance protection to be provided. Any revenue collected but not earned prior to the end of the reporting period is recognized as unearned premiums.

a. The following is an example of revenue that is earned evenly over a 12-month arrangement period because insurance protection is provided evenly during the arrangement period. The premium of $1,200 is collected on July 1. By September 30, three months have been covered earning the exchange program $300. The remaining $900 is unearned because the remaining arrangement period is still open into the next fiscal year: from October 1 through June 30. The $900 is recognized separately on the balance sheet as unearned premium.

b. The following is an example of revenue that is earned for three equivalent national rallies held during a 12-month arrangement period. The premium of $1,500 is collected on July 1. By September 30, two of the three rallies have occurred, earning the exchange program $1,000. The remaining $500 is unearned because the third rally is not scheduled until December 20, which is during the remaining arrangement period from October 1 through June 30. The $500 is recognized separately on the balance sheet as unearned premium.

A17. Nonexchange transaction insurance programs do not recognize unearned premiums because they do not earn premiums. The Board believes that insurance programs in this category should apply general revenue recognition standards. Therefore, no specific revenue recognition guidance is provided in this Statement

A18. Life insurance programs do not recognize unearned premiums. The Board concluded that revenue from life insurance arrangements should be recognized when due from policyholders because there is no better basis for determining when revenue is earned. Premiums are due and collected each pay period or on another recurring basis over the entire duration of the arrangement. In addition, the expected present value of future net premiums is deducted from the expected present value of future claims to arrive at the liability for future policy benefits.

Recognition of Liabilities and Measurement of Future Loss Estimates

A19. Liability for unpaid claims is recognized for all categories. Regardless of category, at the end of the reporting period insurance programs might be processing claims for losses due to adverse events that occurred by the end of the reporting period.

a. The amounts due for claims that have been submitted but not paid are included in the liability for unpaid claims.

b. There are also claims IBNR. The amounts for these claims are not known and must be estimated for adverse events that occurred by the end of the reporting period. If an adverse event is a series of events not completed by the end of the

reporting period, then the Board concluded that these are not claims IBNR and should not be included in the liability for unpaid claims. Nonetheless, for exchange transaction insurance programs other than life insurance, such series should be considered in estimating a liability for losses on remaining coverage.

c. Claims adjustment expenses are costs directly related to settling claims from adverse events that occurred by the end of the reporting period. The Board concluded that CAE should be included in the liability for unpaid claims for submitted and IBNR claims to recognize the full cost to settle claims.

A20. Recognition of a liability for losses on remaining coverage is required for exchange transaction insurance programs other than life insurance.

a. Research by the task force determined that a program has a service obligation to pay for any losses caused by adverse events during the entire arrangement period. The Board agrees and therefore decided to separate the liability for losses on remaining coverage from the liability from the unpaid claims portion.

b. The Board concluded that recognizing a reasonable estimate of future losses for the open arrangement period that extends beyond the end of the reporting period will remove ambiguity created by SFFAS 5 standards to recognize contingency liabilities.

c. According to SFFAS 5, paragraph 38, contingent liabilities must be recognized if a past transaction has occurred and a future outflow or other sacrifice of resources is probable and measureable. Under the new standards, the liability for losses on remaining coverage is the estimated future cash flows arising from adverse events that are expected to happen during the period that coverage will be provided. Therefore, the Board's next challenge was how to consistently address uncertainty regarding measurement.

d. Task force research showed that federal insurance programs were using a variety of statistical modeling methods to estimate future losses depending on their unique uncertainties and risk factors. For example, the Department of Agriculture's Risk Management Agency oversees crop insurance and relies upon a regression analysis;27 the Department of Homeland Security's Federal Emergency Management Agency oversees flood insurance and relies on a lognormal distribution;28 and the National Credit Union Administration uses an internal econometric model that applies estimated failure and loss rates, taking into account the historical loss history, insuree, risk ratings, insuree financial ratios, and other conditions.

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[27] Regression analysis is a statistical technique used to measure the extent to which a change in one quantity (variable) is accompanied by a change in some other quantity (variable). GAO, Aug 1, 1974-Case Study (CS-5), *Using Regression Analysis To Estimate Costs Published*, page 1.

[28] In statistics the best known distribution is the normal, the familiar bell-shaped curve which is symmetrical about its mean. Certain other distributions stem from the normal. For example… the lognormal distribution…A random variate x is lognormally distributed if the logarithm of x is normally distributed. In short, the distribution of x is itself lognormal when the distribution of log x is normal. A typical lognormal distribution is skewed to the right and has a lower bound such that the probability of x being less than this lower bound is exactly zero. Lester G. Telser, Review of the Lognormal Distribution, Journal of Farm Economics 41. No 1, Feb., 1959, page 161.

e. To address such measurement challenges, the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 7, paragraphs 44-54, describes a variety of pricing tools and methods for developing an expected cash flow estimate.

f. To allow for a variety of estimating methods for federal insurance programs, the ED required that programs should first use expected cash flow to estimate the cost to settle claims on remaining coverage. The ED acknowledged that there would be various methods available to estimate cash flows and probabilities. Further, the proposal provided that if expected cash flow estimates were not practical and appropriate, then an entity could estimate a single most-likely amount to be paid to settle future claims during the remaining open arrangement period.

g. A number of respondents were concerned with implementation of and auditing to the terms “practical and appropriate.”

h. In addition, one member believed that the entity should be able to use any method that provides a reasonable estimate of cash flows, based on all available information existing at the balance sheet date, including experience with previous trends, and, as appropriate, the views of independent experts. However, the majority of members still preferred expected cash flow to estimated cash flow. After discussion, all members agreed to allow any method for which the objective is a reasonable estimate of expected cash flows. This allows management the flexibility to choose a method that produces a reasonable estimate of expected cash flows specific to the program’s future adverse event uncertainties and risk factors.

A21. Recognition of a liability for future policy benefits is required for life insurance programs. Future benefits and premiums are estimated using financial and/or actuarial methods, depending on the portfolio risk characteristics and arrangement duration. These amounts are discounted to the present value to recognize the liability for future benefits.

A22. Estimates for the liability for losses on remaining coverage and future policy benefits are recognized by insurance portfolios with similar characteristics, including arrangement duration. The Board decided not to define “arrangement duration” due to the subjective nature of duration. For example, one insurance program might determine that a 36-month arrangement is short-duration, while another assigns the arrangement to a long-duration group. Recognizing these liabilities by groups of arrangements allows judgment by each insurance program in defining the duration of their arrangements.

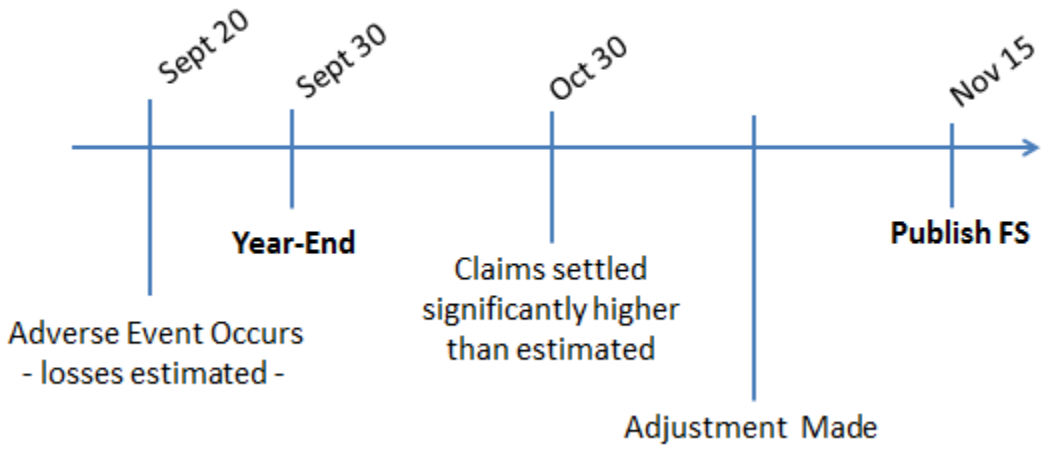
Subsequent Events

A23. Certain respondents requested clarification regarding subsequent events and the application of SFFAS 39 in relation to whether these standards are to add to or supplement SFFAS 39. The Board determined that the treatment of subsequent events should differ for the liability for unpaid insurance claims versus the liability for losses on remaining coverage as follows.

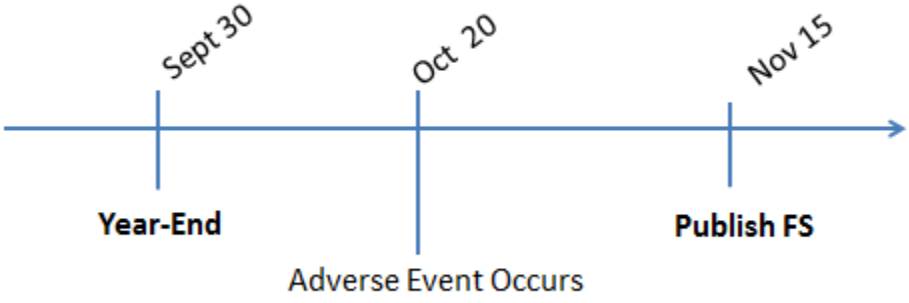
Liability for Unpaid Insurance Claims

A24. For the liability for unpaid insurance claims, events or transactions occurring after the balance sheet date but before the financial report is issued are considered subsequent events. A subsequent event may or may not result in the adjustment of the financial statements, depending on whether it is a recognized or nonrecognized event. See SFFAS 39 for detailed guidance. Examples of subsequent events for insurance programs with a September 30 year-end and a November 15 financial statement (FS) publication date may include the following.

a. Recognized event: claims settled on October 30 for an amount significantly different from the liability recorded for a major disaster that occurred on September 20 would require adjustment to the liability for unpaid claims in the financial statements.



b. Nonrecognized event: a major disaster that occurs on October 20 would not require an adjustment to the financial statements but may require disclosure.



Liability for Losses on Remaining Coverage

A25. The liability for losses on remaining coverage estimates future events. Due to the uncertainty of the occurrence, magnitude, and timing of these future events, the Board decided that all subsequent events relating to the liability for losses on remaining coverage should be classified as nonrecognized events in accordance with SFFAS 39, paragraph 15.

Disclosures

A26. Disclosures are required for each insurance program category to aid the reader in understanding the estimates and fiscal health of insurance programs in relation to the risk they assume for losses incurred due to adverse events.

Avoiding Duplicity of Information

a. Task force research informed the Board that current standards required presentation of similar information in multiple places (for example, notes and required supplementary information), which burdened the agencies and readers. In addition, disclosures were inconsistent among programs, making it difficult to determine the fiscal health—the amount of loss estimated versus the amount and funding types necessary to settle the actual losses—of individual programs as well as insurance programs at the government-wide level.

b. The Board concluded that the updated disclosures will avoid duplication by allowing insurance programs to reference relevant notes.

Changes in the Liability for Unpaid Insurance Claims

c. For consistent reporting, the Board requires a reconciliation of the liability for unpaid claims that a number of insurance programs already produce. The Board reviewed the current reconciliations and consolidated relevant information for consistent reporting. All categories should report this information so readers receive consistent information.

d. The Board concluded that requiring disclosure of full costs, premiums collected, appropriations used, borrowing needed during the reporting period, as well as the ability to repay the borrowing should provide a holistic picture of an insurance program's performance.

Insurance In-Force

e. The Board concluded that disclosing the balance of insurance in-force as of the end of the reporting period will provide useful information as to the maximum risk exposure to the program. However, one respondent requested, and the Board subsequently agreed, to update the standard to provide more clarity on how the program should explain that paying the full amount of insurance in-force is very unlikely.

Low Probability, High Impact Adverse Events-Uncertainty

f. Some respondents were concerned about how to disclose the uncertainty of adverse events, including those that are low probability, high impact (very rare, but upon occurrence causes extreme loss). The Board understands that uncertainty is subjective to each insurance program in relation to the risks it insures—which may cause extreme loss that is hard to estimate. Some programs may also encounter uncertainty in relation to a multitude of events that must occur over time and often do not occur within one reporting period.

   i. The following are examples of hard to predict adverse events that may cause substantial losses: a "Katrina" type[29] of hurricane, a political uprising in a country that completely disrupts American businesses, or an unusual detrimental weather pattern combined with volatile commodity pricing.

   ii. Due to this uncertainty in magnitude and timing, the Board concluded that the disclosure about estimating uncertainty allows management to discuss its particular constraints in determining the liability for losses on remaining coverage.

Disclosures – Financial Report of U.S. Government

A27. Disclosures for the financial report of the U.S. Government should be reported at a high level of detail. The Board concluded that detailed disclosures should be found at the component reporting entity level.

[29] Per FEMA - Hurricane Katrina was a long-lived hurricane that made landfall three times along the United States coast and reached Category 5 at its peak intensity... CNN reported that …Hurricane Katrina is the costliest disaster in the history of the global insurance industry. The National Flood Insurance Program paid out $16.3 billion in claims...Private Insurance companies have paid an estimated $41.1 billion in claims.

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APPENDIX B: ABBREVIATIONS

CAE	Claim adjustment expense
CFR	Consolidated financial report of the U.S. Government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IBNR	Incurred but not reported
OMB	Office of Management and Budget
RSI	Required supplementary information
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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APPENDIX C: GLOSSARY

Adverse Event—may be a single-occurring event or a series of events that cause losses to the beneficiary or beneficiaries as identified in the insurance arrangement.

Cash Surrender Value—is the sum of money an insurance company will return to the policyholder if the policy is canceled before its maturity or the insured event (death) occurs.

Claim Adjustment Expenses (CAE)—are incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

Arrangement Period—is the period over which adverse events that occur are covered.

Exchange Transaction Insurance Programs Other Than Life Insurance—cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined in SFFAS 7.

In-Force—refers to arrangements that are unexpired as of a given date.

Incurred But Not Reported (IBNR)—refers to estimated claims from adverse events that have occurred as of the end of the reporting period, but have not yet been reported to the insurance program for settlement.

Insurance Claim—is a formal request for payment for losses as authorized under the insurance arrangement.

Insurance Arrangement (Arrangement)—is a general term used for a contract or other agreement between an insurance program and specific parties, such as but not limited to individuals, state, local, or foreign governments, other federal agencies, or businesses. An arrangement may include and/or identify: the term the insurance arrangement is in-force, the insurance program's responsibilities, the risk assumed by the insurance program, such as: all risk for covered losses, partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance, a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid or risks shared by a third party; the adverse event, the insured party or parties and their premium requirements, the beneficiary or beneficiaries and their responsibilities for filing claims, and/or the financial compensation.

Insurance Portfolios—is a grouping of insurance programs or arrangements that have some meaningful relationship based on arrangement period/duration, shared risks, management, customers, geographic regions, or other factors.

Insurance Program—is a general term used to refer to a program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

Liability for Losses on Remaining Coverage—is an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open arrangement period.

Life Insurance Programs—cover the risk of loss from death of individuals involved in exchange transactions as defined in SFFAS 7.

Nonexchange Transaction Insurance Programs—cover the risk of loss from adverse events through nonexchange transactions as defined in SFFAS 7.

Premiums—is a general term used to refer to exchange revenue billed by insurance programs. Programs may refer to their exchange revenue by various terms, including but not limited to premiums, assessments, and/or fees.

Recoveries—include monies: returned from another agency through an indemnification agreement, a third party or commercial insurance company to repay all or part of a loss originally paid for by the program, recouped from the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or received from adjustments to previously paid insurance claims.

Settlement Amount—is the amount at which an asset can be realized or a liability can be liquidated.

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FASAB Board Members

D. Scott Showalter, Chairman

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Christina Ho

Sam M. McCall

Mark Reger

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Robin M. Gilliam, Assistant Director

Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone (202) 512- 7350
Fax (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

TAX EXPENDITURES

Statement of Federal Financial Accounting Standards 52

May 31, 2017

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as proposals after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, D.C. 20548
Phone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement requires certain information on tax expenditures to assist users of the consolidated financial report of the U.S. Government (CFR) in understanding the existence, purpose, and impact of tax expenditures.

Specifically, this Statement requires that the CFR:

1. Include narrative disclosures and information regarding tax expenditures that inform the reader regarding the:
    a. definition of tax expenditures,
    b. general purpose of tax expenditures,
    c. impact on and treatment of tax expenditures within the federal budget process, and
    d. impact of tax expenditures on the government's financial position and condition.
2. Alert readers regarding the availability of published information on tax expenditure estimates, such as those published annually by the Department of the Treasury's Office of Tax Policy.

This Statement also encourages presentation of tax expenditure estimates as other information (OI)[1] in the CFR.[2]

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[1] The term *Other Information* (OI) used in this Statement and the term *Other Accompanying Information* (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

[2] Although the Federal Accounting Standards Advisory Board (FASAB) does not require OI to be presented, FASAB may at times encourage voluntary reporting of items to help in the development of information that may enhance overall federal financial reporting. For example, FASAB may consider an item to be relevant to entity operations but, for the moment, does not meet other criteria for required information.

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TABLE OF CONTENTS

Summary 3

Standards 5

- **Scope** 5
- **Definitions** 5
- **Disclosure Requirements** 6
- **Required Supplementary Information** 6
- **Other Information** 7
- **Effective Date** 7

Appendix A: Basis for Conclusions 8

Appendix B: Tax Expenditures Explained 20

Appendix C: Task Force Members 27

Appendix D: Abbreviations 28

Appendix E: Glossary 29

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STANDARDS

SCOPE

1. This Statement requires narrative disclosures and information regarding tax expenditures, and it encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by the Department of the Treasury's (Treasury) Office of Tax Policy, as other information (OI) in the consolidated financial report of the U.S. Government (CFR).[3]

2. The reporting requirements in this Statement apply to the CFR. They do not apply to the financial statements of component reporting entities. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.

3. This Statement does not alter or contradict the definition of tax expenditures, as established by the Congressional Budget and Impoundment Control Act of 1974. This Statement does not affect the Treasury or the Joint Committee on Taxation's (JCT) interpretation of the statutory definition. Hence, this Statement does not affect the policies and practices of Treasury's Office of Tax Policy or the JCT with respect to the definition, identification, recognition, and measurement of tax expenditures.

DEFINITIONS

4. Tax expenditures

   The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344) defines **tax expenditures** as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

   While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

5. Baseline provisions

   Baseline provisions are the starting points used to measure the impact of tax expenditures on tax revenues as compared to revenues that would be collected otherwise, absent the special exclusion, exemption, deduction, credit, preferential rate, or deferral. Certain practical aspects of the tax code are incorporated into the baseline—such as progressive tax rates, personal exemptions, standard deductions, deductions of expenses incurred in order to earn income, and deferrals of unrealized income.

[3] The term other information (OI) used in this Statement and the term other accompanying information (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

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DISCLOSURE REQUIREMENTS

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

6. Disclosures about tax expenditures should help provide readers with a general understanding of how tax expenditures affect the government's tax collections, financial position, and financial condition; and how budgetary objectives can be achieved through the mechanism of tax expenditures.

7. Disclosures within the notes to the financial statements should include:

    a. a "plain language" definition of the term tax expenditures;[4]

    b. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions; and

    c. a description of how tax expenditures affect nonexchange revenue, tax collections, and refunds, as well as whether tax expenditure amounts are presented in the basic financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

8. Management's discussion and analysis (MD&A) should include:

    a. a "plain language" definition of the term tax expenditures;

    b. the general purpose of tax expenditures;

    c. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions;

    d. information about other factors that may affect tax collections in order to place tax expenditure information in an appropriate context;

    e. a description of how tax expenditures are treated for budgetary and financial reporting purposes, including their impact on the surplus or deficit and their treatment within the federal budget process, and how they affect the government's financial position and condition; and

    f. a statement regarding the availability of published information on tax expenditures, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

[4] This Statement does not establish the wording of the "plain language" definition.

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OTHER INFORMATION

9. The Federal Accounting Standards Advisory Board (FASAB or "the Board") encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by Treasury's Office of Tax Policy, as OI in the CFR.

10. The Board encourages the presentation of tax expenditure estimates in a manner that informs readers of:

    a. the general magnitude of tax expenditures and their impact on federal revenues (revenue effect) during the fiscal year;

    b. the source of the estimates; and

    c. the availability of published information wherein the estimates presented in OI were originally published, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

EFFECTIVE DATE

11. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

INTRODUCTION

A1. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.[5] The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

a. This Statement contributes to Objectives 1, 2, and 3.

i. Objective 1, Budgetary Integrity, states that:

> Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

1. Sub-objective 1A states that:

> Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used …

2. Sub-objective 1C states that:

> Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

ii. Objective 2, Operating Performance, states that:

[5] SFFAC 1, par. 109.

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> Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed…

iii. Objective 3, Stewardship, states that:

> Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.
>
> Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

A2. Tax expenditures reduce federal revenues as a result of tax legislation. These reductions have historically been measured relative to normal baseline provisions of an individual and corporate income tax system. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds by federal agencies and programs. Accordingly, the Board sought to provide budgetary information, which contributes to Objective 1. In particular, such tax expenditure information should contribute to sub-objectives 1A and 1C by providing information to assist readers in understanding how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

A3. Tax expenditures may be used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory programs. The Board believes that the service efforts, costs, and accomplishments of the reporting entity—the U.S. government—include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, financial reports should provide operating performance information, which contributes to Objective 2.

A4. Because tax expenditures may be viewed as alternatives to spending or regulatory programs, they can also be viewed as government investments of forgone budgetary resources designed to address policy objectives. Thus, individual tax expenditures may affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and/or (3) the nation's current and future well-being. Accordingly, financial reports should provide stewardship information, which contributes to Objective 3.

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PROJECT HISTORY

A5. In October 2014, the Board approved this project in order to determine what information regarding tax expenditures should be included in general purpose federal financial reports (GPFFRs). The decision followed an October 2013 educational briefing to the Board that resulted in identifying the topic as a high priority.

A6. Throughout the project, the Board relied on a task force that included experts in the areas of tax expenditures, tax policy, and federal financial reporting. The task force provided critical assistance and knowledge to the Board and FASAB staff in developing (1) recommendations to the Board, (2) Appendix B: Tax Expenditures Explained, and (3) illustrations that were included in the exposure draft (ED). The task force also provided technical comments and feedback on working drafts and attended Board meetings to answer technical questions and provide insight during deliberations.

A7. In December 2015, the task force issued its Report to the FASAB, which included three recommendations to the Board and three options for the Board's consideration with respect to the presentation of tax expenditure estimates in the CFR.

a. The first recommendation of the task force was to include an introduction section or background paper, as drafted by the task force, to educate readers of and respondents to the Board's ED and the final Statement regarding tax expenditures.

    i. The Board approved this recommendation to be implemented in a proposed standard, but elected to include a condensed introduction section along with the full background paper developed by the task force (with minor changes) as an appendix section (Appendix B: Tax Expenditures Explained). This recommendation was ultimately implemented in this Statement.

b. The second recommendation of the task force was to require certain narrative disclosures regarding tax expenditures within the notes to the financial statements and MD&A of the CFR.

    i. Task force members decided early in the project that they did not generally support issuing proposed standards that affected component reporting entities of the federal government due to potentially significant challenges and costs associated with doing so. For example, implementing accounting standards for identifying tax expenditures that are key performance or financial indicators for a component reporting entity could be time consuming and costly to the preparer.

    ii. The task force concluded that this recommendation would improve users' awareness and understanding of tax expenditures while avoiding extensive, voluminous, or costly disclosures.

    iii. The Board approved the recommendation to be implemented in a proposed standard with certain minor changes to the recommendation as written in the task force report. This recommendation was ultimately implemented in this Statement.

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c. The third recommendation of the task force was to require the inclusion of hyperlinks in the CFR to inform readers regarding other online sources of information where readers of the government-wide report can obtain more detailed information regarding tax expenditures.

   i. FASAB staff worked with members of the task force and other members of the federal financial statement auditing community to develop proposed language for implementing this recommendation.

   ii. The Board discussed how best to implement this recommendation. Board members came to the conclusion that the language in paragraph 8.f provides discretion to the preparer to embed a hyperlink to information sources that it deems to be most appropriate, should reporting on tax expenditures evolve, expand, or improve in the future.

   iii. The Board sought to develop a requirement that would continue to be relevant in the future and also allow the preparer to exercise discretion in selecting information sources that are referenced in the CFR.

   iv. Board members determined that implementing the requirement in paragraph 8.f will likely necessitate the use of electronic hyperlinking in the CFR, given (1) the costs and burdens of using alternative methods for implementing the requirement, such as postage and printing costs, and (2) the availability and minimal costs associated with hyperlinking to electronic information available on the internet. The Board encourages the use of hyperlinks in implementing the requirement.

   v. The Board concluded that the requirement in paragraph 8.f makes it sufficiently clear to the preparer and auditor that the reader should be informed that the information referenced is unaudited. Moreover, the Board concluded that MD&A was an appropriate section for directing users to unaudited reports.

d. Options for consideration proposed by the task force regarding the presentation of tax expenditure estimates were to (1) encourage the inclusion of tax expenditure estimates as OI in the CFR, (2) require the inclusion of tax expenditure estimates within required supplementary information (RSI) of the CFR, or (3) neither encourage nor require the inclusion of tax expenditure estimates within the CFR and focus exclusively on narrative content and links to other resources for comprehensive reporting of estimates.

   i. Task force members who supported the placement of tax expenditure estimates in OI were primarily concerned about the quality, timeliness, and availability of reliable data upon which these estimates are based. These task force members were also concerned that existing differences in the list of tax expenditures identified by two credible sources of such estimates—Treasury's Office of Tax Policy and the JCT—may pose challenges, particularly if such information were audited. Additionally, estimation methodologies for certain tax expenditures can neither be tested nor improved over time by way of assessing their historical performance against tax return data or transactions;

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assessing historical performance for certain tax expenditures requires the use of data that are not collected on tax returns or otherwise available because these estimates are imputed rather than based on recordable transactions that actually occurred. Task force members supporting the inclusion of estimates in OI believed that these unique challenges impede the preparer's ability to (1) identify a generally accepted universe of tax expenditures; (2) develop estimates generally accepted as reliable, fair, and correctly measured; and (3) include estimates within RSI or basic information without negative or potentially unresolvable audit challenges.

ii. These members recommended—and the Board ultimately concluded—that encouraging the inclusion of estimates in OI avoids such costs and challenges, increases transparency and context surrounding the general magnitude and impact of tax expenditures on the government's financial position, and elevates tax expenditure estimates into an unaudited section of the CFR to create more transparency.

REQUIREMENT FOR INFORMATION IN MD&A AND NOTES

A8. The Board concluded that the CFR's MD&A should include a discussion of tax expenditures, their general purpose, and how they affect the government's financial position and condition. This Statement also requires discussion of other factors that may affect tax collections in order to place tax expenditure information in an appropriate context. The specific requirements are presented in paragraph 8 and sub-paragraphs 8.a-8.f.

A9. Requiring information on tax expenditures in the MD&A and notes to the financial statements in the CFR is important for the following reasons:

a. Discussion regarding the topic of tax expenditures is currently absent; however, tax expenditures have had a significant impact on the federal government's financial position, tax collections, and performance outcomes each year. The significant impact of tax expenditures warrants discussion in MD&A because MD&A should "provide a clear and concise description of the reporting entity and its … activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition."[6]

b. Tax expenditures are significant to the management, budgetary, and oversight functions of the Congress and the Administration. Tax expenditures are often used by the federal government as a mechanism to address policy objectives. Tax expenditures may also affect the judgment of citizens about the efficiency and effectiveness of the tax code in accomplishing certain financial or policy objectives. Therefore, tax expenditures are consistent with the provisions of Statement of Federal Financial Accounting Standards 15, paragraph 6, which states:

[6] Statement of Federal Financial Accounting Standards 15, par. 1.

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MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the GPFFR as a source of information. … Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

i. lead to significant actions or proposals by top management of the reporting unit;

ii. be significant to the managing, budgeting, and oversight functions of the Congress and the Administration; or

iii. significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.

c. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.[7] The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

d. Objective 1, Budgetary Integrity, states that:

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

i. Sub-objective 1A states that:

Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used …

ii. Sub-objective 1C states that:

Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

e. Tax expenditures reduce federal revenues via tax legislation. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds to federal agencies and programs. Accordingly, the MD&A and financial statement note requirements in this Statement will provide budgetary information and contribute to addressing Objective 1. In particular, the disclosure requirements will contribute to

[7] SFFAC 1, par. 109.

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addressing sub-objectives 1A and 1C because these disclosures provide readers with an understanding of how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

f. Objective 2, Operating Performance, states that:

   Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed; and the management of the entity's assets and liabilities.

g. Tax expenditures are used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory programs. The service efforts, costs, and accomplishments of the reporting entity—the U.S. government—include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, this Statement will result in information that alerts readers to the efforts and costs associated with tax expenditures and, therefore, will provide operating performance information and contribute to addressing Objective 2.

h. Objective 3, Stewardship, states that:

   Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

   Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

i. Because tax expenditures are often viewed as alternatives to spending or regulatory programs, they can be viewed as government investments of forgone budgetary resources designed to address policy objectives. Thus, tax expenditures affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and (3) the nation's current and future well-being. Accordingly, the Board concluded that the requirements for MD&A and notes to the financial statements in the CFR provide stewardship information and contribute to addressing Objective 3.

A10. Requiring information on tax expenditures in the notes to the financial statements in the CFR is important for the following reasons:

a. The requirements will help readers understand that the tax system is used to accomplish policy goals as well as collect revenue.

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b. The requirements will help readers understand that some "efforts" and related costs are not transparent in the financial statements but do affect them.

c. The requirements provide context of other factors affecting tax collection in order to place tax expenditures in an appropriate context and help readers to have a more complete understanding of factors affecting the government's financial position and condition.

A11. The information reported in accordance with the requirements of this Statement for MD&A and the notes to the financial statements in the CFR will improve users' awareness and understanding of tax expenditures, their use, and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.

A12. The information reported in accordance with requirements of this Statement will help users to evaluate and understand (1) the impact of the tax code on budgetary resources and uses; (2) the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed and/or affected by the tax system; and (3) how the tax code relates to and/or affects the government's investments and financial position, and how the government's financial condition has changed and may change in the future as a result.

REPORTING ESTIMATES IN OTHER INFORMATION

A13. Regarding cost-benefit considerations, SFFAC 1, paragraph 155 states that "for many purposes, other information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective." Paragraphs 9-10 of this Statement provide readers with a means of easily accessing other relevant tax expenditure information sources.

A14. Regarding the inclusion of estimates in OI and informing readers of the source and availability of published information wherein the estimates were originally published; the Board concluded that suitable amounts of detail, context, and explanations can accompany estimates presented in a reasonably concise manner while also meeting the needs of users with different levels of knowledge regarding tax expenditures. Accordingly, the inclusion of statements to alert readers that the published information includes a complete population of the tax expenditure estimates identified by the reporting party and whether such information includes details of the estimating conventions and explanatory definitions of the tax expenditures presented in OI would also be helpful to users.

A15. The Board may elect to evaluate the costs, limitations, benefits, and other implications of developing additional measurement, recognition, and disclosure guidance in the future.

A16. Given the conceptual issues that make tax expenditures unauditable, before any future efforts are potentially undertaken, the following matters need to be considered:

a. How best to define, identify, and measure tax provisions that are both relevant for financial reporting purposes and generally accepted by economists and other experts

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b. Whether it is feasible to develop estimates that are considered to be representationally faithful, consistent, comparable, and auditable

c. If auditability can be achieved, what considerations would enable the preparer and auditor to achieve their respective responsibilities in a reasonably effective and efficient manner

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A17. The ED was issued June 2, 2016, with comments requested by September 15, 2016. Upon its release, notices and press releases were sent to the following organizations:

a. The *Federal Register*;

b. *FASAB News* and the related listserv subscribers, including:

i. the *Journal of Accountancy*, *AGA Today*, *Accounting Today*, the *CPA Journal*, *Government Executive* and the *CPA Letter*;

ii. the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network;

iii. committees of professional associations generally commenting on FASAB EDs in the past; and

iv. other individuals and organizations in the federal accountability community.

A18. This broad announcement was followed by electronic mailings of the ED and subsequent reminder notices to:

a. Relevant congressional committees, including:

i. the House Committee on Oversight and Government Reform,

ii. the Senate Committee on Homeland Security and Governmental Affairs,

iii. the House Committee on Ways and Means,

iv. the Senate Committee on Finance,

v. the House Committee on the Budget,

vi. the Senate Committee on the Budget, and

vii. the JCT;

b. Non-profit, public policy, and accounting organizations, such as:

i. state and territorial CPA societies,

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ii. accounting, tax, and public policy and research organizations,

iii. accounting and auditing firms, and

iv. taxpayer associations;

c. Individuals that have published articles, commentary, and/or research regarding tax expenditures, such as:

i. college professors,

ii. economists, and

iii. tax policy analysts.

A19. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A20. FASAB received 12 responses from federal agencies, users of federal financial information, and professional associations. The majority of respondents agreed with the proposed requirements in the ED, which are implemented in this Statement in paragraphs 6-8 and the related sub-paragraphs.

A21. However, some respondents disagreed with Board proposals in the ED to encourage the presentation of major tax expenditure estimates in OI in a manner that informs readers of the general magnitude of tax expenditures and their impact on federal revenues. A few respondents viewed RSI as a more appropriate classification for the information. Other respondents expressed a preference to exclude estimates from the CFR altogether and refer readers to external resources wherein comprehensive reports and estimates can be obtained.

A22. The Board carefully considered respondents' views and found them to be consistent with the considerations, costs, benefits, and views expressed by task force and Board members in earlier deliberations.

A23. The Board concluded that it would not be appropriate to change the ED proposal from encouraging the presentation of major tax expenditure estimates from external sources in OI to requiring such information in RSI. Such a change would classify the information as required information. For reasons discussed in paragraphs A7.d.i and A16, the Board concluded that such a requirement must be preceded by the development of recognition and measurement criteria.

A24. The Board also concluded that it would not be appropriate to remove the ED proposal to encourage the presentation of major tax expenditure estimates. For reasons discussed in paragraph A7.d.ii, the Board maintains that the implementation of paragraphs 9-10 and the related sub-paragraphs will enhance user awareness and understanding of tax

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expenditures and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.

A25. One respondent expressed that requirements to report on tax expenditures should also be extended to at least certain component reporting entities. The respondent noted that many component reporting entity objectives and achievements are financed as much through tax expenditures as through outlays.

A26. The Board agrees that tax expenditures contribute to component reporting entity performance objectives and costs inherent to the achievement of those objectives. In its review of the respondent's comment letter, the Board concluded that cost-benefit considerations regarding its decision not to extend requirements to component reporting entities should be clarified in the basis for conclusions.

A27. The Board concluded early in the project that there is strong evidence of significant challenges to identifying and assigning tax provisions and aligning those provisions with agency goals. Board members considered problems identified in a Government Accountability Office (GAO) report issued in July 2016,[8] including the following:

a. There is a continuing lack of clarity about the roles of different federal agencies in conducting reviews of tax expenditures. This lack of clarity can lead to inaction in identifying tax expenditures' contributions to agency goals.

b. Whether or not agencies have a defined role in administering tax expenditures influences whether those agencies identify tax expenditure contributions to their goals.

    i. If agencies do not have a defined role in administering a tax expenditure, they may choose not to identify the tax expenditure's contributions to their goals.

    ii. The agencies that linked tax expenditures to performance measures typically had a defined role in administering them, and therefore collected data on those tax expenditures.

A28. Before efforts can be undertaken by FASAB to extend requirements to component reporting entities, many issues need to be considered and deliberated by the Board, such as:

a. how best to define and identify tax provisions that are relevant for financial reporting purposes,

b. the extent to which a component reporting entity's role in administering a tax provision should affect recognition of that tax provision for financial reporting purposes,

[8] GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, GAO-16-622 (Washington, D.C.: July 7, 2016).

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c. the extent to which the alignment of a component reporting entity's missions, goals, and objectives with the accomplishments of a tax provision should affect recognition of that provision for financial reporting purposes, and

d. the types of information most relevant to users of GPFFRs and how this information should be presented therein, if at all.

A29. A few respondents expressed concerns about or provided suggested edits to an illustration included in the ED.

A30. Instead of addressing comments on the illustration, the Board elected to remove the illustration from the ED for the following reasons:

a. The primary purpose of the illustration was to enable ED respondents to envision how the proposed requirements might be implemented in the CFR.

b. The illustration was in a non-authoritative appendix.

c. There is only one CFR. Treasury and the Office of Management and Budget (OMB) officials expressed that including such an illustration in the final Statement was not essential to understanding provisions of the standard.

d. The illustration may become outdated as the CFR preparer may develop more innovative ways to present information and/or as tax policy evolves.

BOARD APPROVAL

A31. This Statement was approved by the Board with a vote of seven members in favor of its issuance and two members, Ms. Ho and Mr. Reger, abstaining from the vote. Written ballots are available for public inspection at the FASAB office.

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APPENDIX B: TAX EXPENDITURES EXPLAINED

Purpose

In light of the Board's mission to improve federal financial reporting, it is paramount that such reporting assists report users in evaluating the service efforts, costs, accomplishments, and fiscal sustainability of the federal government and in understanding how these efforts and accomplishments have been financed. Although tax expenditures have similarities to federal spending in their impact on service efforts, costs, accomplishments, and fiscal sustainability; they have historically received little focus in general purpose federal financial reporting. Establishing reporting requirements with respect to this topic requires an understanding of tax expenditures, the methods used to estimate income tax expenditures, and considerations in using those estimates.

This section provides an overview of tax expenditures to aid preparers and users in understanding reporting in regard thereto. Specifically, this section:

1. defines tax expenditures and describes the six types of tax expenditures;
2. provides context with respect to the purpose of tax expenditures, why they are important, and their relationship to government performance, taxpayer behaviors, and the economy; and
3. summarizes how tax expenditure estimates are prepared by Treasury. This ultimately affects how tax expenditure estimates can be used and interpreted.

Background

The Congressional Budget and Impoundment Control Act of 1974 (the Budget Act) defines tax expenditures as

> *"…revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."* (Section 3(a)(3) of Public Law 93-344)

Generally, tax expenditures are provisions in the tax law available to certain subsets of taxpayers who engage in certain activities, face special circumstances, or otherwise meet certain criteria. The government uses tax expenditures to stimulate behavior that will accomplish public policy goals such as facilitating homeownership, reducing the cost of borrowing for state and local governments, encouraging higher education, or promoting domestic energy production.

Tax expenditures are "revenue losses" in that the provisions reduce income taxes owed and, therefore, revenue collected. Tax expenditures resemble federal spending in that such provisions affect the federal deficit/surplus by impacting income tax revenue; however, tax expenditures are often not treated the same as federal spending for budgetary or financial reporting purposes.[9] Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Many tax expenditures can only be removed or changed through tax legislation. While tax expenditures help determine the

[9] In certain cases a tax preference may provide cash in the form of a refundable tax credit even if the taxpayer owes no tax. The budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer's tax liability as outlays. As such, a portion of this type of tax preference is reported as outlays in the budget to the extent payments exceed the taxpayer's liability, whereas the portion offsetting the taxpayer's liability reduces budget revenues but is not explicitly reported in the budget.

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government's net revenue, tax expenditure estimates are not explicitly displayed in the Statements of Net Cost or Changes in Net Position.

How Tax Expenditures Are Identified

The first step in identifying tax expenditures is defining the tax baseline so that the provisions considered "special" (per the Budget Act definition above) can be distinguished from those provisions consistent with a baseline tax system. Traditionally, for the federal income tax, the baseline tax system is a comprehensive income tax with certain practical provisions that are generally accepted as being part of a baseline tax system. Accordingly, provisions such as the personal exemption, standard deductions, deductions of expenses incurred in earning income, and a progressive rate structure are considered to be part of the baseline tax system for measurement purposes.

Judgments about such provisions are based on a general consensus view of analysts regarding practical provisions of a baseline tax system versus "special" provisions that constitute a tax expenditure. For example, the personal exemption and standard deduction are viewed as defining a zero-rate bracket that is part of baseline tax law as are the other graduated rate brackets in the individual income tax. In contrast, the child tax credit is considered a tax expenditure because it provides a "special" benefit that would not exist under baseline tax law.

After determining the baseline tax system, the credits, deductions, special exceptions and allowances that reduce tax liability below the level implied by the baseline tax system are then considered to be tax expenditures.

Types of Tax Expenditures

There are six types of tax expenditures—exclusions, exemptions, deductions, credits, preferential rates, and deferrals. Table 1 below describes each and provides an example.

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Table 1: Examples of Provisions That Are Tax Expenditures When They Are Exceptions to the Normal [Baseline] Tax Structure

Tax expenditure	Description	Examples
Exclusion	Excludes income that would otherwise constitute part of a taxpayer's gross income.	Employees generally pay no income taxes on contributions their employers make on their behalf for medical insurance premiums.
Exemption	Reduces gross income for taxpayers because of their status or circumstances.	Taxpayers may be able to reduce their tax liability if they have a dependent who is a child aged 19 through 23 and is a full-time student.
Deduction	Reduces gross income due to expenses taxpayers incur.	Taxpayers may be able to deduct state and local income taxes and property taxes.
Credit	Reduces tax liability dollar-for-dollar. Additionally, some credits are refundable meaning that a credit in excess of tax liability results in a cash refund.	Taxpayers with children under age 17 potentially can qualify for up to a $1,000 partially refundable, per child credit, provided their income does not exceed a certain level.
Preferential tax rate	Reduces tax rates on some forms of income.	Capital gains on certain income are subject to lower tax rates under the individual income tax.
Deferral	Delays recognition of income or accelerates some deductions otherwise attributable to future years.	Taxpayers may defer paying tax on interest earned on certain U.S. savings bonds until the bonds are redeemed.

Source: GAO-13-167SP: Guide for Evaluating Tax Expenditures.

In considering these six types of tax expenditures, it may be possible to achieve certain public policy outcomes in a variety of ways. For example, some public policy outcomes may be achieved through a preferential rate, a deduction, or a credit. Because a variety of approaches can produce the same cash effect, the types are different in form rather than substance.

Most reports do not categorize tax expenditures by type. The types are presented to aid in understanding the mechanisms used to establish preferences.

Budget Act Requirements and History

The term “tax expenditures” was introduced in 1967 by Assistant Secretary for Tax Policy, Stanley Surrey, in a speech calling for a “full accounting” of them. Following his speech, estimates were prepared by Treasury and later by the JCT of the Congress.

In 1974, the Budget Act charged the House and Senate Budget Committees with the duty “to request and evaluate continuing studies of tax expenditures, to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and to report the results of such studies to the Senate on a recurring basis.” The Budget Act further required that the annual President’s Budget include tax expenditure estimates.[10]

[10] Kleinbard, Edward. Tax Expenditure Framework Legislation, *Research Paper Series and Legal Studies Research Paper Series, Paper No. C10-1.* USC Center in Law, Economics and Organization. 2010.

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Estimates are now available annually from both the JCT[11] and the President's Budget.[12] Each JCT report contains a discussion of the concept of tax expenditures, identification of new tax expenditures enacted into law, a general explanation on how the committee staff measures tax expenditures, estimates of tax expenditures, and distributions of selected individual tax expenditures by income class.

Treasury prepares estimates provided in the President's Budget. These estimates are for the current fiscal year and the ten years thereafter. The estimates are intended to support budget analysis and are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in assessing the efficiency and effectiveness of achieving specific public goals through the use of tax expenditures. Treasury provides the tax expenditure estimates before the end of each fiscal year and makes them available on the Treasury website before the President's Budget is issued.[13]

Government Performance Reporting for Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) originally put in place a framework for performance planning and reporting, and the GPRA Modernization Act of 2010 (GPRAMA) has significantly enhanced the statutory framework.[14] The GPRAMA framework aims at taking a more crosscutting and integrated approach to focusing on results and improving government performance. OMB is required to coordinate with agencies to establish federal government priority goals—otherwise referred to as cross-agency priority (CAP) goals.[15] GPRAMA requires certain agencies to identify a subset of agency goals as agency priority goals (APG), which reflect the highest priorities of each agency. Fully implementing GPRAMA requirements could provide the foundation for reviewing tax expenditure performance and assessing their contributions toward federal goals. GPRAMA requires OMB to identify tax expenditures that contribute to the CAP goals. In addition, OMB guidance has directed agencies to identify tax expenditures that contribute to their APGs since 2012 and to their strategic objectives since 2013.[16]

While OMB has determined that there are no tax expenditures that are critical to achievement of the current CAP goals, agencies have not yet completed actions necessary to identify tax expenditures that contribute to their APGs.[17]

[11] See https://www.jct.gov/publications.html?func=select&id=5 for JCT Publications on Tax Expenditures. As of January 6, 2017, estimates for fiscal years 2015-2019 were available in report number JCX-141R-15.

[12] See https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf for the Fiscal Year 2017 President's Budget. The Analytical Perspectives, Chapter 14 provides estimates for fiscal years 2015 through 2025. (Last accessed January 6, 2017.)

[13] See http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx for the latest estimates of tax expenditures. (Last accessed January 6, 2017.)

[14] Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993) and Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

[15] OMB set the first interim CAP goals in 2012 and identified the next set of CAP goals in March 2014, which is to be updated every four years.

[16] OMB, Circular A-11 (2015).

[17] GAO, *Managing for Results: Implementation of GPRA Modernization Act Has Yielded Mixed Progress in Addressing Pressing Governance Challenges,* GAO-15-819 (Washington, D.C.: Sept. 28, 2015) and GAO, *OMB Improved Implementation of Cross-Agency Priority Goals, But Could Be More Transparent About Measuring Progress*, GAO-16-509 (Washington, D.C.: May 20, 2016).

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How Treasury Prepares the Administration's Estimates

As noted in the definition above, tax expenditures arise from special provisions allowing an exclusion, exemption, or deduction from gross income, a credit, a preferential rate of tax, or a deferral of liability. Deciding whether a provision of tax law is a special exception to the baseline income tax system is a matter of judgment. The baseline used by Treasury to identify these special exceptions is adapted from a comprehensive income tax approach in which income is the sum of consumption and the change in net wealth in a given period of time with certain departures.[18] This baseline assumes an individual income tax and a separate corporate income tax.[19]

Preparing tax expenditure estimates requires consideration of certain information about the economy, presently and in the future. Treasury estimates for economic activity are consistent with the economic assumptions in the President's Mid-Session Review of the prior year's budget and reflect current law as of July 1.[20]

Each tax expenditure is measured by the difference between tax liability under current law and the tax liability that would result if the tax expenditure provision were repealed and had never existed. It is assumed that there is no behavioral response to the elimination of the provision and taxpayers simply recalculate their tax in the absence of the provision in question. Thus, tax expenditures calculate revenues forgone by the existence of the rule but not necessarily the amount of revenue that would be raised if it were repealed. For example, the ability to deduct mortgage interest expense on owner-occupied housing is considered to be a tax expenditure. The tax expenditure estimate reports the revenue change that would occur if this deduction were repealed, but does not take into account any revenue effect that might occur as a result of most changes in taxpayer behavior, such as taxpayer decisions to own homes. However, in recalculating the tax due in the absence of this deduction, the tax expenditure estimate assumes taxpayers would switch from itemizing deductions to claiming the standard deduction if that were tax minimizing in the absence of the ability to deduct mortgage interest on an itemized return.

When possible, Treasury uses samples of tax returns provided by the Internal Revenue Service as the basis for tax expenditure estimates. For provisions benefiting individual tax filers the Individual Tax Model (ITM) Tax Calculator is often used. The ITM is based upon a stratified sample of individual tax returns that represent the entire tax filing population. This sample is augmented by additional data to represent the U.S. population. The ITM projects these individual records forward consistent with the Administration's economic forecast. The ITM Tax Calculator allows the computation of tax for each record under differing tax laws.

For example, the Lifetime Learning tax credit is considered a tax expenditure because the baseline tax system would not allow credits targeted at particular activities, investments, or industries. Treasury uses the ITM Tax Calculator to compute tax liability for each filing unit under current law and current law with the Lifetime Learning tax credit removed.

[18] For example, one major departure is that income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as a tax expenditure. Another example is that values of assets and debt are not generally adjusted for inflation.

[19] Treasury and the JCT differ in their assumed baselines from which tax expenditures are measured. For a summary of the differences see Altshuler, Rosanne and Robert Dietz. "Reconsidering Tax Expenditure Estimation." *The National Tax Journal*, June 2011, 64 (2, Part 2), 459-490.

[20] "Current law baseline" refers to the budget estimates prepared by the Administration based on laws enacted at the time they are prepared. If a provision will expire or change under currently enacted law then the baseline projections reflects the effects of that expiration or change.

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As another example, the exclusion of public assistance benefits is considered a tax expenditure because transfers from the government would be considered income to the taxpayer under the baseline tax system. Since tax records do not record the receipt of these types of benefits, Treasury estimates the value of this tax expenditure by supplementing historical Bureau of Economic Analysis National Income and Product Accounts data with U.S. Department of Health and Human Services and state expenditure data to determine the total forecasted value of public assistance transfers to taxpayers under current law over the budget window. The tax expenditure is calculated by multiplying the aggregate public transfers by an estimate of the average effective tax rate for tax filers receiving public assistance benefits.

Treasury estimates the cash effect of each tax expenditure. Some tax expenditures represent deferrals of taxation (a tax not paid in the current tax year will be paid in a future tax year when the deferral reverses). Estimates for such deferrals are based on the net tax effect of current year deductions or exclusions and reversals of prior year deferrals included in current year taxable income.[21] For example, defined contribution employer plans are estimated as the net tax effect of current year contributions excluded from income and income reported upon withdrawals from plans.

Year-to-year differences in the calculations for each tax expenditure reflect changes in tax law, including phase outs of tax expenditure provisions and changes that alter the baseline income tax structure, such as the tax rate schedule, the personal exemption amount, the standard deduction, and other factors. For example, the dollar value of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law.

Understanding Estimates

Tax expenditure estimates are developed to aid policymakers. It is important to understand that they are not transaction-based amounts. The estimates are updated annually using the best available data and models. However, data limitations and resource constraints are inherent in the process. For example, some data collected on tax returns are not available in time for the annual estimates; other data are not collected on tax returns at all and must always be estimated.

The major considerations regarding the estimates are identified below.

Not Necessarily Equivalent to Forgone Revenue. Estimates should be regarded as approximations. As with expenses incurred with spending programs, tax expenditure estimates do not necessarily equal the change in the deficit[22] that would result from repealing these special provisions because:

a. eliminating a tax expenditure may have incentive effects that alter economic behavior and

b. tax expenditures are interdependent even without incentive effects.

Difficulty in Calculating Totals. A total for the estimated tax expenditures is not provided in the President's Budget because each tax expenditure is estimated independently assuming other parts of the tax code remain unchanged. The estimates might be different if two or more tax expenditures were changed simultaneously because of potential interactions

[21] To complement these estimates, Treasury also reports a discounted present-value estimate of the future net revenue effects for the tax expenditure activity in the most recently concluded calendar year.

[22] Note that repealing certain spending programs would also not reduce the deficit by the amount of spending because of interaction with other programs and the tax system. For example, Social Security benefits may be taxed so that eliminating the benefits would also reduce tax revenue and possibly increase spending in other benefit programs. Thus, the change in the deficit would be smaller than the direct spending eliminated through the adjustment to the Social Security program.

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among provisions. Nonetheless, other experts do present a total summing the separate estimates. The Congressional Budget Office (CBO) has modeled the interaction of the ten largest tax expenditures in the individual income tax law and found that interactions that overstate the effect are similar in size to interactions that understate the effect.[23] As a result, CBO concluded that the total is a meaningful estimate for the general magnitude of tax expenditures under current tax law. If the law changes in significant ways the interactions may not result in offsetting over- and understatements of the effect to the same extent.

Completeness. As noted earlier, significant judgments are required to identify special provisions of the income tax code. Given the complexity of the tax code, differences in judgments lead some to include provisions in tax expenditure lists that others would exclude and vice versa. In addition, special provisions can be included in taxes other than income taxes (for example, excise taxes), but these generally are not included in reports on tax expenditures.

Expiring Provisions. Estimates are based on tax law enacted as of July 1 of the reporting year and assume that any provisions scheduled to expire will expire. As noted above, provisions likely to be extended are ignored for estimation purposes until such legislation is actually enacted. In other words, estimates are based on current law rather than analyzing policy outcomes likely to occur. As a result, an extensive knowledge of tax policy may be required in order to understand multi-year tax expenditure projections when provisions are scheduled to expire or when provisions of previous legislation are phased in.

Alternatives. Estimates involve significant judgments and, as a result, there are alternative approaches to estimation. For example, alternatives regarding the application of marginal tax rates, treatment of related tax provisions, or selection of a different baseline (such as a consumption tax rather than an income tax) would affect tax expenditure estimates. In addition, while estimates are provided for the cash (current revenue) effect for each of the ten fiscal years covered by the projections, a present value alternative that considers the full life cycle of the taxable activity may be more useful for tax expenditures involving deferrals or other long-term revenue effects. For such tax expenditures, the present value effects are important because deferrals will reverse in later years, and a present-value estimate for the activity in the current calendar year would include this activity.

See http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx for a complete listing of tax expenditures reported and estimated by Treasury.

[23] Congressional Budget Office. *The Distribution of Major Tax Expenditures in the Individual Tax System.* May 2013.

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APPENDIX C: TASK FORCE MEMBERS

R. Scott Bell	Department of the Treasury, Senior Accountant
Robert Bixby	The Concord Coalition, Executive Director
Robert Dietz	NAHB, Tax and Market Analysis, Senior Vice President
Bert Edwards	GWSCPA Federal Issues and Standards Committee (FISC) Member
Regina Kearney	Office of Management and Budget, Senior Advisor
John McClelland	Department of the Treasury, Office of Tax Analysis, Economist
James McTigue, Jr.	Government Accountability Office, Strategic Issues, Director
Tim Morgan	PricewaterhouseCoopers, Partner (retired)
Dan Murrin	EY, Partner; GWSCPA FISC Member
MaryLynn Sergent	Government Accountability Office, Strategic Issues, Assistant Director
Jamie Taber	Office of Management and Budget, Economist
Alexandra Thornton	Center for American Progress, Tax Policy, Senior Director
Robin Valentine	KPMG LLP, Partner
David Weiner	Congressional Budget Office, Tax Analysis Division, Assistant Director

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APPENDIX D: ABBREVIATIONS

APG	Agency Priority Goals
CAP	Cross-Agency Priority
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
GPFFR	General Purpose Federal Financial Report
GPRA	Government Performance and Results Act of 1993
GPRAMA	GPRA Modernization Act of 2010
ITM	Individual Tax Model
JCT	Joint Committee on Taxation
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
OI	Other Information
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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APPENDIX E: GLOSSARY

Tax expenditures

The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344) defines **tax expenditures** as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

Baseline provisions

Baseline provisions are the starting points used to measure the impact of tax expenditures on tax revenues as compared to revenues that would be collected otherwise, absent the special exclusion, exemption, deduction, credit, preferential rate, or deferral. Certain practical aspects of the code are incorporated into the baseline—such as progressive tax rates, personal exemptions, standard deductions, deductions of expenses incurred in order to earn income, and deferrals of unrealized income.

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Christina Ho

Patrick McNamee

Mark Reger

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Ricky A. Perry, Jr.; Detailee

Leigha K. Kiger, Communications Specialist

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814
Mailstop 6H19
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

BUDGET AND ACCRUAL RECONCILIATION

AMENDING STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS (SFFAS) 7, SFFAS 22, AND SFFAS 24

Statement of Federal Financial Accounting Standards 53

October 27, 2017

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as proposals after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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SUMMARY

This Statement amends requirements for a reconciliation between budgetary and financial accounting information established by Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. To increase informational value and usefulness, and to support the government-wide financial statement reconciling net operating cost to the budget deficit, this Statement provides for the budget and accrual reconciliation (BAR) to replace the statement of financing. The BAR explains the relationship between the entity's net outlays on a budgetary basis and the net cost of operations during the reporting period.

The BAR will start with net cost of operations and be adjusted by

- components of net cost that are not part of net outlays,
- components of net outlays that are not part of net cost, and
- other temporary timing differences, which reflect some special adjustments.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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TABLE OF CONTENTS

Summary **1**

Standards **5**

Scope 5

Amendments to SFFAS 7 5

Rescission to SFFAS 22 9

Amendment to SFFAS 24 9

Effective Date 9

Appendix A: Basis for Conclusions **10**

Appendix B: Abbreviations **15**

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STANDARDS

SCOPE

1. This Statement applies when a component reporting entity is presenting general purpose financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board*. This information is not required in the consolidated financial report of the U.S. Government as a whole.

AMENDMENTS TO SFFAS 7, *ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES AND CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING (SFFAS 7)*

2. Paragraphs 80 to 82 of SFFAS 7 established standards regarding a reconciliation and are replaced with the following paragraphs:

> 80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different. To better understand these differences, the reconciliation should explain the relationship between the net cost of operations[1] and net outlays by the entity during the reporting period. The reconciliation should reference the reported "net outlays"[2] and related adjustments as defined by Office of Management and Budget (OMB) Circular A-11: *Preparation, Submission, and Execution of the Budget*.
>
> 81. The net cost of operations should be adjusted by
>
> (a) components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);
>
> (b) components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and
>
> (c) other temporary timing differences (e.g., prior period adjustments due to correction of errors).
>
> 82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis

[1] The terms "net cost of operations" and "net cost" are used interchangeably to refer to the total cost incurred by the reporting entity less exchange revenue earned during the period.

[2] OMB Circular A-11: *Preparation, Submission, and Execution of the Budget* states, "Outlay means a payment to liquidate an obligation (other than the repayment to the Treasury of debt principal). Outlays are a measure of Government spending. Subtract all offsetting collections (unexpired and expired) from gross outlays to yield net outlays so that the contribution of the budget account to the Federal Government's bottom line (the surplus or deficit) can be determined."

amounts used in financial accounting. A narrative explaining the purpose, the nature, and the line items of the reconciliation also should be presented with the reconciliation. The amount and nature of non-cash outlays should be disclosed. For purposes of this Statement, non-cash outlays are outlays that are recognized without a concurrent cash disbursement, such as interest accrued by the Department of the Treasury (Treasury) on debt held by the public and the change in allowance for subsidy cost.

3. Paragraphs 91 to 93 of SFFAS 7 amended Statement of Federal Financial Accounting Concepts 2, *Entity and Display,* to address the then new reconciliation. To ensure SFFAC 2 aligns with the amended standards, these paragraphs are replaced with the following paragraphs:

   91. Subobjective 1C of the Budgetary Integrity objective states that information is needed to help the reader to determine "how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities." This objective arises because accrual-based expense measures used in financial statements differ from the obligation and outlay-based measures used in budgetary reporting.

   92. To satisfy this objective, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a **Budget and Accrual Reconciliation** (BAR) that reconciles the net budgetary outlays for a federal entity's programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity.

   93. The **Budget and Accrual Reconciliation** is added to SFFAC No. 2's suggested list of items included in the section titled "Financial Reporting for an Organizational Entity." In addition, a footnote (referencing the Reconciliation of Net Costs to Outlays) should be added stating the following:

   OMB will provide guidance regarding details of the display for the Budget and Accrual Reconciliation, including whether it should be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

4. The header before paragraph 95 of SFFAS 7 titled "Statement of Financing" is replaced with "Budget and Accrual Reconciliation."

5. Paragraphs 95 to 102 of SFFAS 7 amended SFFAC 2 to provide for the reconciliation. These paragraphs are amended to ensure the concepts and the related illustration (presented as Appendix 1-G of SFFAC 2) align with the amended standards. Paragraphs 95 to 102 and the related illustration are replaced with the following:

   95. The purpose of the reconciliation of Net Costs to Outlays is to explain how budgetary resources outlayed during the period relate to the net cost of operations for the reporting entity. This information should be presented in a way that clarifies the relationship between the outlays reported through budgetary accounting and the accrual

basis of financial (i.e., proprietary) accounting. By explaining this relationship, the reconciliation provides the information necessary to understand how the budgetary outlays finance the net cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the reconciliation are indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from outlays to net cost of operations.

96. **Net Cost of Operations** is from the Statement of Net Cost.

97. **Components of net cost that are not part of net outlays** are most commonly (a) the result of allocating assets to expenses over more than one reporting period (e.g., depreciation) and the write-down of assets (due to revaluations), (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period, and (c) costs financed by other entities (imputed inter-entity costs).

98. **Components of net outlays that are not part of net cost** are primarily amounts provided in the current reporting period that fund costs incurred in prior years and amounts incurred for goods or services that have been capitalized on the balance sheet (e.g., plant, property and equipment acquisition and inventory acquisition).

99. **Other temporary timing differences** reflect special adjustments (e.g., prior period adjustments due to correction of errors).

100. **Net Outlays** is the summation of the above amounts and equals the Statement of Budgetary Resources net outlays amount.

101. The preparer should present material amounts separately in the reconciliation and discuss these in the narrative. The use of “other” captions should be minimized and individually material amounts should not be netted to report an immaterial amount.

102. The following is an example for the financial statement format. This format and its narrative will be added to the appendices of SFFAC No. 2.

Entity and Display, Appendix 1-G

EXAMPLE FINANCIAL STATEMENT FORMATS – BUDGET AND ACCURAL RECONCILIAITON

NARRATIVE

Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis below illustrates this reconciliation by listing the key differences between net cost and net outlays.

Unrealized valuation loss on investment in the reconciliation is related to the write down of security investment due to recent market volatility, which did not result in an outlay but did result in a cost. The large increase of accounts payable compared to last year is because this year's rent expense has not been paid but was included in the net cost this year and not included in the outlays. The large variance in the "transfers in/(out) without reimbursement" between fiscal year (FY) 201X and FY201X is primarily due to the transfer of program management responsibility from agency 1 to agency 2 as discussed in further detail in Note X. In addition, the decrease in "Imputed financing source" is a result of the payment in FY201X for the ABC Settlement.[*]

RECONCILIATION EXAMPLE

For the year ended September 30, 201X

	Intra-governmental	With the public	Total FY 201X
NET COST	**$xxx**	**$xxx**	**$xxx**
Components of Net Cost That Are Not Part of Net Outlays:			
Property, plant, and equipment depreciation	xxx	xxx	xxx
Property, plant, and equipment disposal & revaluation	xxx	xxx	xxx
Year-end credit reform subsidy re-estimates	xxx	xxx	xxx
Unrealized valuation loss/(gain) on investments	xxx	xxx	xxx
Increase/(decrease) in assets:			
Accounts receivable	xxx	xxx	xxx
Loans receivable	xxx	xxx	xxx
Investments	xxx	xxx	xxx
Other assets	xxx	xxx	xxx
(Increase)/decrease in liabilities:			
Accounts payable	xxx	xxx	xxx
Salaries and benefits	xxx	xxx	xxx
Insurance and guarantee program liabilities	xxx	xxx	xxx
Environmental and disposal liabilities	xxx	xxx	xxx
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	xxx	xxx	xxx
Other financing sources:			
Federal employee retirement benefit costs paid by OPM and imputed to the agency	xxx	xxx	xxx
Transfers out (in) without reimbursement	xxx	xxx	xxx
Other imputed financing	xxx	xxx	xxx
Total Components of Net Cost That Are Not Part of Net Outlays	**xxx**	**xxx**	**xxx**

[*] This is an illustration of what might be presented in the narrative paragraph. It is an example of how to explain the material line items in the reconciliation and describes why some material line items either increase or decrease net cost but do not have the same impact on net outlays.

Components of Net Outlays That Are Not Part of Net Cost:			
Effect of prior year agencies credit reform subsidy re-estimates	xxx	xxx	xxx
Acquisition of capital assets	xxx	xxx	xxx
Acquisition of inventory	xxx	xxx	xxx
Acquisition of other assets	xxx	xxx	xxx
Other	xxx	xxx	xxx
Total Components of Net Outlays That Are Not Part of Net Cost	**xxx**	**xxx**	**xxx**
Other Temporary Timing Differences	**xxx**	**xxx**	**xxx**
NET OUTLAYS	**$xxx**	**$xxx**	**$xxx**[3]

RESCISSION OF SFFAS 22, CHANGE IN CERTAIN REQUIREMENTS FOR RECONCILING OBLIGATIONS AND NET COST OF OPERATIONS, AMENDMENT OF SFFAS 7, ACCOUNTING FOR REVENUE AND OTHER FINANCING

6. SFFAS 22 is rescinded in its entirety by this Statement.

AMENDMENT TO SFFAS 24, SELECTED STANDARDS FOR THE CONSOLIDATED FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT

7. The following paragraph replaces SFFAS 24, paragraph 9:

> 9. Paragraphs 77-82 of SFFAS 7 are not applicable to the consolidated financial report of the U.S. Government as a whole.[1] [Text of footnote 1: Footnote rescinded by SFFAS 53.]

EFFECTIVE DATE

8. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Early adoption is permitted. In the initial year of implementation, the disclosure requirements that were applicable in prior reporting periods (SFFAS 7 (unamended) paragraphs 80 to 82) are not required for comparative presentations.

The provisions of this Statement need not be applied to immaterial items.

[3] Total Net Outlays can be linked to the Statement of Budgetary Resources, and equals gross outlays less actual offsetting collections and distributed offsetting receipts. The net outlays for Intra-governmental and With the Public listed in the format are calculated totals.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. The Statement of Financing (SOF) note disclosure has been criticized as too complex and not useful. In July 2012, the Association of Government Accountants' research report (titled *Government-wide Financial Reporting*) suggested improvements in the processes used to prepare the consolidated financial report, as well as related standards. Moreover, the consolidated financial report of the U.S. Government (CFR) includes a basic financial statement reconciling the Unified Budget Deficit (deficit) and the Net Cost of Operations. The deficit is based on receipts and outlays rather than obligations. The current component reporting entity obligation-based SOF reconciliation does not align with the CFR reconciliation.

A2. In February 2016, the Board agreed to undertake a project to assess the SOF and formed a Budget and Accrual Reconciliation (BAR) task force. Through this project, the Board planned to address concerns regarding the reconciliation and the need to support the CFR reconciliation by aligning the component reporting entity disclosures with the CFR requirements. In addition to agreeing with the concerns of the Board, the BAR task force identified the following topics to be addressed:

   a. The complexity and usefulness of the SOF note
   b. Ways to more directly relate budgetary data and accrual data for a less complex presentation
   c. Support for the CFR reconciliation statement (limited to component reporting entity requirements)

A3. The BAR task force, which included industry representatives from several public accounting and consulting firms, as well as representatives with financial reporting preparation and policy background from the following federal agencies, supported the development of this proposed Statement:

   a. Department of Energy (DOE)
   b. Treasury
   c. Department of Veterans Affairs (VA)
   d. Small Business Administration (SBA)
   e. U.S. Coast Guard (USCG)
   f. Securities and Exchange Commission (SEC)

A4. During the initial phase of the project, the BAR task force was divided into subgroups to research (a) the usefulness of the current SOF, (b) a new component reporting entity reconciliation format, and (c) the potential amendment to the existing standards to adopt

the new reconciliation format. The SOF sub-group reviewed 23 major agencies' current SOF notes to understand their current SOF note preparation process and surveyed task force members on the advantages and disadvantages of the current SOF note. Based on the research result, the task force came to the following conclusions:

a. Each agency established its own processes.
b. The SOF is time consuming to prepare.
c. Without government-wide guidance, the SOF note is not comparable between agencies.
d. The SOF note is too complex to be useful.

A5. Subsequently, the BAR task force researched and developed a first draft of the BAR format based on the objectives identified. In addition, the BAR subgroups (a) performed agency-level piloting of the BAR, (b) researched detailed account level guidance needed to support the BAR, (c) aligned the current format to the related CFR format, and (d) conducted other research including consideration of changes to the existing standards.

A6. In June 2016, the Board approved the BAR task force's recommendations based on its research results. These recommendations included the following:

a. The current SOF note should be replaced due to its complexity and limited usefulness.

b. There is a need to develop an alternative presentation format that would better relate budgetary and accrual data, as well as support the CFR reconciliation.

A7. By the end of July 2016, the task force proposed an updated BAR. Six agencies—-DOE, SBA, SEC, Treasury, USCG, and VA—piloted the BAR and provided their feedback on the pilot process and how the updated BAR compares to the current SOF note. Based on the pilot results, the BAR task force identified many advantages and some disadvantages of replacing the SOF note with a reconciliation of net cost to net outlays.

A8. In August 2016, the Board tentatively approved the new format and supported continued development efforts, including involving more agencies to pilot the BAR. By the end of this project phase, a total of 13 agencies—including 11 cabinet agencies—joined the pilot efforts.

A9. Based on feedback from the task force and pilot agencies, the new BAR

a. supports the CFR reconciliation,

b. is easier to prepare than the current SOF note disclosure,

c. is easier for users not familiar with federal budgeting and accounting to understand due to its similarity to the commercial cash flow statement, and

d. requires that each agency develop a new process to support the development of the new BAR.

A10. The task force developed detailed account level guidance for each line item of the BAR and compared it to the information needed to support the CFR budget deficit and net cost

reconciliation. The task force found that a majority of the current CFR reconciliation line items will be supported by the new reconciliation. The remaining line items primarily relate to budget receipts, which were intentionally omitted in the new reconciliation to simplify the presentation and reduce the preparation burden on the component reporting entities.

A11. According to the task force respondents, the new reconciliation is an improvement in comparison to the existing reconciliation. The BAR is more closely aligned with information presented in component reporting entity financial statements. It is easier to understand, and readily auditable. Further, the requirement to provide a narrative explanation of the reconciliation and significant reconciling items also enhances its understandability. For most agencies, it does not require a change of the agencies' current software.

A12. Treasury has collaborated with the task force representatives in developing guidance that could be used to prepare the BAR. Such guidance will facilitate implementation and reduce costs.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A13. The Board issued the exposure draft (ED), *Budget and Accrual Reconciliation*, on December 21, 2016, with comments requested by March 14, 2017.

A14. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

A15. FASAB received 27 responses from preparers, users of federal financial information, and professional associations. The majority of respondents agreed with the proposals to (1) replace the SOF with the BAR, (2) present the BAR as a footnote, and (3) present a narrative disclosure accompanying the BAR.

A16. Approximately half of the respondents disagreed with the proposed effective date and the proposal for the restatement of comparative prior period information. Nine out of 27 respondents also disagreed with the proposal to have a breakdown of the Intragovernmental and With the Public in the reconciliation.

A17. Some respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A18. The Board did not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' significant comments are summarized below.

A19. Some respondents disagreed with the proposed effective date because they believed it did not allow them sufficient time to test the new format. To maximize agency success in adopting the proposed Statement and allow each agency sufficient time testing the new

process, the Board agreed to change the effective date to periods beginning after September 30, 2018, with early adoption permitted.

A20. Some respondents stated that to restate prior period data, a one-year phase-in period would be needed. During this time, comparative data could be collected and reported while agencies continued to provide the SOF. Most of the respondents believed that a change to the BAR format should be done prospectively. The Board considered that the restatement of the prior period data does not add any additional value, and the prior year SOF would not be comparable with the BAR format during the implementation year. Ultimately, the Board agreed to present only data for one reporting period in the first year of implementation, with a comparative presentation in the following reporting period.

A21. The agencies listed various reasons or challenges that they would face, should agencies be required to present separately in the BAR Intragovernmental and With the Public data. For example, while the BAR reconciles line items from the Statement of Net Cost and Statement of Budgetary Resources, only the Statement of Net Cost provides information needed to distinguish between amounts that are Intragovernmental as opposed to With the Public. That distinction is not made regarding amounts, including outlays, shown on the Statement of Budgetary Resources. A few agencies also stated that outlays by trading partner are not readily available in their current systems, and agencies are concerned about the additional system investment cost and the labor-intensive work to segregate information for certain line items associated with this breakdown request.

A22. Treasury has stated it needs the audited breakdown of Intragovernmental and With the Public to support the elimination process during consolidation. Without the breakdown, the BAR format is less beneficial for the CFR reconciliation because intragovernmental amounts will not be identified for elimination.

A23. After carefully considering the comments received on the breakdown, the Board proposed an updated BAR format without the breakdown of the budgetary net outlays. However, the format retains the breakdown of line items above the net outlays based on the following:

a. Although the BAR format is illustrated in the Statement, this Statement does not explicitly require this breakdown. The Office of Management and Budget (OMB) and Treasury have the option to establish more or less detailed requirements upon implementation or in the future.

b. In the proposed BAR format, the line items for the section “Components of Net Cost That Are Not Part of Net Outlays” are taken directly from the Balance Sheet and the Statement of Net Cost. The needed breakdowns already exist in those statements. The majority of the individual line items for the section “Components of Net Outlays That Are Not Part of Net Cost” can be supported by USSGL for the breakdown.

A24. To ensure the updated BAR format reasonably addressed agency concerns before finalizing this Statement, Treasury updated the detailed account level guidance with a breakdown of Intragovernmental and With the Public. The updated format and guidance were provided to the nine agencies expressing concerns about the breakdown during the comment period. Six of the nine agencies responded after piloting both the format and the guidance, and they all preferred this updated format. Based on the positive feedback from

those respondents, the revised format is included as an illustration to be presented in SFFAC 2 as amended by this Statement.

A25. The Board believes disclosing information about any non-cash outlays would aid in preparing the CFR reconciliation of the budget surplus (deficit) to the change in cash.

BOARD APPROVAL

A26. This Statement was approved for issuance by all members of the Board.

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APPENDIX B: ABBREVIATIONS

BAR	Budget and Accrual Reconciliation
CFR	Consolidated Financial Report of the U.S. Government
DOE	Department of Energy
FASAB	Federal Accounting Standards Advisory Board
FECA	Federal Employees' Compensation Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
OMB	Office of Management and Budget
OPM	Office of Personnel Management
SBA	Small Business Administration
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOF	Statement of Financing
Treasury	Department of the Treasury
USCG	United States Coast Guard
VA	Department of Veterans Affairs

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FASAB Board Members

D. Scott Showalter, Chair

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FASAB Staff

Wendy M. Payne, Executive Director

Grace Wu, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

LEASES:

AN AMENDMENT OF STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS (SFFAS) 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT, AND SFFAS 6, ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT

Statement of Federal Financial Accounting Standards 54

April 17, 2018

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Mailstop 1155
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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SUMMARY

This Statement revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's general purpose federal financial reports and includes appropriate disclosures.

This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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TABLE OF CONTENTS

Summary 4

Standards 6

- **Scope** 6
- **Definitions** 7
- **Lease Term** 8
- **Short-Term Leases** 10
- **Contracts or Agreements that Transfer Ownership** 11
- **Intragovernmental Leases** 11
- **Lessee Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases** 13
- **Lessor Recognition, Measurement, and Disclosures for Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmenal Leases** 16
- **Financial Report of the U.S. Government Disclosures** 19
- **Lease Incentives and Lease Concessions** 20
- **Contracts or Agreements with Multiple Components** 20
- **Contract or Agreement Combinations** 21
- **Lease Terminations and Modifications** 21
- **Subleases** 23
- **Sale-Leaseback Transactions** 23
- **Lease-Leaseback Transactions** 24
- **Amendments to SFFAS 5, *Accounting for Liabilities of the Federal Government,* and SFFAS 6, *Accounting for Property, Plant, and Equipment*** 24
- **Implementation** 26
- **Effective Date** 27

Appendix A: Basis for Conclusions 28

- **Project History** 28
- **Summary of Outreach Efforts and Responses** 29
- **Considerations Related to Benefits and Costs** 30
- **Scope** 33
- **Definitions** 34
- **Lease Term – Options to Extend or Terminate** 34
- **Remeasurement** 35
- **Short-Term Leases** 35
- **Intragovernmental Leases** 36
- **Leases Other than Short-Term Leases, Contracts or Agreements that Transfer Ownership, and Intragovernmental Leases** 36
- **Board Approval** 37

Appendix B: Abbreviations 38

Appendix C: Glossary 39

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_54.pd

STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. For purposes of applying this Statement, a **lease**[1] is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E)[2] (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. To qualify as a lease, the underlying asset typically should be identified by being explicitly specified in a contract or agreement. However, an asset also can be identified by being implicitly specified at the time that the asset is made available for use by the lessee. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease.

3. To determine whether a contract or agreement conveys the right to control the use of the underlying asset, a federal entity should assess whether the contract or agreement gives the lessee both of the following:

    a. The right to obtain economic benefits or services from use of the underlying asset as specified in the contract or agreement

    b. The right to control access to the economic benefits or services of the underlying asset as specified in the contract or agreement

4. The lease definition excludes contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component (par. 73). A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset.

5. This Statement does not apply to

    a. leases of assets under construction or

    b. leases (licenses) of internal use software (SFFAS 10, *Accounting for Internal Use Software*, as amended).

[1] Terms defined in the Glossary are shown in **bold-face** the first time they appear.
[2] SFFAS 6, *Accounting for Property, Plant, and Equipment*.

DEFINITIONS

Definitions in paragraphs 6 through 13 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

6. **Lease** – A lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

7. **Short-Term Lease** – A short-term lease is a lease with a lease term (as defined in par. 14-21) of 24 months or less.

8. **Intragovernmental Lease** – An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*[3] whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

9. **Lease Incentives** – Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to the lessee's prior lessor, or the lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

11. **Leasehold Improvements** – Leasehold improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

12. **Lessor Improvements** – Lessor improvements are additions, alterations, remodeling, renovations, or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

13. **Initial Direct Lease Costs** – Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases that would not have been incurred without entering into the lease.

[3] SFFAS 47, *Reporting Entity*, par. 38–42.

LEASE TERM

14. The lease term is the noncancelable period plus certain periods subject to options to extend or terminate the lease. The noncancelable period is the shorter of

    a. the period identified in the lease contract or agreement that precedes any option to extend the lease or

    b. the period identified in the lease contract or agreement that precedes the first option to terminate the lease.

15. The lessee's lease term includes the noncancelable period and the following periods, if applicable:

    a. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option

    b. Those periods specified in the lease contract or agreement that follow a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessee will not exercise that option

    c. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessor will exercise that option

    d. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessor will not exercise that option

16. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessee determined that it was not probable that a lessee option to extend would be exercised; any subsequent option periods would not be evaluated.

17. The lessor's lease term includes the noncancelable period and the following periods, if applicable:

    a. Those periods specified in the lease contract or agreement that relate to a lessor's option to extend the lease if it is probable, based on all relevant factors, that the lessor will exercise that option

    b. Those periods specified in the lease contract or agreement that follow a lessor's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if it is probable, based on all relevant factors, that the lessor will *not* exercise that option

c. Those periods specified in the lease contract or agreement that relate to a lessee's option to extend the lease if there is significant evidence, based on all relevant factors, that the lessee will exercise that option

d. Those periods specified in the lease contract or agreement that follows a lessee's option to terminate the lease (up until the point in time when there is another option or, if none, the end of the lease) if there is significant evidence, based on all relevant factors, that the lessee will not exercise that option

18. The options should be considered in chronological order. If a determination is made that an additional period will not be added to the lease term for an option based on the likelihood criteria above, subsequent options would not be considered. For example, if the lessor determined that it was not probable that a lessor option to extend would be exercised; any subsequent option periods would not be evaluated.

19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied:

    a. Periods for which both the lessee and lessor (1) have an option to terminate the lease without permission from the other party or (2) have to agree to extend are cancelable periods and are excluded from the lease term. For example, month-to-month lease holdovers, also referred to as rolling lease extensions, or any lease that continues into a holdover period until a new contract or agreement is signed would be considered cancelable if both the lessee and the lessor have an option to terminate. Therefore, either could cancel the lease at any time. These holdover periods are cancelable periods and should be excluded from the lease term.[4]

    b. If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.

    c. An availability of funds or cancellation clause allows federal lessees to cancel a lease agreement, typically on an annual basis, if funds for the lease payments are not appropriated. This type of clause should affect the lease term only when it is probable that the clause will be exercised.

20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee will exercise options identified in paragraph 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following:

    a. A significant economic incentive, such as contractual or agreement terms and conditions for the optional periods that are favorable compared with current market rates

[4] SFFAS 1, *Accounting for Selected Assets and Liabilities*, applies to any related accounts payable or accounts receivable amounts.

b. A significant economic disincentive, such as costs to terminate the lease and sign a new lease (for example, negotiation costs, relocation costs, abandonment of significant leasehold improvements, costs of identifying another suitable underlying asset, costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location, or a substantial cancellation penalty)

c. The history of exercising options to extend or terminate

d. The extent to which the asset underlying the lease is mission critical to the federal entity

21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

a. The lessor or lessee elects to exercise an option that was previously presumed would not be exercised under the likelihood criteria in paragraphs 15 and 17

b. The lessor or lessee does not elect to exercise an option that was previously presumed would be exercised under the likelihood criteria in paragraphs 15 and 17

c. An event specified in the lease contract or agreement that requires an extension or termination of the lease takes place.

SHORT-TERM LEASES

22. A short-term lease is a lease with a lease term (as defined in paragraphs 14 - 21) of 24 months or less.

LESSEE TREATMENT OF SHORT-TERM LEASES

23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due if payments are made subsequent to that reporting period. The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.

LESSOR TREATMENT OF SHORT-TERM LEASES

24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due if payments are received subsequent to that reporting period. The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.

CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP

25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14–19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.[5]

INTRAGOVERNMENTAL LEASES

26. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. Any lease that meets the definition of an intragovernmental lease would be required to follow the accounting and disclosure guidance described in paragraphs 27–38.

27. A lessee should recognize lease payments, including lease-related operating costs (for example, maintenance, utilities, taxes, etc.) paid to the lessor, as expenses based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. Prepaid rent or a payable for rent due should be recognized as an asset or liability, respectively, and an expense should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

28. A lessor should recognize lease receipts, including lease-related operating costs (for example, maintenance, utilities, or taxes) received from the lessee as income based on the provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. Rent paid in advance or a receivable should be recognized as a liability or asset, respectively, and income should be recognized in the appropriate reporting period based on the specifics of the lease provisions.

29. Rental increases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases in costs or anticipated appreciation in property values, but the amount of the increase is specified in the lease) or they may be contingent on future events.

30. Rental increases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation (tied to a specific economic indicator where the specific amount of the change is not known).

31. If the lease provides for rental increases, a lessee should recognize the expense in the period of the increase.

32. Lease incentives should be recognized by the lessee as deferred revenue when received from the lessor and then as reductions of lease rental expense on a straight-line basis over the lease term. The lessee should recognize the expenses or losses to which the incentives

[5] SFFAS 6, *Accounting for Property, Plant, and Equipment,* par. 26.

relate in the reporting period the costs are incurred. For example, an incentive equal to the moving expense incurred by the lessee to occupy the leased space reduces rent expense over the lease term, and the moving expense is recognized in the reporting period incurred (that is, when the move occurs). Lease incentives provided to the lessee should be recognized by the lessor as reductions of lease rental income on a straight-line basis over the lease term.

33. Lease concessions should be recognized by the lessee as reductions of lease rental expense on a straight-line basis over the lease term. Lease concessions should be recognized by the lessor as reductions in rental income on a straight-line basis over the lease term.

34. Leasehold improvements that are placed in service at or after the beginning of the lease term should be amortized over the useful life (the normal operating life in terms of utility to the lessee) of the leasehold improvement, but no longer than the expected lease term.

35. Lessor improvements are components of the leased property and should be capitalized and depreciated by the lessor over their useful life consistent with the lessor's accounting for PP&E.[6]

36. Initial direct lease costs incurred by the lessee should be expensed when incurred. Initial direct lease cost incurred by the lessor should be expensed when incurred.

DISCLOSURES FOR INTRAGOVERNMENTAL LEASES

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

    a. A general description of significant intragovernmental leasing arrangements, including general lease terms with any applicable specific intragovernmental requirements

    b. Annual lease expense in total and by major leased PP&E category.

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

    a. A general description of significant leases, including a breakdown of the number of leases with federally-owned assets and privately-owned assets

    b. Future lease payments that are to be received to the end of the lease term for each of the five subsequent fiscal years and in five-year increments thereafter

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[6] This recognition is consistent with PP&E capital improvements outlined in SFFAS 6, *Accounting for Property, Plant and Equipment*, par. 37.

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LESSEE RECOGNITION, MEASUREMENT, AND DISCLOSURES FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

39. At the commencement of the lease term, a lessee should recognize a lease liability and a PP&E right-to-use lease asset (hereinafter referred to as the lease asset), except as provided in paragraphs 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraph 26–38 (intragovernmental leases).

LEASE LIABILITY

40. A lessee initially should measure the lease liability at the present value of payments expected to be made during the lease term. Measurement of the lease liability should include the following, if required by a lease:

    a. Fixed payments

    b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

    c. Variable payments that are fixed in-substance as described in paragraph 41

    d. Amounts that are probable of being required to be paid by the lessee under residual value guarantees

    e. The exercise price of a purchase option if it is probable that the lessee will exercise that option

    f. Payments for penalties for terminating the lease, if the lease term reflects the lessee exercising (1) an option to terminate the lease or (2) an availability of funds or cancellation clause

    g. Any lease incentives (par. 70–71) receivable from the lessor

    h. Any other payments to the lessor that are probable of being required based on an assessment of all relevant factors

41. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included. Rather, these variable payments should be recognized as an expense in the reporting period in which those payments are incurred. However, any component of these variable payments that is fixed in-substance should be included in the lease liability. An example is a lease payment based on a percentage of sales or usage but with a required minimum amount to be paid. That required minimum payment is fixed in-substance.

42. The future lease payments should be discounted using the interest rate the lessor charges the lessee, which may be the interest rate implicit in the lease. If the interest rate cannot be

reasonably estimated by the lessee, the **lessee's estimated incremental borrowing rate**[7] (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

43. In subsequent financial reporting periods, the lessee should calculate the amortization of the discount on the lease liability and recognize that amount as interest expense for the period. Any payments made should be allocated first to the accrued interest liability and then to the lease liability.

44. The lessee should remeasure the lease liability at subsequent financial reporting dates if one or more of the following changes[8] have occurred at or before that financial reporting date, based on the most recent lease contract or agreement before the changes, and if the changes individually or in the aggregate, are expected to significantly affect the amount of the lease liability since the previous measurement:

    a. There is a change in the lease term.

    b. An assessment of all relevant factors indicates that the likelihood of a residual value guarantee being required to be paid has changed from probable to not probable or vice versa.

    c. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

    d. There is a change in the estimated amounts for payments already included in the liability (except as provided in par. 45).

    e. There is a change in the interest rate the lessor charges the lessee if used as the initial **discount rate**.

    f. A contingency, upon which some or all of the variable payments that will be made over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease liability in paragraph 40. For example, an event occurs that causes variable payments that were contingent on the performance or use of the underlying asset to become fixed payments for the remainder of the lease term.

45. If a lease liability is remeasured for any of the changes in paragraph 44, the liability also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the liability since the previous measurement. A lease liability is not required to be remeasured solely for a change in an index or rate used to determine variable payments.

[7] A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.
[8] Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

46. The lessee also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease liability:

    a. There is a change in the lease term.

    b. An assessment of all relevant factors indicates that the likelihood of a purchase option being exercised has changed from probable to not probable, or vice versa.

47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the lessee's estimated incremental borrowing rate.

48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the lessee's estimated incremental borrowing rate at the time the discount rate is updated should be used.

LEASE ASSET

49. A lessee should initially measure the lease asset as the sum of the following:

    a. The amount of the initial measurement of the lease liability (par. 40)

    b. Lease payments made to the lessor at or before the commencement of the lease term, less any lease incentives (par. 70–71)

    c. Initial direct lease costs that are necessary to place the lease asset into service

50. A lease asset should be amortized in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset, except as provided in paragraph 51. The amortization of the lease asset should be reported as amortization expense.

51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. In that circumstance, if the underlying asset is nondepreciable, such as land, the lease asset should not be amortized.

52. The lease asset generally should be adjusted by the same amount when the corresponding lease liability is remeasured based on paragraph 44–48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

53. Leased assets classified as PP&E are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The change in the manner or duration of use of the underlying asset is an indicator that the right of use asset may be impaired (SFFAS 44, par. 12). If the underlying asset is impaired, it should be reduced first

for any change in the corresponding lease liability. Any remaining amount should be recognized as an impairment.[9]

COMPONENT REPORTING ENTITY DISCLOSURE REQUIREMENTS FOR LESSEES

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

    a. A general description of its leasing arrangements, including:

        i. the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

        ii. the existence, terms, and conditions of residual value guarantees provided by the lessee

    b. The total amount of lease assets and the related accumulated amortization, to be disclosed separately from other PP&E assets

    c. The amount of lease expense recognized for the reporting period for variable lease payments not previously included in the lease liability

    d. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    e. The amount of the annual lease expense and the discount rate used to calculate the lease liability

LESSOR RECOGNITION, MEASUREMENT, AND DISCLOSURES FOR LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENAL LEASES

55. At the commencement of the lease term, a lessor should recognize a lease receivable and a deferred revenue, except as provided in paragraph 22–24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26–38 (intragovernmental leases). Any initial direct lease costs incurred by the lessor should be reported as an expense of the period.

LEASE RECEIVABLE

56. A lessor initially should measure the lease receivable at the present value of lease payments to be received for the lease term, reduced by any provision for uncollectible

[9] SFFAS 44, Accounting *for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18–25.

amounts. Measurement of the lease receivable should include the following types of payments that might be required by a lease:

a. Fixed payments

b. Variable payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate), initially measured using the index or rate as of the commencement of the lease term

c. Variable lease payments that are fixed in-substance as described in paragraph 57

d. Residual value guarantees that are fixed payments in substance (par. 57)

e. Any lease incentives (par. 70–71) payable to the lessee

57. Variable payments based on future performance of the lessee or usage of the underlying asset should not be included in the measurement of the lease receivable. Rather, those payments should be recognized as revenue in the reporting period to which those payments relate. However, any component of those variable payments that is fixed in substance should be included in the lease receivable. For example, if a lease payment is based on a percentage of sales but has a required minimum payment, that required minimum is a fixed payment in substance. Similarly, a residual value guarantee is an in-substance fixed payment if it stipulates the underlying asset will be sold at the end of the lease term, with the lessee assuming a liability for any shortfall if the sales price is less than an agreed-upon minimum amount.

58. Amounts to be received under residual value guarantees (that are not fixed in substance) should be recognized as a receivable and revenue when (a) a guarantee payment is required (as agreed to by the lessee and lessor) and (b) the amount can be reasonably estimated. Amounts to be received for the exercise price of a purchase option or penalty for lease termination should be recognized as a receivable and revenue when those options are exercised.

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee, which may be the interest rate implicit in the lease. Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.

60. In subsequent financial reporting periods, the lessor should calculate the amortization of the discount on the receivable and report that amount as interest revenue for the period. Any payments received should be allocated first to the accrued interest receivable and then to the lease receivable.

61. The lessor should remeasure the lease receivable at subsequent financial reporting periods if one or more of the following changes have occurred at or before that financial reporting period, based on the most recent lease contract or agreement before the changes,[10] and the

[10] Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of par. 80–86 for lease modifications and terminations.

changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:

a. There is a change in the lease term.

b. There is a change in the interest rate the lessor charges the lessee.

c. A contingency, upon which some or all of the variable payments that will be received over the remainder of the lease term are based, is resolved such that those payments now meet the criteria for measuring the lease receivable in paragraph 56. For example, an event occurs that results in variable payments that were contingent on the performance or use of the underlying asset becoming fixed payments for the remainder of the lease term.

62. If a lease receivable is remeasured for any of the changes in paragraph 61, the receivable also should be adjusted for any change in an index or rate used to determine variable lease payments if that change in the index or rate is expected to significantly affect the amount of the receivable since the previous measurement. A lease receivable is not required to be remeasured solely for a change in an index or rate used to determine variable lease payments.

63. The lessor also should update the discount rate as part of the remeasurement if one or both of the following changes have occurred and the changes individually or in the aggregate are expected to significantly affect the amount of the lease receivable:

a. There is a change in the lease term.

b. There is a change in the interest rate the lessor charges the lessee.

Deferred Revenue

64. A lessor initially should measure the deferred revenue to include the following:

a. The amount of the initial measurement of the lease receivable (par. 56)

b. Lease payments received from the lessee at or before the commencement of the lease term that relate to future periods (for example, the final month's rent), less any lease incentives (par. 70–71) paid to, or on behalf of, the lessee at or before the commencement of the lease term

65. A lessor subsequently should recognize the deferred revenue in a systematic and rational manner over the term of the lease. The deferred revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63.

Underlying Asset

66. A lessor should not derecognize the asset underlying the lease. A lessor should continue to apply other applicable guidance to the underlying asset, including depreciation and

impairment. However, if the lease contract or agreement requires the lessee to return the asset in its original or enhanced condition, a lessor should not depreciate the asset during the lease term.

Component Reporting Entity Disclosures for Lessors

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases:

    a. A general description of its leasing arrangements, including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined

    b. The carrying amount of assets on lease by major classes of assets, and the amount of related accumulated depreciation

    c. The total amount of revenue (for example, lease revenue, interest revenue, and any other lease-related revenue) recognized in the reporting period from leases

    d. The amount of revenue recognized in the reporting period for variable lease payments and other payments not previously included in the lease receivable, including revenue related to residual value guarantees and termination penalties

68. In addition to the disclosures in paragraph 67, if a federal entity's principal ongoing operations consist of leasing assets through the use of non-intragovernmental leases, the federal entity should disclose a schedule of future lease payments that are included in the lease receivable, showing principal and interest, for each of the five subsequent years and in five-year increments thereafter.

Financial Report of the U.S. Government Disclosures

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

    a. A general description of its leasing arrangements

    b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from other PP&E assets

    c. Principal and interest requirements to the end of the lease term, presented separately, for the lease liability for each of the five subsequent years and in five-year increments thereafter

    d. A general reference to relevant component reporting entity reports

LEASE INCENTIVES AND LEASE CONCESSIONS

70. Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee, for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. Lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40–48) and by lessors consistently with the lessor's lease receivable (par. 56–63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for (financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.

CONTRACTS OR AGREEMENTS WITH MULTIPLE COMPONENTS

72. Lessors and lessees may enter into contracts or agreements that contain multiple components, such as a contract or agreement that contains both a lease component and a nonlease component, or a lease that contains multiple underlying assets.

73. If a lessor or lessee enters into a contract or agreement that contains both a lease (such as the right to use a building) and a nonlease component (such as a maintenance services for the building), the federal entity should account for the lease and nonlease components as separate contracts or agreements, unless the contract or agreement meets the exception in paragraph 76.

74. If a lease involves multiple underlying assets and the assets have different lease terms, the lessor and lessee should account for each underlying asset as a separate lease component. The provisions of this paragraph should be applied unless the contract or agreement meets the exception in paragraph 76.

75. To allocate the contract or agreement price to the different components, lessors and lessees should first use any prices for individual components that are included in the contract or agreement, as long as the price allocation does not appear to be unreasonable based on

the terms of the contract or agreement and professional judgment, maximizing the use of observable information, for example, using readily available observable stand-alone prices. Stand-alone prices are those that would be paid or received if the same or similar assets were leased individually or if the same or similar nonlease components (such as services) were contracted individually. Some contract or agreements provide discounts for bundling multiple leases or lease and nonlease components together in one contract or agreement. These discounts may be taken into account when determining whether individual component prices do not appear to be unreasonable. For example, if the individual component prices are each discounted by the same percentage from normal market prices, those component prices would not be considered unreasonable.

76. If a contract or agreement does not include prices for individual components or if any of those prices appear to be unreasonable as provided in paragraph 75, lessors and lessees should use professional judgment to determine their best estimate for allocating the contract or agreement price to those components, maximizing the use of observable information. If it is not practicable to determine a best estimate for price allocation for some or all components in a contract or agreement, a federal entity should account for those components as a single lease unit.

77. If multiple components are accounted for as a single lease unit as provided for in paragraph 76 , the accounting for that unit should be based on the primary lease component within that unit. For example, the primary lease component's lease term should be used for the unit if the lease components have different lease terms.

CONTRACT OR AGREEMENT COMBINATIONS

78. Contracts or agreements that are entered into at or near the same time with the same counterparty should be considered to be part of the same lease contract or agreement if either of the following criteria is met:

    a. The contracts or agreements are negotiated as a package with a single objective.

    b. The amount of consideration to be paid in one contract or agreement depends on the price or performance of the other contract or agreement.

79. If multiple contracts or agreements are determined to be part of the same lease contract or agreement, that contract or agreement should be evaluated in accordance with the guidance for contracts or agreements with multiple components in paragraphs 72–77.

LEASE TERMINATIONS AND MODIFICATIONS

80. The provisions of a lease contract or agreement may be amended while the contract or agreement is in effect. Examples of amendments to lease contracts or agreements include changing the contract or agreement price, lengthening or shortening the lease term, and adding or removing an underlying asset. An amendment should be considered a lease modification unless the lessee's right to use the underlying asset decreases, in which case the amendment should be considered a partial or full lease termination. By contrast,

exercising an existing option, such as an option to extend or terminate the lease as discussed in paragraphs 15-19, is subject to the guidance for remeasurement.

LEASE TERMINATIONS

81. The lessee and lessor should account for an amendment during the reporting period resulting in a decrease in the lessee's right to use the underlying asset (for example, the lease term is shortened or the number of underlying assets is reduced) as a partial or full lease termination.

Lessee Treatment of Lease Terminations

82. A lessee generally should account for the partial or full lease termination by reducing the carrying values of the lease asset and lease liability and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing the underlying asset from the lessor, the lease asset should be reclassified to the appropriate class of owned asset.

Lessor Treatment of Lease Terminations

83. A lessor should account for the full or partial termination of a lease by reducing the carrying values of the lease receivable and related deferred revenue and recognizing a gain or loss for the difference. However, if the lease is terminated as a result of the lessee purchasing an underlying asset from the lessor, the carrying value of the underlying asset also should be derecognized and included in the calculation of any resulting gain or loss.

LEASE MODIFICATIONS

84. The lessee and lessor should account for an amendment during the reporting period resulting in a modification to a lease contract or agreement as a separate lease (that is, separate from the most recent lease contract or agreement before the modification) if both of the following conditions are present:

    a. The lease modification gives the lessee an additional lease asset by adding one or more underlying assets that were not included in the original lease contract or agreement.

    b. The increase in lease payments for the additional lease asset does not appear to be unreasonable based on (1) the terms of the amended lease contract or agreement and (2) professional judgment, maximizing the use of observable information (for example, using readily available observable stand-alone prices).

Lessee Treatment of Lease Modifications

85. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessee should account for a lease modification by remeasuring the lease liability. The lease asset should be adjusted by the difference between the remeasured liability and the liability immediately before the lease modification. However, if the change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain.

Lessor Treatment of Lease Modifications

86. Unless a modification is reported as a separate lease as provided in paragraph 84, a lessor should account for a lease modification by remeasuring the lease receivable. The deferred revenue should be adjusted by the difference between the remeasured receivable and the receivable immediately before the lease modification. However, to the extent the change relates to payments for the current period, the change should be recognized as revenue or expense for the current period.

SUBLEASES

87. A sublease involves three parties: the original lessor, the original lessee (who also is the lessor in the sublease), and the new lessee. The original lessor should continue to apply the general lessor guidance. The federal entity that is the original lessee and becomes the lessor in the sublease should account for the original lease and the sublease as two separate transactions, as a lessee and a lessor, respectively. Those two separate transactions should not be offset against one another. The new lessee should apply the general lessee guidance.

88. The original lessee (and now the lessor in a sublease) should include the sublease in its disclosure of the general description of lease arrangements. Its lessor transactions related to subleases should be disclosed separately from its lessee transactions related to the original lease.

SALE-LEASEBACK TRANSACTIONS

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale[11] to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

90. The sale and lease portions of a sale-leaseback transaction should be accounted for as two separate transactions—a sale transaction and a lease transaction—except that the difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred revenue or deferred expense to be recognized in the statement of net cost in a systematic and rational manner over the term of the lease. However, if the lease portion of the transaction qualifies as a short-term lease, any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be recognized immediately.

91. A sale-leaseback transaction is considered to have off-market terms if there is a significant difference between (a) the sales price and the estimated fair value of the asset or (b) the present value of the contractual lease payments and the estimated present value of what the lease payments for that asset would be at a market price, whichever of the two

[11] See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 295.

differences is more readily determinable. The difference should be reported based on the substance of the transaction (for example, as a borrowing, a nonexchange transaction, or an advance lease payment) rather than as a part of the sales-leaseback transaction.

92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions in addition to the disclosures required of a lessee (par. 54). A buyer-lessor should provide the disclosures required of a lessor (par. 67).

LEASE-LEASEBACK TRANSACTIONS

93. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be accounted for as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

AMENDMENTS TO SFFAS 5, *ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT,* AND SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

94. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 5, *Accounting for Liabilities of the Federal Government,* paragraphs 43–46. Therefore, the paragraphs marked below are rescinded.

SFFAS 5: *Accounting for Liabilities of the Federal Government*

[43.] ~~**Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:~~

- ~~The lease transfers ownership of the property to the lessee by the end of the lease term.~~
- ~~The lease contains an option to purchase the leased property at a bargain price.~~
- ~~The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.~~
- ~~The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.~~

~~The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.~~

~~If a lease does not meet at least one of the above criteria it should be classified as an operating lease.~~

[44.] ~~The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor. [footnote 20: "The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception. See SFFAS No. 6, Accounting for Property, Plant, and Equipment.] However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.~~

[45.] ~~The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.~~

[46.] ~~During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability. [footnote 21: OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.]~~

95. This Statement replaces the measurement and reporting requirements for lease accounting established in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 20 and 29. Therefore, the paragraphs marked below are rescinded.

SFFAS 6: *Accounting for Property, Plant, and Equipment*

[20.] ~~Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, [footnote21: Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to~~

risk levels.] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

[footnote 22: "Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life [footnote 23: "Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value [footnote 24: "Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[29.] The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard [footnote 35: See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*.] unless the net present value exceeds the fair value of the asset).

IMPLEMENTATION

96. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. Therefore, in the period of implementation,

    a. the determination of the lease term would assume that the lease term began as of the beginning of the period of implementation and

b. the lease liability and lease asset should initially be measured based on the remaining lease term and associated lease payments as of the beginning of the period of implementation.

97. The following implementation guidance addresses specific leasing circumstances.

a. Prospective Implementation – Entities should report the effect of implementing this Statement on existing leases prospectively in accordance with paragraph 13 of SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Accordingly, any changes in assets or liabilities related to existing leases should be treated prospectively. The change should be accounted for in the period of implementation and applicable future periods. No adjustments should be made to previously reported expenses or revenue.

b. Lease Term – The lease term should be determined based on the provisions of this Statement (par. 14-21). However, the lease term of an existing lease should be based on the number of years remaining in the lease contract or agreement as of the beginning of the period of implementation and not the number of years in the initial lease term. For example, if the initial lease term was 20 years, with no options to extend, at the beginning of Year 20X1 and the entity implements this Statement in Year 20X7 (six years into the lease at the beginning of Year 20X7), the initial lease term upon implementation would be 14 years.

c. Short-Term Leases – A short-term lease would be determined based on the provisions of this Statement (par. 22–24). However, if the remaining lease term of an existing lease meets the definition of a short-term lease that lease should apply the short-term lease guidance. For example, if the initial lease term was 60 months as of the beginning of Year 20X1, with no options to extend, and the entity implements this Statement in Year 20X5 (48 months into the lease at the beginning of Year 20X5); the initial lease term at implementation would be 12 months and the lease would meet the definition of a short-term lease. Hence, the entity should account for the lease as a short-term lease.

EFFECTIVE DATE

98. The requirements of this Statement are effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.

The provisions of this Statement need not be applied to immaterial items.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_54.pd

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. This Statement amends the lease accounting standards in SFFAS 5 and 6, which had been in effect since 1995. Under SFFAS 5 and 6, leases were classified as either capital or operating depending on whether the lease met any of four tests.

A2. The Federal Accounting Standards Advisory Board (FASAB or "the Board") undertook this project primarily because SFFAS 5 and 6

a. do not make meaningful distinctions between capital and operating leases based on the substance of lease transactions and

b. are based on Financial Accounting Standards Board (FASB) lease accounting standards, which have been amended.

A3. Lease accounting was first addressed by FASAB during the development of SFFAS 5 and 6. At that time, the Board decided to use the high-level language on lease accounting from FASB Statement of Financial Accounting Standards (SFAS) No. 13 *Accounting for Leases* [subsequently codified in Accounting Standards Codification (ASC) – Topic 840 *Leases*]. This minimal lease guidance included the definition of a capital lease, the criteria for capital leases, and the measurement of a capital lease asset and liability. The Board had plans to use this preliminary guidance as a placeholder until it was prepared to add lease accounting to its agenda as a separate project. Lease accounting had been on the list of potential Board agenda items each time the Board has considered its agenda for new projects.

A4. There are several areas of lease accounting that were covered by the FASB standards that were never specifically addressed in the FASAB standards. Some of those topics include leasehold improvements, lease terms, leveraged leases, and subleases. The federal community often stressed that the federal standards on lease accounting should be comprehensive to reduce confusion on whether FASB standards apply to federal entities when FASAB's are silent on a topic.

A5. Because FASB revised its standards, it was imperative for the Board to revisit lease accounting. One alternative was for the Board to issue detailed implementation guidance on the existing standards. The Board believed that the effort needed to issue such implementation guidance would be better used amending SFFAS 5 and 6. The Board closely reviewed the lease proposals of four standards setters (as stated in paragraph A8) to determine what underlying concepts, if any, would be applicable for federal financial reporting of leases. The Board believes this Statement offers the appropriate guidance for the accounting and financial reporting of leases for federal entities.

A6. In August 2011, FASAB began a project to revise its current standards on lease accounting. FASAB staff formed a task force to assist in developing this Statement. Task force members included accounting, budget, and subject matter experts from federal agencies and independent public accounting firms.

A7. The task force met several times over the course of the project and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations in developing and describing alternatives to present to the Board. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of the exposure draft (ED) preceding this Statement.

A8. In evaluating an approach applicable to federal leases, the Board considered the approaches used in the following documents:

a. FASB's SFAS 13, *Accounting for Leases* [superseded by FASB's ASC 840, which was subsequently superseded by ASC 842]

b. Governmental Accounting Standards Board's (GASB) Statement No. 87, *Leases*

c. International Accounting Standards Board's International Accounting Standard 17, *Leases* [superseded by International Financial Reporting Standard 16]

d. International Public Sector Accounting Standards Board's International Public Sector Accounting Standard 13, *Leases*

A9. At the inception of the project, the Board decided to coordinate with GASB on the lease project because of the similarities among governmental entities regarding lease activities and reporting objectives. Staff worked closely with GASB staff during the development of this Statement. In 2014, FASAB and GASB met to discuss issues related to each of their ongoing lease accounting projects. As a result of this collaboration, similar wording may appear in some sections of the FASAB and GASB standards.[12]

A10. This Statement amends the lease accounting standards in SFFAS 5 and SFFAS 6. This Statement also establishes distinct standards for intragovernmental leases.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A11. FASAB issued the ED, titled *Leases,* on September 26, 2016, with comments requested by January 6, 2017. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

[12] The GASB material is copyrighted by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is used with permission.

A12. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Committee on Oversight and Government Reform

b. House Committee on Transportation

c. House Committee on Budget

d. Senate Committee on Homeland Security and Governmental Affairs

e. Senate Committee on Budget

f. Senate Committee on Environment and Public Works

A13. FASAB received 25 responses from preparers, auditors, professional associations, and citizens. Many respondents had concerns with the definition of leases and the scope of the Statement. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A14. The Board extended an invitation to the respondents of the Leases ED to discuss with the Board their comments on the ED and provide further clarification on their responses. In April 2017, five federal entities addressed the Board to further elaborate on their written comments.

A15. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

CONSIDERATIONS RELATED TO BENEFITS AND COSTS

A16. Throughout the course of developing this Statement, the Board sought to minimize the cost of improving the lease accounting requirements. The Board's assessment of the expected benefits and perceived costs of issuing new standards is often more qualitative than quantitative because it is difficult to accurately estimate the costs of implementing new standards. The Board has made its assessments based on the available evidence of expected benefits and perceived costs with the goal of a balance between maximizing benefits and minimizing costs.

BENEFITS

A17. This Statement will improve upon the existing guidance in SFFAS 5 and 6 by providing

a. relevant and meaningful financial information needed by federal financial statement users and

b. comprehensive lease standards that appropriately address the various lease transactions/activities of the federal community.

A18. One of the primary objectives of this Statement is providing federal leasing information needed to meet the operating performance reporting objective.[13] Recognition of all PP&E leases, except for short-term leases and intragovernmental leases, and the related liabilities ensures the balance sheet informs users regarding the resources and obligations used to fulfill the entity's programs and activities. Additionally, this Statement requires the recognition of the interest cost associated with the entity's leases. This will ensure relevant and comparable information is available to assess the entity's operating performance as well as to monitor the entity's investment in PP&E and financing activities.

A19. The Board is aware that this Statement will require entities to ensure all of their leases are appropriately identified for evaluation, which can improve accountability of its resources and obligations. As noted in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Accounting*, accounting can and should contribute to achieving and demonstrating several aspects of accountability, such as

a. accountability for financial resources;

b. accountability for faithful compliance or adherence to legal requirements and administrative policies;

c. accountability for efficiency and economy in operations; and

d. accountability for the results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness

This Statement contributes to each of these aspects of accountability but is most helpful in achieving accountability for efficiency and economy in operations. By removing somewhat arbitrary and bright-line (rules-based) criteria, a more complete and representationally faithful reporting of PP&E, liabilities, and costs will be provided as discussed in paragraph A21.

A20. The Board believes that in a lease transaction, a lessee receives the right to control the use of another entity's PP&E (the underlying asset—the asset that is subject to the lease, such as a vehicle or building) for a period of time as specified in the contract or agreement. In exchange, the lessee promises to make payments over time for the right to control the use of that underlying asset. The guidance in SFFAS 5 and 6 was based on the notion that some leases are essentially financed purchases of the underlying asset (classified as capital leases) and other leases (classified as operating leases) are not. The classification of a lease as capital or operating depended on whether the lease met any of four tests. Those tests were intended to determine whether most of the risks and benefits of ownership of the underlying asset were transferred to the lessee. Those tests have been criticized because they often resulted in similar leases being accounted for in different ways; making it challenging to identify the total resources needed to support operations and the related obligations.

[13] SFFAC 1 establishes the operating performance objective and indicates that federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

A21. The Board believes that this Statement increases the comparability among federal entities by recognizing those similar leases as lease assets and lease liabilities and disclosing key leasing information. This approach would replace bright-line distinctions between capital and operating leases. The increased comparability will allow financial report users to make lease liability and interest cost comparisons among federal entities. This Statement also provides a clear definition of a lease that is intended to align with the concept of control established in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. The Board believes that this lease definition will reduce opportunities for entities to structure leasing transactions to achieve a specific accounting outcome. Such opportunities could result in misstated PP&E resources, related obligations, and costs.

COSTS

A22. The Board understands that many federal entities—particularly those having a significant number of long-term leases with non-federal entities—will incur additional costs as a result of this Statement. Based on feedback from the task force and ED responses, the initial costs to implement the revised standards will most likely result from reviewing existing lease agreements, ensuring all leases are appropriately identified, educating staff about how to apply the new requirements, implementing processes and controls to ensure all material leasing activity is captured going forward, and some system changes. Those costs will vary based on the number of leases that an entity has and the complexity of those arrangements. For example, it may take more effort to account for a lease agreement with options to extend and multiple components than a lease without those elements.

A23. Respondent comments related to costs and benefits raised concerns about the overall effort and resources needed to implement the proposed guidance. Some respondents also raised concerns regarding limited resources to assess a significant volume of leases. Overall, the evaluation and analysis needed to implement this Statement is similar to the capital leases evaluation and analysis needed in SFFAS 5 and 6, which should help mitigate some of the costs of implementation.

A24. Once implementation of the Statement is complete, the ongoing costs for many entities are unlikely to be significantly higher than the costs of complying with the previous standards. In the previous leases standards, entities were also required to identify leases, evaluate each lease to determine the applicable accounting model to apply (capital or operating), and to subsequently account for each lease, including the ongoing disclosure requirements. This Statement does not substantially change this level of effort and entities may be able to apply the requirements of this Statement using similar systems and processes as those used in previous leases standards to meet those reporting and disclosure requirements.

A25. Additionally, the Board made several decisions in the interest of reducing implementation costs. These include, but are not limited to, the provisions regarding:

a. Allowing a short-term lease exception and not requiring disclosures related to short-term leases by either lessees or lessors

b. Not requiring a lessor to derecognize the underlying asset or calculate a residual value

c. Allocation of the contract price to multiple components of a lease that allows the stated contract prices to be used if they do not appear to be unreasonable

d. Allocation of the contract price to multiple components that allow best estimates to be used for allocation if no separate prices are included in the contract or if stated prices appear to be unreasonable

e. The requirement to treat an entire multiple-component contract as a single lease unit if determining a best estimate is not practicable

f. The exclusion of intragovernmental leases from balance sheet recognition and measurement as a lease asset and corresponding liability

g. The extension of the effective date until fiscal year 2021 which allows more time to prepare and reduces the number of existing leases to be evaluated

A26. For many federal entities, the Board's decisions relating to intragovernmental leases will reduce the preparer's level of effort in comparison to the current lease accounting and financial reporting standards. The majority of federal entities engage primarily in intragovernmental leases. Consistent simplified treatment of intragovernmental leases will also reduce the cost of intragovernmental eliminations. These cost reductions were considered carefully by the Board.

A27. This Statement requires that leases unexpired at the beginning of the reporting period in which the Statement is implemented be recognized and measured using the facts and circumstances that exist at the beginning of the reporting period. The Board concluded that this approach to transition, as opposed to a retrospective approach, provides an appropriate balance between minimizing costs of transition and providing users of financial statements with comparable financial information. This implementation approach should further significantly reduce the costs associated with transitioning to the new lease requirements.

SCOPE

A28. For purposes of applying this Statement, a lease is defined as a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. Leases include contracts or agreements that, although not explicitly identified as leases, meet the definition of a lease (which reflects the substance of a lease). This definition does not include contracts or agreements for services, except those contracts or agreements that contain both a lease component and a service component. A service contract is a contract that directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task rather than to provide a tangible asset. Service contracts include maintenance of equipment or real property, advisory services, communications services, transportation services, and research and development.

A29. This Statement does not apply to leases of assets under construction or leases (licenses) of internal use software.

A30. GASB's Leases Statement No. 87 specifically excludes "contracts that meet the definition of a service concession arrangement in paragraph 4 of Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* (SCAs)." Currently, FASAB standards are silent on SCAs. Through its discussions, the task force identified several federal entities that have SCAs, and there was a concern that the proposed lease definition could inadvertently include SCAs. The Board considered specifically excluding SCAs from this Statement. To accomplish this, the Board considered adopting GASB's definition of SCA from Statement No. 60 because there is no federal definition.

A31. The Board eventually decided that specifically excluding SCAs from the standards would raise more questions. Furthermore, SCAs are expected to be addressed in the public-private partnership recognition and measurement project; therefore, the Board agreed to remain silent on SCAs in this Statement until such guidance is issued. The Board believes the generally accepted accounting principles hierarchy will continue to guide preparers and auditors in accounting for SCAs.

DEFINITIONS

A32. In this Statement, a lease is defined as "a contract or agreement whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration." In the early stages of the project, the Board deliberated over the use of "contract" or "agreement" in the definition of a lease. The Board considered GASB's approach—where the term contract is more precise and limiting and requires that a lease be legally enforceable. Because legal enforceability is not the primary driver in intragovernmental leasing transactions, although legal enforceability is a primary driver for the non-intragovernmental leases, the Board decided to add "agreement" in addition to "contract" in the lease definition to alleviate ambiguity in its application. This should be especially relevant in the case of intragovernmental leases, which are often referred to as "lease agreements."

A33. The Board also reconsidered the broad scope of the lease definition, which included all nonfinancial assets not specifically excluded in the standards. During deliberations after receiving comment letters, the Board determined that the broader lease definition would necessitate the development of a definition of "nonmonetary assets" and "intangibles," plus the inclusion of a more developed list of excluded transactions. Also, several respondents and task force members advocated a more narrow definition of leases. In an effort to reduce preparer burden, the Board reconsidered its decision and reevaluated the benefits of a narrower lease definition. The Board decided to narrow the scope of the definition to only include PP&E.

LEASE TERM – OPTIONS TO EXTEND OR TERMINATE

A34. Federal leases often include lessee options to extend or terminate a lease. Due to federal budget scoring rules and the availability of funds, many federal leases include relatively short noncancelable periods. The Board concluded that the lease term used to measure the lease liability should not be limited to the noncancelable lease periods, but it should

include certain options to extend or terminate so that the lease term reflects how long the lease is expected to be in effect.

A35. The Board considered several potential probability thresholds for including options to extend or terminate the lease in the lease term. The Board considered its own definition of probable, GASB's definition of probable, and FASB's probability threshold "reasonably certain." FASAB's probable definition equates to more likely than not (>50% probability). GASB's probable definition equates to likely to occur and has a higher threshold of probability than more likely than not. FASB's reasonably certain probability has an even higher threshold than likely to occur. The Board agreed to retain its definition of probable because it is more clearly understood with the federal reporting community and there seemed to be no compelling reason to introduce a new term for the sake of a higher threshold.

A36. During deliberations after receiving comment letters, the Board considered additional ways to reduce the preparer's burden and agreed on the following points:

a. The "noncancelable period" language should be clarified.

b. Both the lessee and the lessor's options to extend or terminate the lease contract or agreement, if probable, should be included in the lease term at its commencement.

c. When the lessee or lessor is assessing its own options to extend or terminate the contract or agreement, the level of probability is at the probable threshold; however, when the lessee or lessor is assessing the other party's options to extend or terminate the contract or agreement, the level of probability is at a higher threshold, like reasonably certain, and should be based on significant evidence.

REMEASUREMENT

A37. This Statement requires that when a lease liability is remeasured, the corresponding lease asset be adjusted by the same dollar amount (except in cases of impairment and in cases in which the adjustment would cause the asset to be reported as a negative amount). While acknowledging that adjusting the lease asset for a change in the lease liability results in the lease asset no longer being measured at adjusted historical cost, the Board believes that such an adjustment is practical.

SHORT-TERM LEASES

A38. The Board considered the short-term lease exception GASB proposed, which requires governments to recognize leases with useful lives or maturities of less than one year. The Board decided to align the short-term lease exception with the PP&E standards, which define PP&E as a tangible asset with an estimated useful life of 24 months or more. The reporting of short-term leases in this Statement is intended to reduce the cost to federal entities implementing these standards. This short-term exception eliminates the need for preparers to calculate amounts for short-term lease assets and liabilities. This exception requires lessees and lessors to recognize those leases with useful lives or maturities of less than two years as expense and revenue based on the payment provisions of those

lease contracts or agreements and those standards regarding recognition of accruals. This measurement approach is not cash-basis recognition, as federal entities are still required to recognize receivables and payables for lease payments paid or received before or after the period to which they apply.

INTRAGOVERNMENTAL LEASES

A39. During the research phase of the project, the General Services Administration (GSA) provided an educational session to the Board where GSA representatives explained in-depth GSA's role in federal leasing. Based primarily on that discussion, the Board agreed that intragovernmental leases should be accounted for differently than leases between federal entities and non-federal entities. The Board agreed that a simplified approach for recognizing intragovernmental leases would be pragmatic and cost efficient.

A40. This Statement provides the overall recognition, measurement, and disclosure requirements for intragovernmental leases. An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47 whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration. A lessee would not recognize a lease asset and a corresponding liability for an intragovernmental lease. Accordingly, a lessee would not recognize amortization expense related to a lease asset or interest expense on a lease liability.

A41. The terms "intragovernmental" and "inter-entity" have been used interchangeably. Earlier FASAB standards predominately used "inter-entity." However, government-wide usage of "intragovernmental" has become more common; therefore, the Board used intragovernmental in this Statement to describe leases occurring within a consolidation entity or between two or more consolidation entities as defined under SFFAS 47.

LEASES OTHER THAN SHORT-TERM LEASES, CONTRACTS OR AGREEMENTS THAT TRANSFER OWNERSHIP, AND INTRAGOVERNMENTAL LEASES

RECOGNITION AND MEASUREMENT FOR LESSEES – LEASE LIABILITY

A42. SFFAC 5, defines a liability as a "present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." The Board believes that the lessee taking possession of the underlying asset or gaining access to control the use of the underlying asset is an event that creates such an obligation until the end of the lease term.

A43. The Board believes the present value of future lease payments to be made for the lease term, which represent the obligations of the lessee under the lease contract or agreement, is the appropriate measurement of the liability. Such a calculation is consistent with the premise that a lease is a financing transaction and supports recognition of the cost of the financing.

Recognition and Measurement for Lessees – Lease Asset

A44. An asset is defined in SFFAC 5 as "a resource that embodies economic benefits or services that the federal government controls." Lessees should recognize a lease asset to correspond with the lease liability. At the beginning of a lease, the lessee obtains the right to control the use of another entity's PP&E (the underlying asset), and that right is a resource embodying economic benefits. The Board believes this right meets the definition of an asset. Because the lease liability represents the amount to be paid for the lease asset, the Board concluded that the initial measurement of the lease asset should be based on the measurement of the associated lease liability. PP&E assets generally are measured at historical cost, which is the amount paid for those assets. Therefore, measuring the lease asset based on the lease liability is consistent with historical cost accounting applicable to PP&E.

Recognition and Measurement for Lessors

A45. Symmetry between the lessee and lessor accounting models is important in establishing accounting and financial reporting standards. The Board believes that federal entity lessees and lessors should account for the shared transaction in a way that mirrors how the other party accounts for it.

A46. The lease contract or agreement gives the lessor the right to receive payments in exchange for the lessee's right to control the use of the underlying asset. The Board believes that right meets the definition of an asset in SFFAC 5. The right to receive payments is a resource that can be drawn upon, and the lessor presently controls that right.

BOARD APPROVAL

A47. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

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APPENDIX B: ABBREVIATIONS

ASC	Accounting Standards Codification
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GASB	Governmental Accounting Standards Board
GSA	General Services Administration
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SCA	Service Concession Arrangement
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Discount Rate

A discount rate is an interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.

Initial Direct Lease Costs

Initial direct lease costs are costs that are directly attributable to negotiating and arranging a lease or portfolio of leases and would not have been incurred without entering into the lease.

Intragovernmental Lease

An intragovernmental lease is a contract or agreement occurring within a consolidation entity or between two or more consolidation entities as defined in SFFAS 47, *Reporting Entity*[14] whereby one entity (lessor) conveys the right to control the use of PP&E (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

Lease

A lease is a contract or agreement whereby one entity (lessor) conveys the right to control the use of property, plant, and equipment (PP&E) (the underlying asset) to another entity (lessee) for a period of time as specified in the contract or agreement in exchange for consideration.

Lease Concessions

Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. Lease concessions include rent holidays/free rent periods, reduced rents, or commission credits.

Lease Incentives

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee; for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor.

Leasehold Improvements

Leasehold improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessee.

[14] SFFAS 47, *Reporting Entity*, outlines the characteristics as a whole that an organization would have to be considered a consolidated entity (SFFAS 47 par. 38–42).

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Lessee's Estimated Incremental Borrowing Rate

The lessee's estimated incremental borrowing rate is the estimated rate that would be charged for borrowing the lease payment amounts for the lease term.

Lessor Improvements

Lessor improvements are additions, alterations, remodeling, renovations or other changes to a leased property that either extend the useful life of the existing property or enlarge or improve its capacity and are paid for (financed) by the lessor rather than by the lessee.

Probable

Probable describes that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Short-Term Lease

A short-term lease is a lease with a lease term (as defined in par. 14 - 21) of 24 months or less.

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FASAB Members

D. Scott Showalter, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Patrick McNamee

Mark Reger

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Monica R. Valentine, Assistant Director

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Mailstop 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

AMENDING INTER-ENTITY COST PROVISIONS

Statement of Federal Financial Accounting Standards 55

May 31, 2018

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement: Federal Accounting Standards Advisory Board, exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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SUMMARY

Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts* (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4)*, required reporting entities to recognize the full costs of services received from other federal reporting entities even if there was no requirement to reimburse the providing reporting entity for the full cost of such services.

This Statement revises SFFAS 4 to provide for the continued recognition of significant inter-entity costs by business-type activities and rescinds the following:

a. SFFAS 30*, Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*[1]

b. Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*

With the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, as amended, are restored to their original language prior to the issuance of SFFAS 30. However, the Federal Accounting Standards Advisory Board adjusted the standards to require business-type activities to recognize inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

Materiality

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[1] Conforming amendments will be made to Technical Release 8, *Clarification of Standards Relating to Inter-Entity Costs*, to acknowledge the rescission of SFFAS 30.

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TABLE OF CONTENTS

Summary 1

Standards 3

- **Scope** 3
- **Rescission of SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*** 3
- **Amendments to SFFAS 4, Managerial Cost Accounting Standards and Concepts** 3
- **Rescission of Interpretation 6, *Accounting for Imputed Intra-Departmental Costs: An Interpretation of SFFAS No. 4*** 5
- **Effective Date** 5

Appendix A: Basis for Conclusions 6

Appendix B: Abbreviations 14

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STANDARDS

SCOPE

1. This Statement applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP) as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

RESCISSION OF SFFAS 30, *INTER-ENTITY COST IMPLEMENTATION: AMENDING SFFAS 4, MANAGERIAL COST ACCOUNTING STANDARDS AND CONCEPTS*

2. This paragraph rescinds SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*, in its entirety. In doing so, this removes the broad requirement to recognize certain inter-entity costs.

AMENDMENTS TO SFFAS 4, *MANAGERIAL COST ACCOUNTING STANDARDS AND CONCEPTS*

3. With the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, are restored to their original language prior to the issuance of SFFAS 30.

4. This paragraph amends[2] SFFAS 4, paragraphs 110 and 111 by

    a. revising the subtitle for this section and moving it before paragraph 110
    b. revising the paragraphs to provide for recognition of inter-entity costs by business-type activities and recognition of inter-entity costs for non-business type activities that elect to do so and
    c. providing for other minor updates.

    Recognition

    110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by ~~the various~~ federal entities. ~~Therefore, t~~ The Office of Management and Budget~~, with assistance from the FASAB staff, should~~ may issue guidance identifying ~~the specific~~ additional inter-entity costs ~~for~~ entities ~~to~~

[2] The amendments are shown with strikethrough deletions of existing text and underlined additions.

should recognize. ~~begin recognizing. OMB should then issue guidance identifying these costs~~ The~~se particular~~ inter-entity costs should be specified in accordance with this standard including the recognition criteria presented in paragraphs 111 through 113 ~~below~~. ~~The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards.~~

~~Recognition Criteria~~

111. Recognition of ~~Ideally,~~ all significant inter-entity costs ~~should be recognized. This~~ is ~~especially~~ important when those costs constitute inputs to government goods or services provided ~~to non-federal entities~~ for a fee or user charge. Generally, ~~T~~the fees and user charges should recover the full costs of those goods and services. [Footnote 33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold ~~outside~~ by the federal government. Recognition of inter-entity costs supporting business-type activities [Footnote 33A] and recognition of inter-entity costs for non-business type activities that elect to do so ~~Such recognition, however,~~ should be made in accordance with ~~the~~ implementation guidance provided by FASAB through one or more Technical Releases. [Footnote 33B] ~~issued by OMB as discussed above~~. Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

[Footnote 33: OMB Circular A-25 addresses user charges by federal entities.]
[Footnote 33A: Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. (See also SFFAS 6, *Accounting for Property, Plant, and Equipment*, footnote 27.)]
[Footnote 33B: Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs* provides implementation guidance. Additional TRs may be provided by FASAB if needed.]

5. This paragraph amends the sub-title “Accounting and Implementation Guidance” of SFFAS 4 that precedes paragraphs 108 – 109 by adding a reference to the Recognition paragraphs in SFFAS 4. It does not amend the language contained within those paragraphs.

Accounting and Implementation Guidance [Footnote 31A]

[Footnote 31A: These paragraphs should be read in conjunction with “Recognition” paragraphs 110- 113 to provide a complete understanding of the implementation of standard on inter-entity costing due to different recognition requirements for certain types of activities.]

6. This paragraph amends SFFAS 4 by adding a new sub-title “Component Reporting Entity Disclosures” following paragraph 113 and adding paragraph 113A.

Component Reporting Entity Disclosures

113A. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full cost. An example disclosure includes:

> Goods and services are received from other federal entities at no cost or at a cost less than the full cost to the providing federal entity. Consistent with accounting standards, certain costs of the providing entity that are not fully reimbursed [by the component reporting entity] are recognized as imputed cost [in the Statement of Net Cost], and are offset by imputed revenue [in the Statement of Changes in Net Position]. Such imputed costs and revenues relate to business-type activities (if applicable), employee benefits, and claims to be settled by the Treasury Judgment Fund.[3] However, unreimbursed costs of goods and services other than those identified above are not included in our financial statements.

7. As a result of the above changes, business-type activities are still required to recognize inter-entity costs. Although recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

RESCISSION OF INTERPRETATION 6, *ACCOUNTING FOR IMPUTED INTRA-DEPARTMENTAL COSTS: AN INTERPRETATION OF SFFAS NO. 4*

8. This paragraph rescinds Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4,* in its entirety.

EFFECTIVE DATE

9. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018. Earlier implementation is permitted.

The provisions of this Statement need not be applied to immaterial items.

[3] For simplicity, the illustration addresses only the unreimbursed costs required to be imputed by accounting standards. Component reporting entities should identify the general nature of other imputed costs recognized in their financial statements.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. Since 2014, the Department of Defense (DoD) has requested the Federal Accounting Standards Advisory Board's (FASAB or "the Board") consideration of several financial reporting areas of concern and related audit challenges. While DoD continues its efforts to comply with the Chief Financial Officers Act of 1990 (as amended), it has noted certain challenges in satisfying existing standards including SFFAS 4. Through its goals to associate costs with the related operating activities, SFFAS 4 creates special challenges to large, complex and matrixed organizations such as DoD.

A2. There are many complex relationships among the components of DoD, such as the military services, as well as between DoD and other related departments, such as the U.S. Coast Guard. Many specialized components provide services to other components of DoD. Generally, DoD operates in a matrixed environment. It shares resources, such as employees and assets, across sub-components that have different functional disciplines to accomplish a shared assignment or mission. Often this is done without removing the resources and associated cost from the sub-component. Because of the extensive sharing of resources, implementing the inter-entity costing requirements would be more challenging and costly to DoD than other departments.

A3. For example, the Defense Security Service's (DSS) mission includes a variety of security functions for DoD. While it may be obvious that the security functions are for the benefit of all DoD reporting entities, Congress appropriates the funding to DSS and the cost is primarily (but not always) assumed by DSS. Financial accounting requirements seek to associate the costs of security functions with the activities that benefit from them. For example, the military services request security services but may not be required by law or management practices to fund those security services. Under prior accounting standards, the cost of services would have been associated with each military service through an imputed cost. However, given the complexity of DoD's components and operations, it may not be cost effective to impute costs for such services. In addition, the benefit of doing so

may be reduced at DoD in comparison to other federal departments and agencies due to the challenge of identifying outputs and associating outputs with a single reporting entity.

Generally Accepted Accounting Principles History

A4. FASAB issued SFFAS 4 in July of 1995, and it became effective in fiscal year (FY) 1998. However, the requirement for imputing inter-entity costs that are not reimbursed or are under-reimbursed was not immediately effective in FY1998. The Board explained this in the SFFAS 4 basis for conclusions as follows:

> 248. As discussed above, the Board realizes that there may be problems in implementing the standard on inter-entity costing. Recognition of non-reimbursed or under-reimbursed inter-entity costs is a new concept to federal entities and involves a new way of thinking about costs. There is concern that application of the standard may be inconsistent among federal entities. In addition, there could be problems, particularly at first, in developing estimates of costs; in revising accounting systems and procedures to accommodate these requirements; and in training personnel to accomplish the task. Furthermore, the Board recognizes the concern that some have about the elimination of inter-entity cost transactions for consolidated reporting since the accounting procedures may be complicated.
>
> 249. As a result of these problems and concerns, the Board has expressed the need to take a measured, step-by-step, practical approach to implementation of this standard. Therefore, the Board has decided that, in implementing the standard, it recommends that OMB, with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing and OMB should then issue guidance identifying those costs. OMB should consider the requirements of the standard including the recognition criteria in developing the guidance and it should also consider suggestions and information provided by Treasury, GAO, and other agencies. The Board anticipates the largest and most important inter-entity costs will be identified first, followed by others as entities gain experience in the application of the standard. This approach is seen as a practical way to ensure uniformity in the application and implementation of the standard and to provide time and experience in overcoming any other practical problems which may arise. Also, the Board may recommend specific inter-entity costs for recognition in possible future recommended standards.

A5. In April 2003, the Board issued Interpretation 6 requiring implementation of inter-entity costing for costs between reporting entities that are part of the same department of a larger reporting entity. The requirement was effective for FY 2005.

A6. In August 2005, the Board issued SFFAS 30, requiring full implementation of the inter-entity cost provision in FY 2009. SFFAS 30 followed extensive research on inter-entity costs by an Accounting and Auditing Policy Committee (AAPC) task force. The results were described in the in SFFAS 30 as follows:

> The AAPC Inter-entity Cost Task Force (task force) was formed and initial research was conducted beginning in July 2000. The task force reported its research findings and recommendations to the AAPC at its May 2003 meeting. The task force noted that the current limitation in recognizing inter-entity costs was an impediment to progress towards full costing. The task force did not recommend changes to the current limitations in the application of SFFAS 4 inter-entity costs provisions. However, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. The task force report is available on the AAPC website at http://files.fasab.gov/pdffiles/aapciectfreport.pdf.

A7. As provided in paragraphs 28-30 of the basis for conclusions in SFFAS 30, half the respondents disagreed with the proposal that led to SFFAS 30:

> 28. Approximately one-half of the respondents agreed with the Board's proposal that the inter-entity cost provisions of SFFAS 4 should be fully implemented. In other words, approximately one-half of the respondents disagreed with the Board's proposal and agreed with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis.
>
> 29. Approximately one-half of the respondents believed that there were non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS 4. Additionally, a majority of respondents believed that federal entities would seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.
>
> 30. Approximately one-half of the respondents believed that additional guidance was needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity and that additional guidance was needed to apply the broad and general support exception.

A8. In summary, in its due process of SFFAS 30, the Board determined the main concerns identified by respondents included (1) the lack of implementation guidance and (2) costs not being recognized consistently across agencies. These concerns also supported the task force findings. Therefore, the Board determined that there was a need for additional guidance, which led to the development of Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs*. The Board concluded that the standards, along with the issuance of TR 8, balanced the concerns expressed by the task force and the ultimate goals of SFFAS 4. The majority of the Board determined SFFAS 30 was essential to attain the full cost accounting envisioned by SFFAS 4.

Existing Practices (Current SFFAS 4 Imputed Costs)

A9. The goal of SFFAS 4, as amended, to identify full cost is critical to improving performance measurement. This Board understands the previous Board's reasons for issuing SFFAS 30 because paragraphs 34-36 of SFFAS 4 explain the following:

34. Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to "...improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results."

35*. Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness.* Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show "cost-effectiveness." Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:

(1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;

(2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and

(3) Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness. (emphasis added)

36. Thus … performance measurement requires both financial and non-financial measures. *Cost is a necessary element for performance measurement, but is not the only element.* (emphasis added)

A10. Currently, the inter-entity cost provisions have been implemented as envisioned by most agencies. However, the effect of inter-entity costs other than those associated with personnel benefits and Treasury Judgment Fund activities has been significantly less than one percent of gross costs at most agencies, calling into question the cost benefit of the original Statement. FASAB received additional feedback about imputed costs from representatives of the largest agencies at roundtables on streamlining financial reporting. The comments were consistent with the results that imputed costs are often immaterial at the departmental level. In addition, feedback was consistent that where the outcome of operations requires many sub-components to work together in a matrixed environment (not only for DoD but other departments such as Health and Human Services), relating cost to performance of each sub-component is challenging.

A11. In addition, ongoing implementation efforts at DoD are expected to be very costly given the complex operating relationships among the sub-components of DoD. Consideration of DoD's implementation challenges and the experiences of other federal reporting entities (described above) led to the Board's reconsideration of the requirements contained within SFFAS 4 and SFFAS 30 under FASAB's Evaluation of Existing Standards project so that any changes would be applicable government-wide.

A12. Board members agree inter-entity cost must be imputed for those reporting entities conducting business-type activities because the information is directly tied to rates. However, there are certain reporting entities or departments where the operating environment does not lend itself to full cost. For example, there are large, complex departments that may have sub-components that are not distinct for performance

purposes. Therefore, the ability to relate cost to performance is more challenging for certain organizations than for others.

A13. For example, within DoD, under existing accounting standards, the full cost of inter-entity services would be associated with each military service through an imputed cost. However, given the complexity of DoD's components and operations, it may not be cost effective to impute costs for such services. In addition, the benefit of doing so may be reduced due to the challenge of identifying outputs and associating outputs with a single reporting entity such as a military service.

A14. Based on a government-wide review of (unaudited) percentages of gross cost attributable to imputed costs other than those for personnel benefits and Treasury Judgment Fund settlements, the Board observed the imputed costs are often immaterial at the department level. Personnel benefits and Treasury Judgment Fund settlements are required to be imputed by GAAP standards other than SFFAS 4, and those standards ensure they continue to be imputed.[4] The modifications herein restore the option for future recognition of other inter-entity costs if OMB decides to do so.

A15. The Board carefully considered the cost benefits, operating environments, current reporting, and what must be accomplished for those reporting entities that had not implemented the requirements. After careful consideration, the Board concluded that the standard will not have negative consequences to reporting entities and that its benefits will clearly exceed its costs for reporting entities that had not implemented inter-entity cost requirements as well as reduce the reporting burden for agencies that have been imputing such costs. Therefore, based on research and the current costs to comply with existing standards, the Board decided to amend existing standards by requiring the reporting of inter-entity costs (other than those associated with personnel benefits and the Treasury Judgment Fund settlement, which is required for all entities) to business-type activities.

SUMMARY OF OUTREACH

A16. FASAB issued the exposure draft (ED) *Amending Inter-entity Cost Provisions* on September 1, 2017, with comments requested by November 30, 2017.

A17. Upon release of the ED, FASAB provided notices and press releases to the FASAB subscription email list, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants Topics, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board).

[4] See (1) paragraphs 93-95 of SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, for the costs of employees' benefits, (2) paragraphs 74-76 of SFFAS 5, *Accounting for Liabilities of The Federal Government*, for the pension's costs subset for personnel benefits, and (3) Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*, for Treasury Judgment Fund settlements.

A18. FASAB received 16 responses from preparers, auditors, users of federal financial information, and professional associations. The Board did not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below. The respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A19. The majority of respondents agreed with the proposal to revise SFFAS 4 to provide for recognition of inter-entity costs by business-type activities and to rescind SFFAS 30 and Interpretation 6.

A20. One respondent (the Department of Agriculture) disagreed because it believed recognition of inter-entity costs that are not fully reimbursed should not be limited to business-type activities. The respondent explained that the Commodity Credit Corporation (CCC) has no employees[5] or facilities, and the imputed costs are roughly 10% of operating costs. With further evaluation and consideration of the scenario, the Board determined it may be appropriate to revise the proposed language to remove the word "limit" and allow non-business type activities the election to recognize other imputed costs.

A21. Based on certain responses, there appeared to be confusion regarding the recognition of inter-entity costs by activities that are not business-type activities. The Board clarified the summary, standards, and basis for conclusions to ensure the language regarding recognition of inter-entity costs by activities that are not business-type activities was explicit.

A22. The language explained that with the rescission of SFFAS 30, paragraphs 110 and 111 of SFFAS 4, as amended are restored to their original language. However, FASAB adjusted the standards to require business-type activities to recognize inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed costs and corresponding imputed financing for other types of inter-entity costs.

A23. With the amendments presented in this Statement, the revised paragraphs 110-111 of SFFAS 4 are as follows:

> Recognition
>
> 110. Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by federal entities. The Office of Management and Budget may issue guidance identifying additional inter-entity costs entities should

[5] The Commodity Credit Corporation (CCC) is a Government-owned and operated entity that was created to stabilize, support, and protect farm income and prices. CCC also helps maintain balanced and adequate supplies of agricultural commodities and aids in their orderly distribution. … CCC has no operating personnel. Its price support, storage, and reserve programs, and its domestic acquisition and disposal activities are carried out primarily through the personnel and facilities of the Farm Service Agency (FSA). (https://www.fsa.usda.gov/about-fsa/structure-and-organization/commodity-credit-corporation/index)

recognize. The inter-entity costs should be specified in accordance with this standard including the recognition criteria presented in paragraphs 111 through 113.

111. Recognition of all significant inter-entity costs is important when those costs constitute inputs to government goods or services provided for a fee or user charge. Generally, the fees and user charges should recover the full costs of those goods and services. [Footnote 33] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold by the federal government. Recognition of inter-entity costs supporting business-type activities [Footnote 33A] and recognition of inter-entity costs for non-business type activities that elect to do so should be made in accordance with implementation guidance provided by FASAB through one or more Technical Releases. [Footnote 33B] Activities that are not business-type activities are not required to recognize inter-entity costs other than inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs.

[Footnote 33: OMB Circular A-25 addresses user charges by federal entities.]
[Footnote 33A: Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. (See also SFFAS 6, *Accounting for Property, Plant, and Equipment*, footnote 27.)]
[Footnote 33B: Technical Release (TR) 8, *Clarification of Standards Relating to Inter-Entity Costs* provides implementation guidance. Additional TRs may be provided by FASAB if needed.]

A24. While agreeing with the proposal, one respondent suggested certain provisions of the proposed statement appear to be in conflict. The respondent noted SFFAS 4 appears to require all reporting entities to recognize the full costs of services received from other federal reporting entities even if there is no requirement to reimburse the providing entity for the full cost. This respondent believed that certain elements of the proposal appear to contradict certain portions of SFFAS 4. The Board acknowledges the ambiguity created by the interrelation of the full cost and inter-entity standards contained in different sections of SFFAS 4. This ambiguity is further complicated if particular paragraphs or sentences of SFFAS 4 are read in isolation.

A25. The focus of this Statement is narrow and the Board did not undertake a review of SFFAS 4 in its entirety. The Board addressed the ambiguity by adding clarifying language where appropriate, which included a new footnote to an earlier section within the SFFAS. The new footnote explains the recognition paragraphs (par. 110-113) should be considered in conjunction with other sections to provide a complete understanding regarding the implementation of inter-entity costing due to different recognition requirements for different types of activities.

A26. The majority of respondents generally agreed that component reporting entities should provide a concise statement to acknowledge that significant services were received for which no cost is recognized. However, certain respondents suggested additional explanation and clarification regarding the disclosure. The respondents believed providing

clarity in these areas would ensure consistency and reduce costs associated with preparation and audit. Certain respondents also suggested sample wording of the disclosure.

A27. The Board believed the comments indicated concern regarding the "costs" of determining whether unreimbursed inter-entity costs are "significant" and whether the proposed disclosure, without details of specific costs excluded, provided a meaningful distinction between entities with and without "significant inter-entity costs". Based on the comments, the Board determined the disclosure requirements should be revised. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full cost. In addition, the Board included sample wording for the disclosure in the Statement. The Board believed the sample wording would provide the minimum disclosure and that if the reporting entity recognized other imputed costs, that fact should be disclosed as well.

A28. Although the Board concluded that the proposed Statement will reduce the reporting burden for agencies, it recognizes that any change in standards may require time to implement. Therefore, the Board changed the effective date to be effective for reporting periods beginning after September 30, 2018, with earlier implementation permitted.

A29. As explained in paragraph 12 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources,* "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Therefore, reporting entities follow the guidance in SFFAS 21 paragraph 13.a. – 13.c. for all changes in accounting principles:

a. The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
b. Prior period financial statements presented for comparative purposes should be presented as previously reported.
c. The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure.

Board Approval

A30. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CCC	Commodity Credit Corporation
CFR	Consolidated Financial Report of the U.S. Government
DoD	Department of Defense
DSS	Defense Security Service
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GPFFR	General Purpose Federal Financial Report
GPRA	Government Performance and Results Act
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_55.pdf.

FASAB Members

D. Scott Showalter, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Regina Kearney

Patrick McNamee

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Melissa L. Batchelor, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street NW, Suite 1155
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

CLASSIFIED ACTIVITIES

Statement of Federal Financial Accounting Standards 56

October 4, 2018

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government. Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available on the FASAB website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Mailstop 1155
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

SUMMARY

The objective of this Statement is to balance the need for financial reports to be publicly available with the need to prevent the disclosure of classified national security information or activities in publicly issued General Purpose Federal Financial Reports (GPFFRs). This Statement allows financial presentation and disclosure to accommodate user needs in a manner that does not impede national security.

This Statement permits modifications that do not affect net results of operations or net position. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations and/or net position.

Further, Interpretations of this Statement, which may themselves contain classified information, will address the requirements of this and other standards and permit other modifications when needed to prevent the disclosure of classified information. Modifications permitted by this Statement and future Interpretations may affect the net results of operations and/or net position of those entities applying the Interpretations.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf

TABLE OF CONTENTS

Summary 3

Standards 5

SCOPE 5

DEFINITIONS 5

APPLICATION OF STANDARDS AND DISCLOSURES 6

Presentation and Disclosure Modifications 6

Consolidation Modifications 7

Interpretations 7

Component Reporting Entity Disclosures 7

Financial Report of the U.S. Government Disclosures 7

EFFECTIVE DATE 8

Appendix A: Basis for Conclusions 9

Appendix B: Abbreviations 15

Appendix C: Glossary 16

STANDARDS

SCOPE

1. This Statement applies to federal entities that issue unclassified general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement does not apply to the reporting of financial information within the GPFFR in the classified environment and only applies when the information is presented in the unclassified environment, such as publicly available component reporting entity GPFFRs. This Statement does not apply to classified GPFFRs provided to cleared personnel, including elected officials. This does not relieve reporting entities from their requirements and responsibilities to comply with other accounting standards in the appropriate classified environment.

DEFINITIONS

3. **Classified National Security Information**, also known as "classified information," is any information that has been determined pursuant to Executive Order (EO) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

    a. **TOP SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;

    b. **SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and

    c. **CONFIDENTIAL**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

4. **Original Classification Authority** is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.

5. **Derivative Classification** is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative

classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

APPLICATION OF STANDARDS AND DISCLOSURES

6. Classified information is prohibited from public release. Classified information is determined by an Original Classification Authority (OCA) or by applying derivative classification.

7. Reporting entities are expected to comply with other accounting standards in the appropriate classified environment. Reporting entities should apply this Statement when an OCA concludes, or others determine by applying derivative classification, that the information is classified and, therefore, cannot be presented without modification in unclassified GPFFRs. Component reporting entities have the discretion to apply this Statement at the program or transaction level.

8. This Statement permits certain modifications to prevent the disclosure of classified information in an unclassified GPFFR. This Statement permits the following:

    a. An entity may modify information required by other standards if the effect of the modification does not change the net results of operations or net position.

    b. A component reporting entity is allowed to be excluded from one reporting entity and consolidated into another reporting entity. The effect of the modifications may change the net results of operations and/or net position.

    c. An entity may apply Interpretations of this Statement that allow other modifications to information required by other standards, and the effect of the modifications may change the net results of operations and/or net position.

    The above modifications allowed by this Statement are discussed in more detail in paragraphs 9-11 below.

PRESENTATION AND DISCLOSURE MODIFICATIONS

9. The entity should modify unclassified financial statement presentations, disclosures, required supplementary information (RSI), and required supplementary stewardship information (RSSI) required by other Statements to prevent the disclosure of classified information if the effect of the modification does not change the net results of operations or net position. In this context, modify means:

    a. Presenting amounts associated with one financial statement line item in another financial statement line item but not presenting narrative explaining the modification.

    b. Omitting required disclosures, RSI, or RSSI that would otherwise reveal classified information.

CONSOLIDATION MODIFICATIONS

10. An organization may be excluded from a particular reporting entity to prevent the disclosure of classified information and consolidated into another reporting entity. According to SFFAS 47, *Reporting Entity,* there are organizations[1] that should be included in a particular component reporting entity's GPFFR. Such organizations may be excluded from the particular component reporting entity's GPFFR to prevent the disclosure of classified information and consolidated into another reporting entity.[2] If a reporting entity consolidates an organization that is excluded from another reporting entity's GPFFR to prevent the disclosure of classified information, that consolidation modification may affect one or both reporting entities' net results of operations and/or net position.

INTERPRETATIONS

11. The Board may issue Interpretations of this Statement that affect other Statements. Such Interpretations may permit other unclassified GPFFR presentation and disclosure modification options, as needed. These modification options would prevent unauthorized disclosure in an unclassified GPFFR. Modifications that affect the entity's net results of operations and/or net position may be allowed by Interpretations of this Statement.

COMPONENT REPORTING ENTITY DISCLOSURES

12. All federal component reporting entities must include the following in the summary of significant accounting policies.

    Accounting standards require all reporting entities to disclose that accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

    Component reporting entities must not disclose application of this Statement, including any Interpretations of this Statement.

FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

13. The financial report of the U.S. Government (government-wide financial report) must include the following in the government-wide summary of significant accounting policies.

    Accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information. Accordingly, modifications may have been made to certain presentations and disclosures.

    The government-wide financial report must not disclose specific Interpretations of this Statement that may have been applied.

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[1] Decisions to exclude an organization from a particular component reporting entity to prevent the disclosure of classified information may be evidenced by, for example, approval or concurrence from an oversight organization, such as the Office of Management and Budget.

[2] SFFAS 47, *Reporting Entity*, provides the framework for determining what organizations (for example, component reporting entities or sub-components) should be included in the reporting entity's GPFFRs for financial accountability purposes. A reporting entity may be the government as a whole, another component entity, or a subcomponent reporting entity.

EFFECTIVE DATE

14. This Statement is effective upon issuance.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

A1. In August 2016, the Department of Defense (DoD or the Department) identified several areas for the Federal Accounting Standards Advisory Board's consideration where the application of general accepted accounting principles would result in the exposure of classified information. As the DoD was preparing to commence full-scope financial statement audits, it identified specific accounting standard requirements that would conflict with its responsibility to prevent the unauthorized disclosure of information in accordance with Executive Order (EO) 13526 of December 29, 2009, "Classified National Security Information."

A2. Specifically, EO 13526 recognizes, "Our democratic principles require that the American people be informed of the activities of their Government. Also, our Nation's progress depends on the free flow of information both within the Government and the American people. Nevertheless, throughout our history, the national defense has required that certain information be maintained in confidence in order to protect our citizens, our democratic institutions, our homeland security, and our interactions with foreign nations. Protecting information critical to our Nation's security and demonstrating our commitment to open Government through accurate and accountable application of classification standards and routine, secure, and effective declassification are equally important priorities."

A3. Executive Order 13526, SEC 1.4 authorizes classification of information regarding the following types:

- military plans, weapons systems, or operations;
- foreign government information;
- intelligence activities (including covert actions), intelligence sources or methods, or cryptology;
- foreign relations or foreign activities of the United States, including confidential sources;
- scientific, technological, or economic matters relating to the national security;
- United States Government programs for safeguarding nuclear materials or facilities;

- vulnerabilities or capabilities of systems, installations, infrastructures, projects, plans, or protection services relating to the national security; or
- the development, production, or use of weapons of mass destruction.

Unauthorized disclosure of classified information is prohibited by Title 18 U.S. Code, Section 798.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A4. FASAB issued the ED, titled *Classified Activities* on December 14, 2017, with comments requested by March 16, 2018. Upon release of the ED, FASAB provided notices and press release to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, and committees of professional associations generally commenting on ED's in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A5. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:

a. House Homeland Security Committee: Full Committee

b. House Homeland Security Committee: Sub-committee on Oversight and Management Efficiency

c. House Homeland Security Committee: Sub-committee on Counterterrorism and Intelligence

d. Senate Select Committee on Intelligence

e. House Permanent Select Committee on Intelligence

f. Senate Armed Services Committee

g. House Armed Services Committee

h. House Oversight and Government Reform Committee

i. Senate Homeland Security and Governmental Affairs Committee

j. Senate Appropriations Committee

k. House Appropriations Committee

A6. FASAB received 17 responses from preparers, auditors, and professional associations. Many respondents had concerns with how to inform readers of GPFFRs regarding the potential modifications given the classified nature of the modifications themselves. The Board has revised the disclosure requirements to address the respondents' concerns. The Board has also incorporated revisions proposed by some respondents to clarify this Statement or address issues in the basis for conclusions.

A7. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

STANDARDS ON CLASSIFIED ACTIVITIES

A8. There are many component reporting entities engaged in classified activities. In the recent past, information regarding the total amount budgeted for such classified activities was not publicly disclosed. However, in the last decade, changes were made so that highly aggregated budget numbers for such activities would be made available. Details remain classified including the amount of funding for particular components within the intelligence community and other departments or agencies. Disclosure of the disaggregated funding details would harm national security interests.

A9. Similarly, disaggregated detailed financial reporting could also harm national security interests. To address the issue of classified information being revealed by applying the requirements of SFFAS 47, *Reporting Entity,* this Statement permits certain modifications and disclosures at both the component reporting entity level and at the government-wide level.

A10. The Board had several discussions with national security experts and stakeholders that allowed the Board the opportunity to evaluate the available options for presenting classified information in unclassified GPFFRs without jeopardizing national security, including the specific options suggested by respondents. The Board determined that options other than those permitted in this Statement may not always adequately resolve national security concerns. Therefore, based on the evaluation of the options, the Board concluded that this Statement and future related Interpretations provide the optimal solution. This option would allow reporting entities to issue unclassified, publicly available financial statements that comply with accounting standards. Without this Statement, there is a risk that reporting entities may need to classify their entire financial statements to comply with existing accounting standards, which would likely result in the need to classify a large portion of the government-wide financial statements.

A11. Some respondents suggested that the Board require component reporting entities to only disclose that certain presentation and disclosure modifications have been made when the entity has applied this Statement to prevent the disclosure of classified information. The Board, in consultation with national security stakeholders, concluded that the identification by a component reporting entity that this Statement has been applied would reveal classified information. Doing so would allow GPFFR users to identify component reporting

entities with and without modifications. Further, users could identify changes among component reporting entities over time if modifications are disclosed in some reporting periods but not others. Therefore, the Board is requiring a more neutral disclosure for component reporting entities and the government-wide entity to prevent specific identification of component reporting entities applying this Statement. This neutral disclosure

a. protects the identity of those component reporting entities that have made modifications to prevent the disclosure of classified information, and
b. avoids implying that a component reporting entity has made a modification when they have not.

A12. This Statement and future Interpretations would be applied as needed based on an assessment of the need to prevent the disclosure of classified information or to assist other departments and agencies by including an organization as described in paragraph 10. During the audit, the preparer would inform the properly cleared auditor whether and how this Statement and related Interpretations were applied. GPFFR modified pursuant to this Statement and related Interpretations would be considered in accordance with generally accepted accounting principles.

A13. Some respondents questioned the proposal to require documentation retained in the appropriate environment to adequately support classified information and modifications. Such documentation was intended to allow recorded amounts modified to prevent the disclosure of classified information to reconcile in aggregate to unmodified schedules or other documentation subject to audit. Upon review, members noted that the proposed requirement related to systems, controls, and audit procedures. This proposed level of detail regarding documentation exceeded that of other financial accounting standards.

A14. The Board believes that standards regarding the underlying documentation of modifications are unnecessary and has removed the proposed requirement. The Board expects that – as with other aspects of financial statements – the preparer will maintain sufficient documentation to support modifications. Such documentation is an important aspect of management control over financial reporting. The documentation will be available during the audit but in an environment appropriate to classified information.

A15. Modifications may not be needed to prevent the disclosure of certain classified information. Therefore, this Statement permits, rather than requires, modifications on a case-by-case basis.

PROCESS FOR FUTURE CLASSIFIED INTERPRETATIONS

A16. The Board anticipates issuing classified Interpretations of this Statement to address specific issues raised by affected component reporting entities. The Board has established a process to engage cleared stakeholders in due process regarding classified Interpretations of this Statement. The process will engage users of information related to classified activities.

A17. The six-step process established in the "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of

Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" will be followed in developing classified Interpretations. Appropriate protections will be applied to classified information, consistent with federal law applicable to federal advisory committees and their activities involving information classified pursuant to Executive Order. The six-step process for classified Interpretations and related protections are described below.

a. Identification of accounting issues and agenda decisions

    i. The Board will carry out this step by consulting with cleared stakeholders in secure facilities. Stakeholders - including preparers, auditors, and users of classified information - will be informed regarding the process for raising issues for Board consideration.

b. Preliminary deliberations

    i. Preliminary deliberations will engage all members of the Board. Deliberations will occur during closed meetings. Closed meetings will be approved and announced in the Federal Register consistent with the process established in the Federal Advisory Committee Act.

c. Preparation of initial documents (issues papers and/or discussion memoranda)

    i. We expect that all initial documents will contain classified information and will therefore be subject to federal requirements pertaining to classified information. Initial documents will be prepared by cleared individuals of FASAB staff and representatives of affected organizations who have original or derived classification authority.[3] Such documents will be shared with members in a setting appropriate to the classification level of the documents. Members will be afforded adequate time to review the materials, ask questions, and deliberate over the materials before making decisions regarding the issues raised.

d. Release of documents to the public, public hearings, and consideration of comments

    i. Members of the public will have an opportunity to comment on the proposed Statement. The public will be able to comment on the general subject matter discussed in the proposed Statement and the existence of classified Interpretations. The Board will consider all comments provided.

    ii. Also, because we expect that all documents related to Interpretations will contain classified information, release will be limited to cleared individuals and organizations that have signed a non-disclosure agreement and have a need-to-know, in accordance with federal requirements pertaining to classified information. The Board will ensure a representative group of stakeholders with varied perspectives and appropriate clearances are engaged. The Board expects to seek input from elected representatives of the public and appointed

[3] The Board does not have specific original classification authority. The classification level of all work products will be determined by those with that authority.

government officials to ensure the needs of citizens are balanced against national security interests. The Board will consider all comments and input received from the representative group of stakeholders.

e. Further deliberations, exposure draft, and consideration of comments

    i. This step will occur in closed sessions as noted above. The Board will seek input from cleared individuals, including elected and appointed officials, and organizations to the greatest extent possible given the classified nature of the materials and deliberations. The Board will consider all comments and input received from the representative group of stakeholders.

f. Vote to approve proposed Interpretations

    i. Consistent with the Board's established procedures for consideration of proposed Interpretations, final classified Interpretations will be those approved by a majority of the members and not objected to by a member representing the Comptroller General, the Secretary of the Treasury, or the Director of OMB during a 45-day review period. Final classified Interpretations will be maintained by FASAB. Component reporting entities should contact FASAB to arrange access to the classified Interpretations as needed. FASAB will provide access to any relevant Interpretations following appropriate security procedures.

A18. This approach balances the public's interest in financial information with the need to prevent the disclosure of classified information. The Board's role in promulgating classified Interpretations is to appropriately guide the modifications used in preventing the disclosure of classified information.

A19. The Board may issue Interpretations and implementation guidance in the classified environment. The issuance of classified Interpretations and guidance by the Board will be publicly announced in the Federal Register and on the FASAB website. The public will be made aware of the guidance's existence and the unclassified title of the guidance. All classified guidance will be made available only to those individuals who have been designated as having a need to know and who hold the proper clearances.

PROCESS FOR FUTURE CLASSIFIED INTERPRETATIONS

A20. This Statement was approved unanimously. Written ballots are available for public inspection at FASAB's offices.

This is the original Standard file; please check for the most recent update in the FASAB Handbook at http://files.fasab.gov/pdffiles/handbook_sffas_56.pdf

APPENDIX B: ABBREVIATIONS

CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
EO	Executive Order
DoD	Department of Defense
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Report
OCA	Original Classification Authority
OMB	Office of Management and Budget
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Classified National Security Information, also known as "classified information," is any information that has been determined pursuant to Executive Order (E.O.) 13526, as amended; or any successor orders, to require protection against unauthorized disclosure and is marked to indicate its classified status. Information may be classified at one of the following three levels:

a. **TOP SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause exceptionally grave damage to the national security that the original classification authority is able to identify or describe;

b. **SECRET**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause serious damage to the national security that the original classification authority is able to identify or describe; and

c. **CONFIDENTIAL**, which is applied to information, the unauthorized disclosure of which reasonably could be expected to cause damage to the national security that the original classification authority is able to identify or describe.

Original Classification Authority is an individual authorized in writing, either by the President, the Vice President, or by agency heads or other officials designated by the President, to classify information in the first instance.

Derivative Classification is incorporating, paraphrasing, restating, or generating in new form information that is already classified, and marking the newly developed material consistent with the classification markings of the source of the information. Derivative classification includes the classification of information based on classification guidance. The duplication or reproduction of existing classified information is not derivative classification.

Net results of operations – The term "net results of operations" describes the excess (or the deficit) of the "net cost of operations" over "financing sources." … The net result of operations is also the current period's change in the cumulative results of the entity's operations since its inception, except to the extent that there are prior period adjustments. (*Implementation Guide: Accounting for Revenue and Other Financing Sources*, par. 63. Also, see SFFAC 2, *Entity and Display,* Appendix 1-C for an illustration of the calculation of net results of operations.)

Net position – Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities). (SFFAC 5, *Definitions of Elements of the Accrual Basis Financial Statements.*)

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FASAB Members

D. Scott Showalter, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Carol S. Johnson

Patrick McNamee

George A. Scott

Graylin E. Smith

FASAB Staff

Wendy M. Payne, Executive Director

Monica R. Valentine, Assistant Director

Ross Simms, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 1155

Mailstop 1155

Washington, DC 20548

Telephone 202-512-7350

Fax 202-512-7366

www.fasab.gov

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Federal Accounting Standards Advisory Board

OMNIBUS AMENDMENTS 2019

Statement of Federal Financial Accounting Standards 57

September 27, 2019

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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SUMMARY

The objective of this Statement is to address consistency issues and other improvements that have been identified during implementation and application of certain FASAB Statements. This Statement:

- eliminates the required supplementary stewardship information (RSSI) category by rescinding Statement of Federal Financial Accounting Standards (SFFAS) 8, *Supplementary Stewardship Reporting*,
- updates references to leases in SFFAS 5, *Accounting for Liabilities of the Federal Government*, SFFAS 6, *Accounting for Property, Plant, and Equipment,* and SFFAS 49, *Public-Private Partnerships: Disclosure Requirements,* and
- makes a minor change to SFFAS 6.

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TABLE OF CONTENTS

SUMMARY 1
STANDARDS 3
SCOPE 3
ELIMINATING THE REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION CATEGORY 3
AMENDMENTS TO SFFAS 5, 6, AND SFFAS 49 3
EFFECTIVE DATE 7
APPENDIX A: BASIS FOR CONCLUSIONS 8
PROJECT HISTORY 8
REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION 8
LEASES 9
CLARITY AMENDMENTS 9
SUMMARY OF OUTREACH EFFORTS AND RESPONSES 9
BOARD APPROVAL 10
APPENDIX B: ABBREVIATIONS 11

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

ELIMINATING THE REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION CATEGORY

2. This paragraph rescinds SFFAS 8, *Supplementary Stewardship Reporting*, in its entirety, including the requirement for reporting information in the required supplementary stewardship information (RSSI) category.

AMENDMENTS TO SFFAS 5, 6, AND SFFAS 49

3. SFFAS 54, *Leases: An Amendment of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment,* amended the lease standards in SFFAS 5 and 6. This Statement amends certain references to leases affected by SFFAS 54 as well as other minor changes to improve clarity of existing Statements.

4. Specifically, this Statement amends the following documents:

    - SFFAS 5, *Accounting for Liabilities of the Federal Government*
    - SFFAS 6, *Accounting for Property, Plant, and Equipment*
    - SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*

5. This paragraph amends paragraph 15 of SFFAS 5 to remove a reference to capital leases:

    15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, ~~capital leases,~~ federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

6. The revised paragraph 15 of SFFAS 5 is as follows:

    15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

7. This paragraph amends paragraph 18 of SFFAS 6 by revising the first bullet to remove a reference to capital leases:

18. Property, plant, and equipment also includes:

- assets ~~acquired through capital~~ recognized as a result of leases (see SFFAS 54: *Leases,* for guidance regarding leases and leasehold improvements to be recognized as PP&E assets) ~~(See paragraph 20), including leasehold improvements~~;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[footnote omitted]

8. The revised paragraph 18 of SFFAS 6 is as follows:

18. Property, plant, and equipment also includes:

- assets recognized as a result of leases (see SFFAS 54: *Leases,* for guidance regarding leases and leasehold improvements to be recognized as PP&E assets);
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[footnote omitted]

9. This paragraph amends paragraph 26 of SFFAS 6 by revising the final bullet to remove a reference to “material amounts”; materiality applies to all of the bulleted items

26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;

- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- ~~material amounts of~~ interest costs paid.[footnote omitted]

10. The revised paragraph 26 of SFFAS 6 is as follows:

    26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

    - amounts paid to vendors;
    - transportation charges to the point of initial use;
    - handling and storage costs;
    - labor and other direct or indirect production costs (for assets produced or constructed);
    - engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
    - acquisition and preparation costs of buildings and other facilities;
    - an appropriate share of the cost of the equipment and facilities used in construction work;
    - fixed equipment and related installation costs required for activities in a building or facility;
    - direct costs of inspection, supervision, and administration of construction contracts and construction work;
    - legal and recording fees and damage claims;
    - fair value of facilities and equipment donated to the government; and
    - Interest costs paid.[footnote omitted]

11. This paragraph amends footnote 7 of paragraph 15.b in SFFAS 49 by revising the footnote to remove the reference to capital and operating leases:

15. The following arrangements and transactions are not subject to the provisions of this Statement:

a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

FN 7 – The term leases, as defined under FASAB standards, includes enhanced use leases ~~and both capital and operating~~ ~~leases~~, ~~as defined under current FASAB standards~~.

FN 8 – A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, ~~software~~ product updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

12. The revised footnote 7 of paragraph 15.b in SFFAS 49 is as follows:

15. The following arrangements and transactions are not subject to the provisions of this Statement:

a. Non-lease acquisitions of property, plant, and equipment (PP&E) that are subject to the Federal Acquisition Regulations (FAR) and the private entity is not directly financing, operating, or maintaining the PP&E as part of an overall risk-sharing arrangement or transaction

b. Leases[7] that are not bundled[8] and are entered into using General Services Administration (GSA)-delegated authority (This Statement does not amend existing standards applicable to leases and those standards remain applicable to all such arrangements/transactions.)

FN 7 – The term leases, as defined under FASAB standards, includes enhanced use leases.

FN 8 – A bundled lease typically arises when parties to a leasing arrangement agree to include additional products or services in the leasing arrangement, some of which might be related or tied directly to the underlying leased product or services (for example, product updates or maintenance). Although these additional products or services are not always expressly identified in the underlying lease agreement and may be documented in other agreements, they are nonetheless considered "bundled" with the underlying lease agreement.

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EFFECTIVE DATE

13. Paragraphs 9 and 10 of this Statement are effective upon issuance.

14. Paragraph 2 of this Statement is effective for reporting periods beginning after September 30, 2019. Early adoption is not permitted.

15. Paragraphs 3 through 8, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2020. Early adoption is not permitted.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

A1. SFFAS 8 established the RSSI category to distinguish information about the government's stewardship from basic financial statements and required supplementary information (RSI). The Federal Accounting Standards Advisory Board (FASAB or "the Board") reasoned that information about the government's stewardship may include non-financial data, may be based on projections or assumptions, and may not articulate with basic financial statements.[1] In addition, the importance of stewardship information needed to be highlighted[2] and receive more audit scrutiny than RSI.[3]

A2. Audit guidance for RSSI, however, was never developed. The Board consequently began eliminating the category by reclassifying most of the RSSI elements to the basic financial statements or RSI. Only the stewardship investments information remained in RSSI and this Statement eliminates the requirement to present stewardship investments trend information as RSSI.

A3. While the Board questioned whether the RSSI category should be eliminated, stewardship investment information in some form can help users assess whether government operations have contributed to the nation's current and future well-being. Stewardship investments include expenses incurred for nonfederal physical property, such as highways and bridges; expenses incurred to increase or maintain national economic productive capacity, such as investments in human capital; and expenses incurred for research and development that are intended to provide future benefits or returns. However, outreach regarding this proposal revealed that users may define "investment" more broadly than SFFAS 8 and prefer cash basis data that the Office of Management and Budget reports annually.

[1] SFFAS 8, par. 20.
[2] SFFAS 8, par. 111.
[3] SFFAS 8, par. 114.

LEASES

A4. The Board believes it is appropriate to amend the necessary standards to eliminate references to "capital" and "operating" leases used prior to the issuance of SFFAS 54. The terms "capital" and "operating" leases were eliminated with the issuance of SFFAS 54. This proposal provides conforming amendments to the following statements:

- SFFAS 5, *Accounting for Liabilities of the Federal Government*
- SFFAS 6, *Accounting for Property, Plant, and Equipment*
- SFFAS 49, *Public-Private Partnerships: Disclosure Requirements*

CLARITY AMENDMENTS

A5. Paragraph 26 of SFFAS 6 provides examples of costs that may be included as capitalized cost of acquiring PP&E. One example references "material amounts of interest cost paid." Some found it confusing to qualify only one of the examples as "material," but not the others. The Board believes removing the reference to "material amounts" will not change existing practice while improving the clarity of existing standards.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A6. FASAB issued the exposure draft (ED) on February 22, 2019 with comments requested by April 23, 2019. Upon release of the ED, notices and press releases went to the following: the Federal Register, *FASAB News*, the *Journal of Accountancy, AGA Today*, the *CPA Journal, Government Executive* and the *CPA Letter*, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency (CIGIE), the Financial Statement Audit Network; and committees of professional associations generally commenting on EDs in the past.

A7. FASAB received a total of 11 responses from preparers, auditors, and professional associations. The majority of respondents generally agreed with the Board's proposal to eliminate the RSSI category by rescinding SFFAS 8. Respondents noted that the proposal would remove a reporting requirement that users, in their observation, have not relied upon or utilized. .

A8. Respondents that did not agree with the proposal to eliminate the RSSI category noted that a separate category highlights the importance of the stewardship information and distinguishes it from other information. Stewardship information also informs users on the extent of investments that provide long-term benefits for the nation.

A9. Eliminating the RSSI category does not preclude preparers from reporting investment information in management's discussion and analysis (MD&A), other information, or both. Also, preparers have the discretion to employ the technology they deem appropriate for assisting users in locating the information within their GPFFR and among other reporting that may provide more detailed information.

A10. Stewardship investments may be significant for some reporting entities and warrant discussion in the MD&A. SFFAS 15, *Management's Discussion and Analysis*, states that

MD&A should provide "a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition."[4]

A11. Given the Board's decision to eliminate the RSSI category, the majority of respondents agreed that guidance on reporting stewardship investment information in MD&A would be needed. Guidance would help ensure that reporting entities consistently provide the information that would be most beneficial to users. The Board is conducting a project on improving MD&A, and the project will consider the respondents' concerns and suggestions.

A12. Regarding the clarity amendments, all of the respondents agreed with the proposal to update references to leases in SFFAS 5, SFFAS 6, and SFFAS 49, and make a minor change for clarity. Based on a suggestion from a respondent, the Board edited proposed language to clarify a reference to leasehold improvements. Also, respondents suggested additional changes to SFFAS 6 and other requirements. The Board will review those additional respondent suggestions in future Omnibus amendments or during the evaluation of existing standards.

A13. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised.

BOARD APPROVAL

A14. This Statement was approved for issuance by all members of the Board. Ballots are available for inspection at the Board's offices.

[4] SFFAS 15, par. 1.

The is the original Standard file; please check for the most recent update in the FASAB Handbook at https://files.fasab.gov/pdffiles/handbook_sffas_57.pdf

APPENDIX B: ABBREVIATIONS

ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GPFFR	General Purpose Federal Financial Report
MD&A	Management's Discussion and Analysis
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAS	Statement of Federal Financial Accounting Standards

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Graylin E. Smith

Timothy F. Soltis

FASAB Staff

Monica R. Valentine, Executive Director

Ross Simms, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street, NW

Suite 1155

Washington, D.C. 20548

Telephone 202-512-7350

Fax 202-512-7366

www.fasab.gov

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Federal Accounting Standards Advisory Board

DEFERRAL OF THE EFFECTIVE DATE OF SFFAS 54, *LEASES*

Statement of Federal Financial Accounting Standards 58

June 19, 2020

This is the original Statement; please check for the most recent update in the FASAB Handbook at https://files.fasab.gov/pdffiles/handbook_sffas_58.pdf

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement defers the effective date for Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment,* for three years. The requirements of SFFAS 54 will now become effective for reporting periods beginning after September 30, 2023. Early adoption of SFFAS 54 is not permitted.

Most federal reporting entities should continue their current lease accounting practices until SFFAS 54 becomes effective; they should not follow the Financial Accounting Standards Board's (FASB) new lease standards (Accounting Standards Codification – *Leases* – *Topic 842*) nor should they follow the Governmental Accounting Standards Board's (GASB) new lease standards (GASB Statement No. 87, *Leases*).[1] Rather, reporting entities should continue to follow the current FASAB guidance that addresses lease transactions. This comprises paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6. These paragraphs are not rescinded by SFFAS 54 until it becomes effective. Previously-existing FASB guidance under Accounting Standards Codification – *Leases* – *Topic 840* should continue to be used when the accounting treatment for a lease transaction or event is not specified by paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6.

[1]Except for a limited number of reporting entities permitted to follow FASB generally accepted accounting principles (see SFFAS 34, par. 9-12). Those entities will adopt new lease accounting standards promulgated by FASB as appropriate.

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TABLE OF CONTENTS

Summary **1**

Standards **3**

SCOPE 3

AMENDMENT TO SFFAS 54 3

AMENDMENT TO SFFAS 57 3

EFFECTIVE DATE 3

Appendix A: Basis for Conclusions **4**

Appendix B: Abbreviations **7**

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFR), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement amends SFFAS 54, *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant, and Equipment*, to defer the effective date of implementation by three years.

3. This Statement also amends SFFAS 57, *Omnibus Amendments 2019*, to defer the effective date of certain conforming amendments contained therein related to SFFAS 54.

AMENDMENT TO SFFAS 54

4. Paragraph 98 of SFFAS 54 is amended as follows:

    98. The requirements of this Statement are effective for reporting periods beginning after September 30, ~~2020~~ 2023. Early adoption is not permitted.

AMENDMENT TO SFFAS 57

5. Paragraph 15 of SFFAS 57 is amended as follows:

    15. Paragraphs 3 through 8, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, ~~2020~~ 2023. Early adoption is not permitted.

EFFECTIVE DATE

6. The requirements of this Statement are effective upon issuance.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

A1. In April 2018, the Federal Accounting Standards Advisory Board (FASAB or "the Board") issued SFFAS 54. SFFAS 54 provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's GPFFR and include appropriate disclosures. Such standards were set to go into effect for reporting periods beginning after September 30, 2020.

A2. Since the issuance of SFFAS 54, the Accounting and Auditing Policy Committee (AAPC) initiated a project to develop implementation guidance for the federal financial accounting and reporting community on applying the requirements of SFFAS 54.[1] As part of this effort, the Board and AAPC engaged a task force to obtain feedback from stakeholders and constituents and monitor implementation efforts across the federal government.

SUMMARY OF OUTREACH AND RESPONSES

A3. The Board believes that SFFAS 54 offers appropriate guidance for the accounting and financial reporting of leases for federal entities and maintains the views expressed in the basis for conclusions to SFFAS 54 regarding costs and benefits. Implementation of SFFAS 54 will ensure that GPFFR users receive useful information regarding the resources and obligations that support federal programs and activities and can monitor federal investments in property, plant, and equipment, and lease financing activities.

A4. Notwithstanding such benefits, the Board believes a three-year deferral of the effective date of SFFAS 54 is a prudent response commensurate to the identified implementation challenges, costs, and constraints and will allow reporting entities to reliably implement SFFAS 54.

[1]The AAPC is a permanent committee established by the Board to assist the federal government in improving financial reporting by timely identifying, discussing, and recommending solutions to accounting issues within the framework of existing authoritative literature. The AAPC works under the general oversight of the Board.

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A5. The Board reviewed and discussed implementation issues in August and October of 2019 by reviewing Board and task force briefing materials and receiving feedback and status reports from task force panelists and technical staff.

A6. Through these efforts, the Board gained an understanding of the nature and magnitude of implementation challenges encountered by federal reporting entities. The Board found that challenges were significant for reporting entities with large lease portfolios.

A7. The following factors (not all-inclusive) are examples of significant challenges encountered when implementing SFFAS 54:

a. The need to develop and acquire information technology, data elements, core systems requirements, and internal controls at the government-wide and component reporting entity levels

b. Resource limitations, coupled with extensive preparation activities necessary for implementation

c. The need for the federal financial accounting and reporting community to receive, understand, and apply forthcoming implementation guidance due to the extensive complexity and breadth of implementation issues identified by the leases implementation guidance task force

A8. Based on the initial feedback obtained by the Board and its SFFAS 54 implementation monitoring activities, the Board agreed that proposing a two-year deferral of the effective date of SFFAS 54 in its exposure draft (ED) *Deferral of the Effective Date of SFFAS 54, Leases*, was appropriate. In the proposal, the Board noted that it expected to issue additional SFFAS 54 implementation guidance during fiscal year 2021.

A9. FASAB issued the ED on December 18, 2019, with comments requested by January 31, 2020. Upon release of the ED, notices and press releases went to the following: the Federal Register, the FASAB newsletter*, Journal of Accountancy, Accounting Today*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs and the Association of Government Accountants Financial Management Standards Board), and the roster of AAPC leases implementation task force members and observers.

A10. Twenty-two comment letters were received from preparers, auditors, professional associations, and users of federal financial information. The Board considered responses to the ED at its April 2020 meeting. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. All respondents agreed that a deferral was necessary. Twenty-one of 22 indicated agreement with the two-year deferral, while one of 22 stated that two years would not provide sufficient time to consider forthcoming implementation guidance in conducting implementation preparation activities.

A12. Several respondents agreed with the proposal while expressing concerns about the complexity and breadth of implementation challenges. Respondents also expressed a

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desire to have sufficient time to consider and integrate forthcoming implementation guidance. A few respondents indicated that ongoing systems development efforts and implementation preparation activities are likely to be affected by such guidance. Some were concerned about risks and costs incurred as a result of compressed timeframes for considering the guidance, once finalized and issued.

A13. Based on the feedback obtained through the leases implementation task force, staff research and outreach, and public comments, the Board concluded that a three-year deferral was appropriate.

A14. Most federal reporting entities will continue their current lease accounting practices until SFFAS 54 becomes effective; they should not follow the Financial Accounting Standards Board's (FASB) new lease standards (Accounting Standards Codification – *Leases* – *Topic 842*) nor should they follow the Governmental Accounting Standards Board's (GASB) new lease standards (GASB Statement No. 87, *Leases*).[2]

A15. Rather, reporting entities should continue to follow the current FASAB guidance that addresses lease transactions. This comprises paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6. These paragraphs are not rescinded by SFFAS 54 until it becomes effective. Previously-existing FASB guidance under Accounting Standards Codification – *Leases* – *Topic 840* should continue to be used when the accounting treatment for a lease transaction or event is not specified by paragraphs 43-46 of SFFAS 5 and paragraphs 20 and 29 of SFFAS 6.

BOARD APPROVAL

A16. This Statement was approved for issuance by all members of the Board.

[2]Except for a limited number of reporting entities permitted to follow FASB generally accepted accounting principles (see SFFAS 34, par. 9-12). Those entities will adopt new lease accounting standards promulgated by FASB as appropriate.

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APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
SFFAS	Statement of Federal Financial Accounting Standards

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R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Sallyanne Harper

Patrick McNamee

Terry K. Patton

Graylin E. Smith

Timothy F. Soltis

FASAB Staff

Monica R. Valentine, Executive Director

Ricky A. Perry, Jr., Senior Analyst

Federal Accounting Standards Advisory Board

441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

ACCOUNTING AND REPORTING OF GOVERNMENT LAND

Statement of Federal Financial Accounting Standards 59

July 30, 2021

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, and analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission Statement: Federal Accounting Standards Advisory Board, exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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SUMMARY

The objective of this Statement is to ensure consistent accounting treatment and reporting for federal land.

This Statement sets forth the Federal Accounting Standards Advisory Board's (FASAB or "the Board") agreement with those in the financial reporting community who noted the importance of having accounting standards that provide relevant, reliable, and consistent information concerning federal land.

The Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations such as passage of time and inflation make historical cost less relevant to users. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting estimated acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measures were used to recognize land on the balance sheet.

Prior to the issuance of this Statement, federal accounting standards required the capitalization of the historical cost of general property, plant, and equipment (G-PP&E) land and disclosures regarding restrictions on the use or convertibility of G-PP&E to include G-PP&E land. Similarly, prior to this Statement federal accounting standards required the expensing of stewardship land (SL) for the period in which the acquisition cost was incurred and disclosures on the relationship between SL and the entity's mission, the entity's SL polices, major categories of SL use, and physical units of SL.

This Statement's principal requirements include:

- Reclassifying G-PP&E land and permanent land rights as a non-capitalized asset
- Referencing a note on the balance sheet that discloses information about G-PP&E land and permanent land rights without an asset dollar amount
- Reporting estimated acres of G-PP&E land and SL using three predominant use sub-categories
    - Conservation and preservation land
    - Operational land
    - Commercial use land
- Reporting estimated acres of land held for disposal or exchange
- Reporting land rights information, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights

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MATERIALITY

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial[1]. A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[1] Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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TABLE OF CONTENTS

SUMMARY 1
MATERIALITY 2
TABLE OF CONTENTS 3
STANDARDS 4
SCOPE 4
AMENDMENTS TO SFFAS 6 4
AMENDMENTS TO SFFAS 29 10
AMENDMENTS TO SFFAS 32 16
AMENDMENTS TO SFFAS 7 17
AMENDMENTS TO SFFAS 42 19
EFFECTIVE DATE 20
APPENDIX A: BASIS FOR CONCLUSIONS 21
PROJECT HISTORY 21
APPENDIX B: ILLUSTRATIONS 41
APPENDIX C: ABBREVIATIONS 48
APPENDIX D: GLOSSARY 49
APPENDIX E: TASK FORCE MEMBERS 52

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles*, *Including the Application of Standards Issued by the Financial Accounting Standards Board*.
2. This Statement amends the following guidance:[2]
   a. SFFAS 6, *Accounting for Property, Plant, and Equipment*
   b. SFFAS 29, *Heritage Assets and Stewardship Land*
   c. SFFAS 32, *Consolidated Financial Report of the United States Government Requirements: Implementing Statement of Federal Financial Accounting Concepts 4 "Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government"*
   d. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*
   e. SFFAS 42, *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*
   f. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*[3]
3. This Statement does not change existing standards addressing Tribal land and land rights other than permanent land rights. In addition, this Statement does not apply to:
   a. land held in trust or administered on behalf of Indian tribal governments or individual Indian land,
   b. the Outer Continental Shelf (OCS)[4].

AMENDMENTS TO SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

4. This paragraph amends SFFAS 6 to clarify that land and permanent land rights are to remain in the general property, plant, and equipment (G-PP&E) category but are not to be capitalized.

[2] Amendments to each of the Statements include, where applicable, (1) strikethrough deletions of existing text and (2) red, underlined additions. In some amendments, red underlining has been omitted for reading ease.

[3] Amendments to SFFAS 50, a Statement which amended SFFAS 6, will be incorporated by reference as reflected in the SFFAS 6 amendments contained herein.

[4] The term OCS refers to the seabed, subsoil and energy or mineral resources derived therefrom.

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a. Paragraph 25 is amended as follows:

25. Land and permanent land rights[28.1] acquired for or in connection with other general PP&E[29] ~~shall be included in~~ are considered general PP&E but are not to be capitalized on the balance sheet. General PP&E land shall exclude (1) withdrawn public lands[29.1] or (2) land restricted for conservation, preservation, historical, or other like restrictions. Such land shall remain categorized as stewardship land (SL). ~~unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.. In some instances, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.~~

FN 28.1 – Land rights, such as easements or rights-of-way, that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

FN 29 – "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

FN 29.1 – To the extent consistent with statutory authorities, an entity may withdraw public lands from the public domain for specific uses. For example, an entity may withdraw public land from sale, settlement, or recreational use to expand buffer zones for security or training needs.

b. Paragraph 26 is amended as follows:

26. ~~**All g**~~ **General PP&E**, other than land and permanent land rights, shall be recognized as an asset on the balance sheet and recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include: [no changes to the list that follows]

c. A paragraph and footnote is inserted following the heading "Expense Recognition" and before existing paragraph 35 as follows:

34A. The cost of acquiring general PP&E land and permanent land rights shall be recognized on the statement of net cost for the period in which the cost is incurred. The cost shall include all costs to prepare general PP&E land or a permanent land right for its intended use (for example, razing a building). In some cases, land may be acquired along with existing structures. If the structure is to be used in operations, the amount related to the structure shall be estimated and capitalized while the amount related to the land shall be expensed. If acquisition of the structure is incidental to the acquisition of the land and the structure is not intended to be used in operations, the cost of the entire acquisition shall be expensed. No amounts for general PP&E land or permanent land rights acquired through donation, devise,[40.1] or judicial process shall be capitalized.

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FN 40.1 – Acquisition of general PP&E can also occur due to legal devise or instrument, such as a will or a clause within a will that bequeaths property to an entity.

d. Paragraph 35 is amended as follows:

35. Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E,[41] except land and permanent land rights, shall be expensed as incurred ~~of unlimited duration~~.[42] [no changes to the list that follows]

FN 41 – Software [See SFFAS 10 for standards regarding internally developed software] and temporary land ~~[See SFFAS 10 for standard regarding internally developed software]~~ rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. "Amortization" is applied to intangible assets in the same manner that depreciation is applied to general PP&E—tangible assets.

FN 42 – Temporary ~~L~~land rights, such as easements or rights-of-way, that are for a specified period of time or limited duration shall be depreciated or amortized over that time period.

e. Footnote 46 of paragraph 44 provides examples of major classes of assets. Footnote 46 is amended as follows:

FN 46 – "Major classes" of general PP&E shall be determined by the entity. Examples of major classes that are depreciated/amortized include buildings and structures, furniture and fixtures, equipment, and vehicles~~, and land~~.

5. This paragraph amends paragraph 40 by providing guidance for establishing opening balances consistent with the amended reporting requirements for G-PP&E land. Because SFFAS 50 first amended this paragraph in SFFAS 6, SFFAS 50, paragraph 13 is also amended to conform to amended paragraph 40 shown below. There are no changes to paragraph 40.a–40.e.ii, 40.g, 40.h.i, and 40.i.i.

40.f. Alternative methods for ~~land and~~ temporary land rights. A reporting entity should choose among the following alternative methods for establishing an opening balance for ~~land and~~ temporary land rights. Because a reporting entity may have multiple component or subcomponent reporting entities selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

40.f.i. The reporting entity may exclude ~~land and~~ temporary land rights from the opening balance of general PP&E. If this alternative method ~~is~~ was applied, the reporting entity should prospectively capitalize and depreciate or amortize ~~expense future land and~~ temporary land rights ~~acquisitions~~ acquired, beginning in fiscal year 2026.

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40.f.ii. Temporary ~~L~~land ~~and land~~ rights may be recognized in opening balances based on the provisions of the alternative valuation method (deemed cost) provided in paragraph 40.d.

40.h.ii. A component reporting entity electing to apply the provisions of paragraph 40.f.i. to ~~land and~~ temporary land rights should disclose this fact and describe the alternative methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. ~~A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures.~~ In the event different alternative methods are applied ~~to land and land rights~~ (as permitted by paragraph 40.f.) by subcomponent reporting entities consolidated into a larger reporting entity, the alternative method adopted by each significant subcomponent should be disclosed.

40.i.ii. When a component reporting entity elects to apply the provisions of paragraph 40.f.i. to ~~land and~~ temporary land rights, the U. S. government-wide financial statements should disclose this fact, ~~the number of acres held at the end of each reporting period, an~~ an explanation of the election, the identity of the component reporting entity, and a reference to the component reporting entity's financial report.

6. This paragraph amends SFFAS 6 disclosure requirements.

   a. Two paragraphs that add disclosure requirements applicable to G-PP&E land are inserted immediately following paragraph 45:

      45A. The following disclosures[46.1] should be provided regarding G-PP&E land and permanent land rights:

      a. A concise statement defining an entity's federal land, and explaining how land relates to the mission of the entity.

      b. A brief description of the entity's policies for land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

      c. Land and permanent land rights should be assigned to one of three sub-categories based on predominant use[461.a] and reported in estimated acres of land. The three sub-categories are commercial use land; conservation and preservation land; and operational land. Where land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land[461.b]. The following information should be presented by sub-category of land use:

         i. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at

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the end of each reporting period for land and permanent land rights should be provided.

d. If applicable, the amount of estimated acres held for disposal or exchange and their predominant use. For purposes of this Statement, land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

e. Land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

FN 46.1 – Unless otherwise noted, disclosure requirements are limited to the G-PP&E land category and are not required for each of the three sub-categories of conservation and preservation land; operational land; and commercial use land.

FN 46.1a - Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

FN 46.1b - Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

45B. The financial statement balance sheet should reference a note that discloses information required at paragraph 45A (a through e) about G-PP&E land and permanent land rights but no asset dollar amount should be shown. Existing display and disclosures[46.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

FN 46.2 – For G-PP&E land and land rights, existing disclosures are those that are in effect prior to the amendments contained in paragraph 45A. They include disclosures required by paragraph 40.h for those entities electing an alternative method for land and land rights and, if applicable, the minimum G-PP&E disclosure requirements as required by paragraph 45.

b. The disclosure requirements for the government-wide financial statements at paragraph 45 are amended as follows:

45. [No change to the list that precedes this text.]The ~~above~~ listed disclosure requirements for G-PP&E and G-PP&E land are not applicable to the U.S. Government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. Government-wide financial statements for these activities.

7. This paragraph amends SFFAS 6 by inserting additional definitions immediately after paragraph 20 as follows:

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20A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[24.1] Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

> FN 24.1 – Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

20B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

- concession arrangements;
- grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;
- land sales or land exchanges;
- leases;
- permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;
- forest product sales such as timber, or sales arising from national forests and grasslands; and/or
- public-private partnerships.

20C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

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20D. Operational land sub-category includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

- Military functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.
- Scientific functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).
- Nuclear functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.
- Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

AMENDMENTS TO SFFAS 29, *HERITAGE ASSETS AND STEWARDSHIP LAND*

8. This paragraph amends SFFAS 29 to clarify the definition of SL and references to general PP&E.

   a. Paragraph 33 is amended as follows:

   33. Stewardship Land ~~is~~ includes both public domain[14.1] and acquired land and land rights[15] owned by the Federal Government intended to be held indefinitely. ~~but not acquired for or in connection with[16] items of general PP&E~~. Examples of stewardship land include land reserved, managed, planned, used, or acquired for[16] ~~as forests and parks, and land used for wildlife and grazing~~.

   a. forests and parks;
   b. recreation and conservation;
   c. wildlife habitat and grazing;
   d. historic landmarks and/or the preservation of pre-historic and historic structures (those listed on or eligible for listing on the National Register of Historic Places);
   e. multiple purpose ancillary revenue generating activity (for example, special use permits, mineral development activities, and timber production); and/or
   f. buffer zones for security, flood management, and noise and view sheds.

   FN 14.1 – Public domain land is land that was originally ceded to the United States by treaty, purchase, or conquest in contrast to acquired lands, which have been purchased by, given to, exchanged with, or transferred through condemnation proceedings to the federal government.

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FN 15 – Land rights are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land. Land rights such as easements or rights-of-way that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

FN 16 – ~~"Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.~~ Land used or acquired for or in connection with items of general PP&E but meeting the definition of stewardship land should be classified as stewardship land.

b. Paragraph 35 is amended as follows:

35. Land and land rights ~~owned by the Federal Government and acquired for or in connection with items of~~ meeting the definition of general PP&E established in SFFAS 6, as amended, should be accounted for in accordance with SFFAS 6, as amended. ~~and reported as general PP&E~~.

c. Paragraph 39 is amended and footnote 20 rescinded as follows:

39. Transfers of stewardship land from one Federal entity to another, do~~es~~ not affect the net cost of operations or net position of either entity. ~~However, in some cases, land included in general PP&E may be transferred to an entity for use as stewardship land. In this instance, t~~The transferring and recipient ~~entity~~ entities should properly adjust for estimated acres of land information ~~recognize a transfer out of capitalized assets~~.[20]

FN 20 – Footnote rescinded by SFFAS ##. ~~SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.~~

9. This paragraph amends SFFAS 29 by rescinding paragraph 40.a–40.d.3 and replacing it with the disclosure requirements to require estimated acres of land and clarify the sub-categorization and reporting of land use. Sub-categorization should be based on predominant use using three new sub-categories. Further, disclosures should provide information regarding land held for disposal and transfers of land.[5]

Paragraph 40 is amended and a new paragraph 40A is added as follows:

40. ~~Entities with stewardship land should reference a note[21] on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:~~ The following disclosures[21-21.1] should be provided for stewardship land and permanent land rights:

~~a. A concise statement explaining how it relates to the mission of the entity.~~

~~b. A brief description of the entity's stewardship policies for stewardship land. Stewardship policies for stewardship land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of stewardship~~

[5] Unless otherwise noted, disclosure requirements are limited to the G-PP&E land category and are not required for each of the three sub-categories of conservation and preservation land; operational; and commercial use land.

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~~land consistent with statutory requirements, prohibitions, and limitations governing the entity and the stewardship land.~~

~~c. A concise description of each major category of stewardship land use. Where parcels of land have more than one use, the predominant use of the land should be considered the major use. In cases where land has multiple uses, none of which is predominant, a description of the multiple uses should be presented. The appropriate level of categorization of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets.~~

~~d. Stewardship land should be quantified in terms of physical units. The appropriate level of aggregation and physical units of measure for each major category of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets. For each major category of stewardship land use the following should be reported:~~

~~1. The number of physical units by major category of stewardship land use for which the entity is the steward as of the end of the reporting period;~~

~~2. The number of physical units by major category of stewardship land use that were acquired and the number of physical units by major category of stewardship land use that were withdrawn during the reporting period; and~~

~~3. A description of the major methods of acquisition and withdrawal of stewardship land during the reporting period. This should include disclosure of physical units (by major category of stewardship land use) of transfers of stewardship land between Federal entities and the number of physical units (by major category of stewardship land use) of stewardship land acquired through donation or devise, if material. In addition, the fair value of stewardship land acquired through donation or devise during the reporting period should be disclosed, if known and material.~~

a. A concise statement defining an entity's federal land, and explaining how stewardship land relates to the mission of the entity.[21.2]

b. A brief description of the entity's policies for stewardship land. Policies for land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of land consistent with statutory requirements, prohibitions, and limitations governing the entity and the land.

c. Information of land use by sub-category. Stewardship land and permanent land rights should be assigned to one of three sub-categories based on predominant use[21.1a] and reported in estimated acres of land. The three sub-categories are commercial use land; conservation and preservation land; and operational land. Where stewardship land and permanent land rights have more than one use, the predominant use of the land should be used to sub-categorize the land[21.1b].

   1. Acres of land. The estimated number of acres at the beginning of each reporting period among the three sub-categories and the estimated number of acres at the end of each reporting period for land and permanent land rights.

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d. If applicable, the amount of estimated acres of land held for disposal or exchange and their predominant use. For purposes of this Statement, stewardship land is considered held for disposal or exchange when the entity has satisfied the statutory disposal authority requirements specific to the land in question.

e. Stewardship land rights information should include a general description of the different types of rights acquired by the entity, whether such rights are permanent or temporary, and amounts paid during the year to maintain such rights.

FN 21 – This standard does not prescribe a specific reference or line item entitled "Stewardship Land" as it may be included with other items for which no dollar amounts are recognized (such as heritage assets and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

FN 21.1 – Unless otherwise noted, disclosure requirements are limited to the stewardship land category and are not required for each of the three sub-categories of conservation and preservation land; operational land; and commercial use land.

FN 21.1a - Predominant Use of land. Predominant use is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

FN 21.1b - Aggregation and assignment of land. The level of aggregation of land and permanent land rights used to determine predominant use should be determined by the preparer considering the entity's mission, types of land use and how it manages the assets.

40A. The financial statement balance sheet should reference a note that discloses information required at paragraph 40 (a through e) about Stewardship land and permanent land rights but no asset dollar amount should be shown. Existing disclosures[21.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

FN 21.2 – For stewardship land, existing disclosures are those required by paragraph 40, titled "Disclosures and Required Supplementary Information" that are being rescinded (40.a through 40.d.3) effective fiscal year 2026. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

10. This paragraph amends SFFAS 29 by inserting additional definitions immediately after paragraph 36 as follows:

36A. Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[17.1]

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Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation, or any combination thereof.

FN 17.1 – Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

36B. Commercial use land sub-category includes land or land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

a. concession arrangements;

b. grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;

c. land sales or land exchanges;

d. leases;

e. permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;

f. forest product sales such as timber, or sales arising from national forests and grasslands; and/or

g. public-private partnerships.

36C. Conservation and preservation land sub-category includes land or land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

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36D. Operational land sub-category includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

a. Military functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.

b. Scientific functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).

c. Nuclear functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.

d. Other related functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

11. This paragraph amends paragraph 42 of SFFAS 29, which addresses the U.S. government-wide financial statement disclosures. Amendments will now require presentation of estimated acres of land by category. Paragraph 42 is amended and paragraph 42A is added as follows:

42. The U.S. Government-wide financial statement should include the following information: ~~reference a note on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:~~

a. A concise statement including a general description of the federal government's land explaining how its federal land ~~it~~ relates to the mission of the Federal Government.

b. A ~~description~~ disclosure of the estimated acres of land by predominant use sub-categories and estimated acres of land held for disposal or exchange by ~~of the stewardship land of~~ the Federal Government.

c. A general reference to agency reports for additional information about stewardship land, such as agency ~~stewardship~~ policies ~~for stewardship land,~~ and estimated acres of land~~, and physical units by major categories of stewardship land use~~.

42A. The U.S. Government-wide financial statement balance sheet should reference a note that discloses the information about stewardship land and land rights required by paragraph 42, but no asset dollar amounts should be shown. Existing disclosures[25.1] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If stewardship land

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and general PP&E land are presented in separate notes to the financial statements, include cross references between the notes.

FN 25.1 – Existing disclosures at paragraph 42 are those which are in effect for reporting entities prior to the amendments contained at paragraphs 42 and 42A. To the extent practical, duplication of information, such as statements explaining how stewardship land relates to the entity's mission or its SL policies and procedures, should be avoided and should remain as basic (note disclosure) during the transitional period.

AMENDMENTS TO SFFAS 32, *CONSOLIDATED FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT REQUIREMENTS: IMPLEMENTING STATEMENT OF FEDERAL FINANCIAL ACCOUNTING CONCEPTS 4 "INTENDED AUDIENCE AND QUALITATIVE CHARACTERISTICS FOR THE CONSOLIDATED FINANCIAL REPORT OF THE UNITED STATES GOVERNMENT"*

12. This paragraph amends SFFAS 32 to revise the government-wide disclosure requirements for property, plant, and equipment. Paragraph 23 is amended and paragraph 23A is added as follows:

23. The U.S. government-wide financial statements should include the following disclosures:

a. ~~a~~A broad description of PP&E~~,~~

b. For general PP&E land

i. A note on the balance sheet that discloses information FN1 about general PP&E land and permanent land rights which includes:

1. A concise statement including a general description of the federal government's land explaining how its federal land relates to the mission of the Federal government.

2. A disclosure of estimated acres by predominant use sub-categories and estimated acres of land held for disposal or exchange by the Federal government

c. ~~b~~. ~~t~~The cost (excluding land and permanent land rights), associated accumulated depreciation, and book value by major class~~, and~~

d. ~~c~~. ~~a~~A general reference to agency ~~component entity~~ reports for additional information about general PP&E and general PP&E land~~.~~

23A. The balance sheet should reference a note that discloses the information[2.1] about general PP&E land and permanent land rights required by paragraph 23, but no asset dollar amounts should be shown. Existing display and disclosures[2.2] should continue during the transition period through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures. If general PP&E land and

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stewardship land are presented in separate notes to the financial statements, include cross references between the notes.

FN 2.1 – Additionally, such information may include a description of the different uses of land managed by the entity, its predominant activities, condition information, and policy initiatives in effect during the reporting period.

FN 2.2 – Existing disclosures at paragraph 23 are those which are in effect for government-wide reporting prior to the amendments contained at paragraph 23A.

AMENDMENTS TO SFFAS 7, *ACCOUNTING FOR REVENUE AND OTHER FINANCING SOURCES AND CONCEPTS FOR RECONCILING BUDGETARY AND FINANCIAL ACCOUNTING*

13. This paragraph amends SFFAS 7 to clarify guidance regarding transfers and donations of land.

    a. Footnote 14 at paragraph 62, which discusses revenue arising from donations, should include a reference to the amended SFFAS 6, paragraph 34A under the heading "Expense Recognition." Footnote 14 is amended as follows:

        FN14 – For the recognition criteria for donated property, plant, and equipment, see SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 30, 34A, 62, and 71.

    b. Paragraph 258 discusses non-exchange transactions with the public, specifically donations. This should include G-PP&E land. Paragraph 258 is amended as follows:

        258. Donations: except types of property, plant, and equipment that are expensed.— Donations are contributions to the Government, i.e., voluntary gifts of resources to a Government entity by a non-Federal entity.[51] The Government does not give anything of value to the donor, and the donor receives only personal satisfaction. The donation of cash, other financial resources, or nonfinancial resources (except general PP&E land, permanent land rights, and stewardship property, plant, and equipment) is therefore a nonexchange revenue.

    c. Paragraph 259 discusses non-exchange transactions with the public, specifically donations. This should include G-PP&E land. In addition, this paragraph is amended to conform to paragraph 9.d. of SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, which rescinded the category "federal mission property, plant, and equipment." Paragraph 259 is amended as follows:

        259. The exceptions are for donations of assets that are expensed rather than capitalized. These include general PP&E land and permanent land rights, stewardship PP&E, ~~consists of Federal mission PP&E,~~ heritage assets, and stewardship land. Such PP&E is expensed if purchased, but no amount is recognized if it is received as a donation.[52] Correspondingly, no revenue is recognized for such donations.

    d. Paragraph 296 and footnote 62 discuss sales of property, plant, and equipment. This should include G-PP&E land and permanent land rights. In addition, footnote 62 is amended to conform to SFFAS 23, paragraph 9.d, which rescinded the category "federal mission property, plant, and equipment." Paragraph 296 and footnote 62 are amended as follows:

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296. The entire sales price is a gain if the book value of the asset is zero. The book value is zero (a) if the asset is general property, plant, and equipment (PP&E) that is fully depreciated or written-off or (b) if the asset is general PP&E land, permanent land rights, or stewardship PP&E, for which the entire cost is expensed when the asset is purchased.[62]

FN 62 – SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, has divided property, plant, and equipment (PP&E) into two basic categories: general PP&E and stewardship PP&E (which consists of ~~federal mission PP&E,~~ heritage assets~~,~~ and stewardship land). General PP&E other than land and permanent land rights is capitalized and recognized on the balance sheet; general PP&E land, permanent land rights, and stewardship PP&E ~~is~~ are expensed and thus ~~has~~ have no book value. (Stewardship PP&E is presented in a stewardship statement.)

e. Paragraph 345 discusses intragovernmental transfers of PP&E. This should include G-PP&E land in the requirement. Paragraph 345 is amended as follows:

345. Transfer of property, plant, and equipment without reimbursement: types that are expensed.—Property, plant, and equipment (PP&E) of types that are expensed (~~i.e~~e.g., general PP&E land and stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as either general PP&E land (including permanent land rights) or stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and, therefore, in such a case it is not a revenue, a gain or loss, or other financing source.

f. Paragraph 346 discusses intragovernmental transfers of PP&E classified as G-PP&E by the transferor but as SL by the recipient. This should not include the de-recognition requirement for G-PP&E land and permanent land rights. Paragraph 346 is amended as follows:

346. However, if the asset that is transferred was classified as general PP&E (excluding non-capitalized general PP&E land and permanent land rights) for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

g. Paragraph 358 discusses transfers of PP&E. This should include G-PP&E. Paragraph 358 is amended as follows:

358. Transfer of property, plant, and equipment without reimbursement: types that are expensed. —Property, plant, and equipment (PP&E) of types that are expensed (i.e., general PP&E land [including permanent land rights] and stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as either general PP&E land (including permanent land rights) or stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.

h. Paragraph 361 discusses donations of PP&E. This should include G-PP&E. In addition, this paragraph is amended to conform to SFFAS 23, paragraph 9.d, which rescinded the category "federal mission property, plant, and equipment." Paragraph 361 is amended as follows:

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361. Donation of property, plant, and equipment: types that are expensed.—The acquisition costs of general PP&E land (including permanent land rights), heritage assets, and stewardship land ~~property, plant, and equipment (PP&E) is~~ are recognized as a cost when incurred. ~~Such PP&E consists of Federal mission PP&E, heritage assets, and stewardship land.~~ When such PP&E is donated to the Government, however, no amount is recognized as a cost.[81] Since the donation of such PP&E does not affect the net cost or net position of the recipient entity, it is not a revenue, a gain, or an other financing source.

AMENDMENTS TO SFFAS 42, *DEFERRED MAINTENANCE AND REPAIRS: AMENDING STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS 6, 14, 29, AND 32*

14. Paragraphs 13, 15.d, and 15.e are amended to ensure that deferred maintenance and repair (DM&R) information is reported in non-capitalized G-PP&E land.

a. Paragraph 13 is amended as follows:

13. DM&R should be measured and reported for capitalized general PP&E, non-capitalized general PP&E land (to include permanent land rights), and stewardship PP&E. DM&R also may be measured and reported for general PP&E other than land and permanent land rights that is non-capitalized or fully depreciated ~~general PP&E~~. DM&R should include funded maintenance and repairs (M&R) that have been delayed for a future period as well as unfunded M&R. DM&R on inactive and/or excess PP&E should be included to the extent that it is required to maintain inactive or excess PP&E in acceptable condition. For example, inactive PP&E may be maintained or repaired either to comply with existing laws and regulations, or to preserve the value of PP&E pending disposal.

b. Paragraph 15 is amended as follows:

15. At a minimum, the following information should be presented as required supplementary information (RSI) for all PP&E (each category established in SFFAS 6, as amended, should be included) regardless of the measurement method chosen.

Qualitative **(No edits for items 15.a–15.c or 15.f–15.g.)**

d. Whether DM&R relates solely to capitalized general PP&E and non-capitalized general PP&E land, stewardship PP&E, or also to amounts relating to non-capitalized or fully depreciated general PP&E

e. Capitalized and non-capitalized general PP&E, ~~and~~ non-capitalized heritage assets, and stewardship land for which management does not measure and/or report DM&R and the rationale for the exclusion

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EFFECTIVE DATE

15. The scope of this Statement (paragraphs 1-3) is effective for reporting periods beginning after September 30, 2021. The information required at paragraphs 6 and 7 (G-PP&E land), paragraphs 8-10 (stewardship land), paragraph 11 (government-wide stewardship land), and paragraph 12 (government-wide G-PP&E land) should be presented as RSI for fiscal years 2022 through 2025 and transition to note disclosures in fiscal year 2026. Asset dollar amounts for G-PP&E land and permanent land rights should remain on the balance sheet along with existing disclosures through fiscal year 2025 and cease in fiscal year 2026 when superseded by the transition of the RSI information to note disclosures and paragraphs 4, 5, 13, and 14 become effective. Existing display and disclosure (balance sheet reference) for stewardship land should continue through fiscal year 2025 until they are superseded by the requirements at Paragraphs 8-10 beginning in fiscal year 2026.

16. It is the Federal Accounting Standards Advisory Board's (FASAB or "the Board") intent that the information required by this Statement transition to basic information in fiscal year 2026 after being reported as RSI for a period of four years. Prior to the conclusion of the four-year RSI period, the Board plans to make any necessary adjustments to facilitate the transition to basic information. Early adoption is not permitted.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses the factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement and not the material in this appendix should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

The ensuing paragraphs, beginning with A1 "Project History," discuss in detail the Board's basis for conclusions and agreement with those in the financial reporting community, who expressed the need for uniform accounting guidance that addressed the lack of relevant, reliable, and consistent historical cost information and the application of inconsistent measurement approaches.

Prior to the issuance of this Statement, federal accounting standards required the capitalization of the historical cost of G-PP&E land and disclosures regarding restrictions on the use or convertibility of G-PP&E to include G-PP&E land. Similarly, prior to this Statement federal accounting standards required the expensing of SL for the period in which the acquisition cost was incurred and disclosures on the relationship between SL and the entity's mission, the entity's SL policies, major categories of SL use, and physical units of SL.

The Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations such as passage of time and inflation make historical cost less relevant to users. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measurements were used to recognize land on the balance sheet.

PROJECT HISTORY

A1. The Board added the accounting and reporting of government land project in February 2016 during its three-year plan review. The Board agreed that the project was necessary to address significant differences in accounting treatment and implementation issues arising from SFFAS 6*;* SFFAS 7*;*[6] SFFAS 29; and SFFAS 50,. The Board's most notable concerns included the following:

[6] SFFAS 7 requires that donations made to the government by a nonfederal entity, to include nonfinancial resources such as land or buildings, be recognized (for those inflows of resources that meet recognition criteria for assets) and measured at the estimated fair value of the contribution.

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a. There is limited value in historical/acquisition cost information for capitalized land, given that such information may lose relevance over time due to general inflation, general land appreciation, and environmental harm.

b. There is inconsistent reporting of G-PP&E land arising from differences in how opening balances are valued, as permitted by SFFAS 50. That is, reporting entities may exclude land and land rights from opening balances.

c. There is incomplete reporting on land where neither the total cost of land nor the total physical quantity of land is consistently reported.

d. Some information that is currently reported does not adequately satisfy FASAB's reporting objectives and qualitative characteristics. For example, physical unit grouping (such as number of parks) is not contributing to either the operating performance or stewardship objectives.

e. There are inconsistencies between reporting of SL and G-PP&E land.

A2. SFFAS 6 requires that land and land rights acquired for or in connection with other G-PP&E be capitalized at the cost incurred to bring the assets to a form and condition suitable for use. "Acquired for or in connection with other G-PP&E" is defined as land acquired with the intent to construct G-PP&E. It also includes land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the G-PP&E's common grounds.

A3. By contrast, SFFAS 29 defines "stewardship land" as land (including land rights) other than land acquired for or in connection with other G-PP&E. It does not require balance sheet recognition but, instead, requires expensing the land cost when acquired and disclosures regarding policies for land management, categories of land, and physical unit information.

A4. Most recently, SFFAS 50 allows reporting entities to apply alternative methods in establishing opening balances for G-PP&E. Concerning land, the alternative methods include using deemed cost to establish opening balances of G-PP&E land and land rights or excluding them from opening balances with disclosure of acres of land and expensing of future acquisitions.

A5. The above requirements for both G-PP&E land and SL result in significant differences in accounting treatment for federal land. Specifically, land acquired during the nation's formation may be used in connection with other general PP&E, but it may not (1) have identifiable acquisition costs, (2) be valued at all, or (3) be valued in a way that is similar to G-PP&E land and land rights acquired for similar purposes. G-PP&E only includes land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E. The result is disparate treatment of G-PP&E land. Furthermore, SL, which accounts for an estimated 97 percent of all land managed by the federal government, is expensed when acquired, not capitalized, leading to yet another significant difference in land treatment.

A6. To the extent practical, members requested that future guidance consistently treat all federal land the same regardless of its G-PP&E land or SL distinction. The Board directed staff to identify available options, along with associated benefits and

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drawbacks. In particular, the Board asked staff to (1) consider user information needs; (2) explore and identify the information agencies use to manage land; (3) identify types of information, such as acres of land, that would help demonstrate the government's stewardship and accountability over federal land; (4) address whether land held for disposal (for example, sale, public-private partnerships, donated to state and local governments) should be valued; and (5) consider whether a uniform land accounting policy is a viable option given initial agency and task force feedback that current land categorizations of SL and G-PP&E land be retained.

A7. To assist in evaluating options for enhancing the consistency[7] among existing accounting standards, entity-to-entity comparability, and relevance of information regarding land, the Board established a task force consisting of representation from federal agencies, the commercial sector, and citizen users.[8] The task force held meetings between June 2016 and April 2017. Participants came from diverse disciplines, such as accounting, auditing, civil engineering, financial reporting, business consulting, and program management. The majority of participants agreed that, among federal report preparers and users, there is significant interest in how agencies manage land on behalf of the public and how this information is communicated in financial statements.

A8. Due to the divergent views among task force participants, principally between preparers and users, reaching consensus on the major issues proved challenging. To best meet the project goals and objectives, staff, in addition to engaging in task force discussions, initiated fact-finding meetings with three land-holding agencies: the Department of Defense, the Department of Energy, and the Department of the Interior. Notably, retaining the current land categorizations of SL and G-PP&E land was the one area in which preparers and users unanimously agreed.

Development of the Exposure Draft (ED)

A9. The Board considered its conceptual framework and the divergent task force views in developing its proposal for reporting on land. The Board considered financial and non-financial information (NFI) land reporting options in light of the reporting objectives, qualitative characteristics, cost-benefit considerations, and presentation formats (basic or required supplementary information [RSI]).

It is important to note that a major consideration throughout the Board's deliberations was the guidance in Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.* Specifically, paragraph 9 states:

> An item that meets the appropriate definition of an element is an asset, liability, revenue, or expense, even if it is not recognized in the accrual-basis financial statements because, for example, it is not measurable or its amount is not material. Unrecognized elements are candidates for

[7] Criticism over consistency has arisen because current standards differ in how entities report land and land rights; for example, G-PP&E land is capitalized, whereas SL is not. As such, some believe that inconsistent accounting standards lead to reporting that is not comparable and obscures how a user can assess an entity's performance over land management.

[8] Please refer to Appendix E for the identification of task force participants.

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disclosure in the notes to financial statements or as supplementary information.

Members agreed with those in the financial reporting community who noted the importance of having consistent accounting standards and agreed that there were limitations inherent in historical cost valuations. Alternative methods needed to routinely appraise or corroborate over 622 million acres of land are impractical and cost prohibitive. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency, comparability, consistency, and reliability of land information while either avoiding or at least significantly minimizing burden and costs that would otherwise be borne if monetary measures were used to recognize land on the balance sheet.

To address this, the Board decided to remove such amounts from the balance sheet, expense future acquisitions of land and permanent land rights, treat temporary land rights similarly to leases, and require NFI (number of acres) disclosures. The SFFAS 29 requirement to exclusively use NFI to report federal SL provides a precedent for this approach. A task force analysis noted that approximately 97.0% (or 603.7 million acres) of all land managed by the federal government is SL, which, under SFFAS 29 is reported as NFI. Furthermore, the Board notes that a portion of the remaining ~3.0% (~19.6 million acres) of land currently classified as G-PP&E land is withdrawn land from the public domain. Had this land not been withdrawn, it would be classified as SL and been subject to the SFFAS 29 requirements for non-recognition and disclosure as NFI.

Due to concerns that the stewardship and operating performance reporting objectives and qualitative characteristics, such as relevance and comparability, were not being met, the Board proposed expensing land and permanent land rights and disclosing acres in a note. Additional key conceptual points leading to the Board's proposal include:

a. Historical cost of land and permanent land rights is not useful to the majority of users for assessing stewardship[9] or entity operating performance primarily due to the static nature of the reported dollars (that is, not accounting for inflation or changes in value).[10] In addition, historical cost of land and permanent land rights is not relevant for decision makers.[11]

    i. Having considered the input of the task force, exposure draft (ED) respondents, and subject matter experts, the Board also concluded that, although historical cost information of G-PP&E land may be reliable for certain agencies, such information is not reliable at the government-wide level. This is because some agency historical cost records are incomplete or non-existent.

    ii. Increasing the usefulness and relevance of information can be achieved through the selective use of a measurement attribute (basis) that best reflects the measurable characteristic of an asset or liability.

[9] SFFAC 1, *Objectives of Federal Financial Reporting*, par. 134-145.
[10] SFFAC 1, par. 122-133.
[11] SFFAC 1, par. 161 and SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par.7.

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Measurement attributes that are commonly used to assign monetary amounts to financial statement elements, such as assets and liabilities, like land include: fair value, settlement amount, replacement cost, value in use, and fulfillment cost. However, alternative measurement approaches, such as those that are non-financial in nature, can be used to best reflect an element's characteristics. To that end, during deliberations of SFFAS 29 and SFFAS 50, the Board concluded that number of acres best reflects and communicates land's measurable characteristic, increasing relevance and information usefulness.

b. Prior analysis of user needs, as confirmed by the land task force, revealed that presenting the historical cost of land in the financial statements is of limited value to users. Although users would often obtain information from other publicly available sources, these other sources do not reflect audited or verified information. The need for audited information was identified by the majority of task force participants.[12]

    i. In addressing this limitation, the Board concluded that reclassifying G-PP&E land and permanent land rights as a non-capitalized asset, expensing future acquisitions, and increasing disclosure requirements of non-financial land information is more informative to users and best satisfies the Board's stewardship and operating performance reporting objectives. This decision is consistent with SFFAS 50, which permits reporting entities to not capitalize G-PP&E land and land rights under certain conditions.

    ii. The Board also concluded that if the reporting entity believes that information about the cost of G-PP&E land and permanent land rights is critical to the understanding of the financial statements, such information may be presented in the note disclosure at the reporting entity's discretion without explicit guidance to do so.

c. Fair value reporting is not cost-beneficial given the vast holdings of land. This is primarily due to the impracticalities associated with valuing land, absent conditions such as demographically comparable sales, active markets or willing buyers, and estimations of the environmental liabilities associated with certain federal land.[13]

    i. Citizen users on the task force and some ED respondents noted the benefit of fair value estimates of government federal land. They generally noted that, to assess an entity's stewardship and operating performance, fair value estimates of land parcels would help users assess whether such land should be either sold or transferred to state/local governments. However, the Board concluded that fair valuing land parcels would be prohibitive given the impracticalities and costs. The Board concluded, instead, that number of acres would be more informative to the general public, Congress, and agency management.

[12] SFFAC 1, par. 158-159.
[13] SFFAC 2, *Entity and Display*, par. 73E.g. and SFFAC 5, par. 7

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d. Acres provide a transparent, understandable, and comparable measure across the federal government and allow users to consider how much land was held for particular purposes (operating performance) and how the amount of land held changed over time (stewardship).[14]

    i. The Board realizes that some respondents believe the use of NFI, such as number of acres, to satisfy reporting objectives is relatively unprecedented. However, as previously noted, SFFAS 29 adopted the use of NFI (that is physical unit reporting) to satisfy both reporting objectives and the qualitative characteristics of information in federal reporting. The Board further notes that to address any potential audit challenges related to NFI, the requirements of this Statement are subject to a phased implementation schedule. This will enable the Board to evaluate implementation and identify and address any issues as they arise.

e. As discussed in paragraph A9.a.ii, by moving all land to the measurement of acres, the Board concluded that financial statement reporting will better achieve the qualitative characteristics of consistency and comparability. Additionally, moving away from the current mixed measurement attribute model to a uniform acre model increases the qualitative characteristic of understandability. Finally, advancements in geospatial technology facilitate measuring acres more accurately, which contributes to the qualitative characteristic of reliability. The Board concluded that such advancements, assisted by an RSI transition period, will facilitate development of reliable acre information suitable for presentation as basic information.

f. The NFI relates to a significant asset (an element of financial reporting) that interests a wide audience. Furthermore, it has a high degree of importance and criteria for reliably and consistently measuring acres, making the information appropriate for note disclosure.[15]

    i. As previously noted, G-PP&E land represents approximately ~3.0% (~19.6 million acres) of land—some of which has been withdrawn from the public domain. As such, were it not withdrawn, such land would have to comply with the SFFAS 29 requirements of non-recognition and use of NFI.

g. The selection of an appropriate measurement attribute in specific circumstances should be based on the reporting objectives, qualitative characteristics, and cost-benefit constraints applicable to the financial information in question.[16]

    i. The Board concluded that attempting to apply a monetary measurement attribute to the government's vast holdings of land would fail to meet cost-benefit considerations, as well as such key qualitative characteristics as understandability, relevance, and comparability. The Board concluded that reclassifying previously capitalized G-PP&E land costs as expenses

[14] SFFAC 1, par 156, SFFAC 2, par. 73E.e., and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, par. 9.
[15] SFFAC 2, par. 73E.
[16] SFFAC 5, par. 8.

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accompanied by disclosure of acres would best meet the reporting objectives and qualitative characteristics in a cost beneficial manner.

h. In conclusion, the Board determined that the vast holdings and uses of federal land cannot adequately be conveyed to the public through monetary measurements. Specifically, limitations inherent in valuations, such as passage of time and inflation, changes in economics (for example, base closures, government relocations), demographic or population shifts (for example, shifting veteran populations, rural development activities), and even climate related issues (for example, coastal floods and forest fires), make it impractical and cost prohibitive to annually corroborate or appraise over 622 million acres. Instead, the Board concluded that, consistent with its conceptual framework, reporting acres increases transparency while either avoiding or at least significantly minimizing burden and reporting costs that would otherwise be borne if traditional (that is, monetary based) valuation methods were used for balance sheet recognition.

Summary of Outreach Efforts and Responses

A10. The ED was issued April 30, 2018, with comments requested by July 30, 2018. Upon release of the ED, notices and press releases went to the following: the *Federal Register*, FASAB newsletter, the *Journal of Accountancy, AGA Today*, the *CPA Journal, Government Executive,* and the *CPA Letter*, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, the Financial Statement Audit Network, members of both the Federal Real Property Council and Federal Facilities Council, and committees of professional associations generally commenting on EDs in the past.

A11. This broad announcement was followed by electronic mailings of the ED to the following relevant congressional committees: Senate Energy and Natural Resources and House Natural Resources.

A12. FASAB received a total of 18 responses, which are summarized in the following table by respondent type. The majority of respondents generally agreed with the Board's proposal to reclassify G-PP&E land and permanent land rights as a non-capitalized asset and to issue related disclosure requirements. However, some respondents (1) expressed concerns with what they viewed as a departure from universally accepted accounting principles and (2) identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

Summary of Respondent Types to the ED

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	**13**	**-0-**	**13**

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RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Users, academics, others	**-0-**	**3**	**3**
Auditors	**1**	**1**	**2**
Total	**14**	**4**	**18**

A13. At the August 2018 Board meeting, the Board decided to extend an invitation to (1) the ED respondents to discuss with the Board their comments on the ED and provide clarification of their responses and (2) additional subject matter experts comprising federal land managers, the audit community, and other interested parties to share their expert perspectives regarding land reporting. Eight ED respondents accepted the Board's invitation and clarified their comments at the October 2018 Board meeting. Five subject matter experts shared their views at the October 2018 Board meeting on a variety of matters related to the land ED.

A14. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised.

A15. Respondents who agreed with the Board's proposal to reclassify G-PP&E land and permanent land rights noted:

a. The geographic information system (GIS) can be readily adopted to comply with the reporting requirements for acres and satisfy most auditor concerns.

b. Valuation of land is too costly and questionable in light of environmental liabilities.

c. There will be little financial statement impact to expensing future acquisitions of G-PP&E land and permanent land rights.

d. However, respondents who agreed with reclassifying G-PP&E land and permanent land rights also raised key concerns: (1) the incomparability of physical units creates the potential for inconsistent application within agencies, (2) not all agencies have consistent GIS policies throughout their bureaus, and (3) system changes to policies and information technology databases/applications will require additional time and effort to implement.

A16. Respondents who disagreed with reclassifying G-PP&E land and permanent land rights noted the following concerns:

a. G-PP&E land is an asset that should remain on the balance sheet so as not to distort financial reporting.

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b. The Board's proposal veers from its conceptual framework by over-emphasizing one asset category over all the others.

c. separating a land value from a building value is complicated,

d. The ED leads to duplicative reporting because G-PP&E acres are presented in the Federal Real Property Profile as well as in performance reports.

e. Audit precision and related burdens are problematic because there are no internal controls over acre information systems.

f. The effect of expensing G-PP&E acquisitions in the statement of net cost will be significant.

g. Physical units are not meaningful, and the information already exists in other reports.

h. Many implementation issues will necessitate additional implementation guidance.

i. Some rate-setting entities use and require historical cost information concerning land.

j. Some agency GIS personnel have existing backlogs that take precedent, such as land disputes that will not allow them to satisfactorily support reporting and audit initiatives.

A17. Subject matter experts provided their views on the proposed land ED, which are summarized as follows:

Comments opposing the ED include the following: Data collection should be commensurate with user needs. In this case, the cost of aggregating land information, given the de-centralized manner in which it is stored, may be cost prohibitive. Using the existing Public Land Statistics report for financial reporting purposes, as contemplated by the ED, would require a potentially cost-prohibitive investment of additional resources. The Public Land Statistics are designed for the general public, not financial reporting purposes. SFFAS 50 provides sufficient reporting flexibilities, making the ED unnecessary. Because land benefits future periods, it should remain on the balance sheet; excluding it will understate the financial position. It is unclear how this proposal would improve financial management, which is the intent behind the CFO Act and the Federal Financial Management Improvement Act.

Comments that were neither in support of nor opposed to the ED include the following: Physical unit information, such as acres, needs context to be useful. Interior bureaus are working to improve the Protected Area Database of the United States and the Surface Management Area data. Agencies should be allowed flexibility to explain their unique missions and land responsibilities. Without clearer materiality guidance, acres or other NFI may be more suitable for RSI. Consideration should be given to presentation formats other than disclosures. The use of agreed upon procedures, rather than audits, should be considered for land information. The preparer transition period should not be underestimated; it could take multiple years for auditors to gain comfort. Performance information, which is not contemplated by

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the ED, when combined with cost information would allow an assessment of effectiveness and efficiency and would be valuable to users.

A18. Regarding the concern that expensing land and permanent land rights would distort financial reporting, the Board notes that presentation options exist that could mitigate potential distortions to an entity's operating costs brought about by expensing land and permanent land rights acquisitions. For example, material acquisitions might be presented separately as a major program or as costs not assigned to programs. Nevertheless in its re-deliberations of the land ED, the Board concluded that the respondent comments and subject matter expert views indicated a need to reconsider certain disclosure requirements, the proposed implementation approach, and the related timeline. As a result, the following changes were made to the proposed land ED requirements:

a. Deleting the physical unit disclosure requirements

b. Deleting the requirement to reference DM&R (RSI) presentations

c. Limiting the first two disclosure requirements (that is, how land relates to the entity's mission and an entity's policies over land) to the primary categories of SL and G-PP&E land and not to the sub-categories

d. Simplifying the "estimated acres" reporting requirement by only requiring that beginning and ending balances be provided

e. Clarifying that "acres of land held for disposal or exchange" applies only to land conveyed to non-federal entities

f. Clarifying the type of information to be disclosed at the government-wide level

A19. Concerning the proposed implementation approach and related timeline, the Board agreed that the final Statement should (1) require a specific transition date from RSI to note disclosure, (2) extend the time required for the transition so that the Board would have an opportunity to modify guidance if necessary, and (3) not permit early implementation.

User Needs

A20. Respondents generally agreed that providing "estimated acres of land" would help ensure that user needs are met. One respondent noted that the information should be first designated as RSI and not moved to basic information until there is sufficient confidence in its reliability. Some respondents noted that to focus only on NFI may not be appropriate unless there is some financial information to which NFI relates.

A21. As the Board noted in its ED, users want understandable financial information that is verified or audited so that they can participate in the democratic process and engage in discussions about the nation's finances. Specific to land, users desire transparency (for example, fair value estimates or land measured by parcel size or acre) over how much land an entity manages and its uses. As such, the Board concluded that user needs are best met with information that is relevant, reliable, and understandable while meeting cost-benefit considerations. To that end, the Board maintains its

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position that historical cost information, although reliable in most cases, is not relevant to most users. Given the cost-benefit constraints, number of estimated acres is best suited in meeting user needs.

A22. Moreover, to increase the reliability of the reporting of acres, the Board agrees with those respondents supporting that (1) acreage be treated as basic information (note disclosure) and (2) an RSI transition period be established prior to transitioning to basic note disclosure. Concerning inclusion of financial information with which acres should relate, the Board notes that entities are free to disclose the cost of G-PP&E land and permanent land rights in the notes. Nevertheless, consistent with SL requirements, the Board has modified its proposal to now require entities with G-PP&E land and permanent land rights to reference a note on the balance sheet that discloses information about G-PP&E land and permanent land rights, but no asset dollar amount should be shown.

Retaining Property, Plant, and Equipment (PP&E) Categories

A23. The majority of respondents agreed with the Board's proposal to retain the G-PP&E land and SL categories.[17] SFFAS 6 establishes three categories of PP&E: (1) G-PP&E, (2) heritage assets, and (3) SL. It is important to note that categorizing land in accordance with SFFAS 6 is predicated on an entity's intended use of the land at acquisition and not necessarily how the land is actually used during the reporting period. Due to concerns over inconsistent accounting and reporting of federal land, the Board established three sub-categories based on how entities in fact use the land they manage. The three land-use sub-categories are (1) conservation and preservation land; (2) operational land; and (3) commercial use land. Refer to Appendix B for illustrations concerning the three sub-categories. Therefore, users are provided with both the entity's intended use of the land and permanent land rights (that is, primary categories of SL or G-PP&E land) as well as their actual use (predicated on predominant use by sub-category) during the reporting period.

Land Use – Categorizing and Sub-categorizing Land Consistently

A24. To improve the comparability of reporting federal land and the uniformity of disclosures, the Board proposed three sub-categories predicated on land use for both G-PP&E land and SL: (1) conservation and preservation land; (2) operational land; and (3) commercial use land. Concerning the sub-categories, respondents noted that (1) the entity should determine in which sub-category the acres are placed and should not be required to apportion among the sub-categories and (2) the three sub-category definitions appear after the proposed definition of acres of land held for disposal or exchange, making it appear that there are four unique sub-categories rather than three.

A25. The Board notes that the ED explicitly stated that the sub-categorizations would be predicated on predominant use. Predominant use is not a new requirement and was first introduced in SFFAS 29, which was issued on July 7, 2005. Furthermore,

[17] The Board proposed retaining these two categories primarily because (1) G-PP&E land and stewardship land are acquired for two separate, distinct purposes, (2) these two land types are often maintained and used in completely different ways, (3) keeping the two types of land separate promotes transparency, consistency, and understandability and (4) eliminating the distinction between the two land types could have adverse consequences to legislative requirements and/or budget appropriations.

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concerning G-PP&E land, the General Service Administration's Federal Real Property Council has established predominant use reporting definitions and requirements since 2005.

A26. It is important to note that this Statement continues the practice in SFFAS 29 that provides entities with flexibility in determining predominant use. For example, in cases where land, including permanent land rights, has multiple uses, none of which is predominant, the entity may attempt to sub-categorize such land. In so doing, entities may find it practicable to apportion the estimated acres among the sub-categories. Paragraph A35 provides additional information on determining the level of aggregation and assignment of land and permanent land rights used to determine predominant use To be considered a predominant use, land activities or uses are generally not incidental but are normal and recurring in connection to the entity's mission. Nevertheless, the Board recognizes that future guidance concerning predominant use may be required.

A27. Regarding acres of land held for disposal or exchange, defined at paragraph 20.A., the Board notes that (1) it did not intend to create a fourth sub-category and that narrative presentation or disclosure of said acres is sufficient to meet the Statement's requirements, (2) entities are free to develop graphical or tabular illustrations, and (3) examples found at Appendix B are intended to aid in the application of these key provisions and not illustrate compliance with all of the proposed disclosure requirements.

Developing Uniform Land Disclosure Requirements

A28. Although the majority of respondents agreed with the Board's proposed disclosure requirements, some respondents noted that preparer burden and audit efforts would increase. Examples cited include:

a. Financial reporting systems are not currently designed to capture the newly required information. Acreage information is not expected to be recorded in transaction-based financial accounting and reporting systems. Moreover, this Statement does not require entities to integrate or link property (land) management systems to financial systems solely for the purpose of applying these standards.

b. Agencies have spent considerable resources to ensure compliance and auditability; adding more data elements to the reporting requirements contributes to disclosure overload and exacerbates the existing cost burden.

c. However, some respondents also believed that increases to preparer burden and audit efforts after initial implementation would be temporary. In response to the Board's implementation timeline, more fully discussed below, the Government Accountability Office may issue auditor guidance and the Office of Management and Budget will update its audit bulletin, as necessary.

A29. In connection with the Board's position to reclassify G-PP&E land and permanent land rights as a non-capitalized asset, the Board concluded that developing uniform accounting and reporting requirements across all land categories not only satisfactorily addresses longstanding issues concerning the reporting over land, but

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also increases informational value to users. Many of the disclosure requirements have been taken from existing requirements contained in SFFAS 29 (for example, disclosure of how land relates to an entity's mission and its policies over land). Moreover, the Board considered respondent comments as well as interested party views in developing the final disclosure requirements. As a result, the revised disclosure requirements reflect the following changes:

a. Eliminating physical unit disclosure requirements

b. Eliminating the DM&R reference requirement

c. Limiting the first two disclosure requirements (that is, how land relates to the entity's mission and an entity's policies over land) to the primary categories of SL and G-PP&E land and not to the sub-categories

d. Simplifying the requirement to report estimated number of acres by only requiring the beginning and ending balances be presented

e. Clarifying that "acres of land held for disposal or exchange" applies only to land satisfying legislative disposal authority requirements intended to be conveyed to non-federal entities

f. Clarifying that the Board does not require the reporting of Tribal land held in trust. As an amending Statement, the Board considered inclusion of lands held in trust but elected to continue the long-standing exclusion of such lands due to their fiduciary nature.

g. Clarifying that the Board does not require the reporting of the Outer Continental Shelf (OCS)[18] lands because they do not meet FASAB's definition of land as contained in its handbook, at Appendix E. The definition reads as follows:

> Land is the solid part of the surface of the earth. Excluded from the definition of land are the natural resources (that is, depletable resources such as mineral deposits and petroleum; renewable resources such as timber, and the outer-continental shelf resources) related to land.

Nevertheless, if an entity manages material amounts of OCS acreage, the Board believes that this fact should be disclosed.

h. Clarifying the type of information to be disclosed at the government-wide level

The Board believes that the revised disclosure requirements coupled with a graduated phase-in approach satisfactorily addresses concerns related to preparer burden and audit effort.

[18] The Board notes that it interprets the term OCS to include the seabed, subsoil and energy or mineral resources derived therefrom.

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Definitions

A30. The majority of respondents agreed with the proposed definitions. As previously noted, the task force recommended that the current land categorizations of SL and G-PP&E land be retained. Pursuant to respondent comments, the Board clarified that "acres of land held for disposal or exchange" applies only to land satisfying legislative disposal authority requirements intended to be conveyed to non-federal entities. Concerning land held for disposal or exchange, disposal authorities are generally designed to permit entities to dispose of or exchange land that is no longer required for a federal purpose. Disposal authority might authorize an entity to sell or lease federal land to a state or municipal government or non-profit entity for educational or community development purposes. Additionally, disposal authority might authorize an entity to exchange federal land for non-federal land. Disposal includes conveyances of federal land not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

Land Rights

A31. Prior to issuing its ED, the Board concluded that temporary land rights (that is, other than permanent land rights) would not be subject to the new requirements of this Statement. The rationale for excluding temporary land rights was based on the Board's belief that (1) such land rights are intangible assets and should be addressed in an Intangibles project and (2) the cost of separating such land rights from the underlying asset would be prohibitive. Therefore, in SFFAS 6 the Board provided for the recognition of land rights based on the expected service life of the land rights. Specifically, where land rights are for a limited or finite period of time (that is, temporary), the Board provided for amortization/ depreciation of the cost to acquire and maintain such rights. The land rights considered permanent are capitalized along with land. SFFAS 50 provided alternative methods for establishing opening balances. Specifically, paragraph 13 (which amended par. 40 of SFFAS 6) provides reporting entities that met the SFFAS 50 criteria to apply the option to either (1) exclude both land and (all) land rights from the opening balance of G-PP&E or (2) recognize land and land rights in opening balances based on the provisions of the alternative valuation method (deemed cost).

A32. In its ED, the Board proposed to treat land rights with an unlimited or infinite period of time (that is, permanent) consistent with the proposed requirements regarding land acquisitions (that is, expensing) and to continue treating those temporary land rights consistent with SFFAS 6. During re-deliberations and considering respondent comments specific to land rights, the Board reconsidered its proposed amendment allowing entities electing to exclude land and land rights (from the opening balance of G- PP&E pursuant to SFFAS 50) to expense future acquisitions of temporary land rights. As a result, the Board concluded that those entities electing to exclude land and land rights from their opening balances should capitalize and depreciate/amortize temporary land rights prospectively. The Board concluded that this aforementioned requirement increases comparability and consistency by providing a uniform accounting practice relative to all land rights. Furthermore, the Board notes that, unlike permanent land rights, temporary land rights are limited in duration and have a definite useful service life or economic life. As such, the Board believes that accrual based financial statements benefit from the allocation of costs between accounting periods.

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Requests for Exceptions to De-recognition

A33. Several respondents noted particular circumstances or cases (for example, rate-setting entities) that would require them to continue capitalizing G-PP&E land and permanent land rights. Others also noted the inability to separate the cost of land from an infrastructure or investment holding's overall cost. As a result, some of these respondents asked for an exception to the de-recognition requirement. The Board reviewed each of the cited instances. It notes that exceptions are not warranted because entities are free to include disclosures of the cost of G-PP&E land and permanent land rights at their discretion without explicit guidance to do so. Additionally, it would be confusing to have some entities reporting G-PP&E land and permanent land rights on the face of the financial statements while other entities exclude land and permanent land rights.

Additionally, if the reporting entity believes the cost of G-PP&E land and permanent land rights are critical to the users of financial statements, such information can be presented in the note disclosure. Concerning inseparable land costs, the Board believes that reasonable estimates can be made to identify infrastructure costs apart from land costs to ensure appropriate accounting and reporting. For example, estimates can be derived from (1) public land records such as property tax assessments or ownership documents, (2) comparable market analyses or appraisals, and (3) comparable or similarly recorded real property holdings or investments.

Balance Sheet References

A34. In providing the note disclosure information required for G-PP&E land and permanent land rights (at SFFAS 6, par. 45A) and SL (at SFFAS 29, par. 40), entities may combine the display and/or disclosure for G-PP&E land and permanent land rights and SL. However, the category distinctions should remain evident to the reader. That is, although the Board has established uniform disclosure requirements to increase informational value, the existing distinction between G-PP&E land and SL has been retained.

Disclosure requirements for the CFR (contained at SFFAS 32, par. 23 and SFFAS 29, par. 42) may also combine the display and/or disclosure for G-PP&E land and permanent land rights and SL and permanent land rights. In such cases and to the extent possible, direct references to agency reports for additional category information about G-PP&E land and permanent land rights and SL and permanent land rights should be made.

Supporting Documentation

A35. The Board has continually noted the concerns associated with providing corroborating documentation on historical assets including land. In the basis for conclusions to SFFAS 29 (par. 86-88), the Board briefly discussed the fundamental issues associated with historical assets and SL. In addition, Technical Release (TR) 9, *Implementation Guide for Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land*, addresses this difficulty by specifically noting the complexities regarding land. For example, federal land was acquired through (1) ceded territory by the original thirteen colonies, (2) territorial annexations, (3)

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purchases, and (4) treaties. Acquisitions and disposals of land were not documented like modern land transactions. TR 9 makes the point that records and detailed listings from these periods generally do not exist. As a result, the Board concluded that management's assertion concerning land ownership and its related estimates of acres of land and permanent land rights must be based on non-traditional supporting documentation and reasonable acre estimates, respectively. Consistent with the Board's views on SFFAS 29 and TR 9, for this standard, an entity may estimate acreage based on different underlying sources of data to include traditional and/or geospatial mapping, historical records, surveys, plats, etc., or any combination thereof. Additionally, given the diverse nature of how land has been acquired into the public domain, information from different vintages or time-periods would be expected to affect acreage estimation methods and/or techniques. Additionally, an entity is not expected to adjust its acreage estimates for insignificant amounts of: in-holdings[19], intra-agency shared lands, or acquisitions or disposal of land. Entity estimates can be based on different underlying sources of data applying different measurement and/or mapping methods and can be deemed reasonable within industry accepted tolerance levels applied at an aggregation level (e.g., by national park or reserve, regional/district office, topography/land cover, etc.) as defined by management. That is, the level of aggregation and assignment of land and permanent land rights used to determine predominant use may be determined by the preparer considering the entity's mission, types of land use and how it manages the assets (e.g., by national park or reserve, bureau, regional/district office, topography/land cover, etc.). For example, the reporting entity may determine that predominant use is determined by national park or forest. Further, the entity may determine that the predominant use of a national park or forest is conservation and preservation even though some uses of the national park or forest are for operational or commercial use, but are not predominant uses. Appendix B provides illustrative examples of what sub-categories or activities could be included within each land use sub-category.

Some respondents raised the issue that land and permanent land rights may have multiple uses and it may be difficult to sub-categorize its predominant use into one of the three predominant use sub-categories. The Board considered whether there should be an additional use sub-category if preparers encountered challenges in sub-categorizing land and permanent land rights into one of the three sub-categories. The Board believes that providing the preparer and entity management with a predominant use definition and flexibility in determining the level of aggregation of land used to determine predominant use, would improve the ability of reporting entities to determine predominant use. Further, Appendix B provides an illustration of what sub-categories or activities could be included within each land use sub-category. Nevertheless, the Board also recognizes that these are new sub-categories and that unforeseen implementation issues may be encountered. Consequently, during the implementation phase (FY's 2022-2025) of this standard, the Board encourages reporting entities to communicate any challenges as well as suggestions in sub-categorizing land use reporting to the Land Implementation Task Force.

[19] In-holdings - An in-holding is privately owned land inside the boundary of a national park, national forest, state park, or similar publicly owned, protected area. Generally, in-holdings result from private ownership of lands prior to the designation of the protected park or forest area, which then end up grandfathered within the legally designated boundary.

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A36. The Board notes that it (1) does not seek exact precision in determining estimated acres or predominant use assessments and (2) does not intend to direct or prescribe the use of any particular approach.

A37. The Board concluded that it can facilitate effective reporting on land by (1) providing implementation guidance incorporating aspects of TR 9 and (2) reminding readers that, because most federal land was acquired in a variety of ways and over the nation's early settlement and formation, it is not unreasonable that supporting documentation will be developed using alternative methods and/or take on different forms of corroboration as foreseen by TR 9. For example, ownership can be evidenced by public law, treaties, entity certifications, maintenance or renovation contracts, historical maintenance records, a history of payment of invoices, minutes of meetings, historical databases, initial surveys of land, a history of past/historical practices (for example, the length of time an entity controls the land establishing de facto ownership), or other relevant sources of information. These alternatives may provide acceptable evidence of government ownership. Entities could use the above forms of supporting documentation to reasonably estimate acres or rely on management tools such as geospatial information. The Board expects preparers to apply a variety of documented methods and techniques in arriving at estimates.

Application of this Statement

A38. Reporting entities are subject to the reporting requirements under paragraph 13 of SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*. Specifically, paragraph 12 of SFFAS 21 states, "For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." Therefore, reporting entities with G-PP&E land deemed to be material should follow the guidance in SFFAS 21, paragraph 13.a-13.c. for all changes in accounting principles:

> a. The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
>
> b. Prior period financial statements presented for comparative purposes should be presented as previously reported.
>
> c. The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure.

SFFAS 21 provides that the adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and briefly describe the effect on beginning net position.

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Implementation and Effective Date

A39. The Board proposed in the Exposure Draft issued on April 30, 2018, that the disclosure requirements would begin in fiscal year 2021 as RSI and transition to note disclosures with removal of G-PP&E land and permanent land rights from the balance sheet in fiscal year 2024.

The Board considered respondent comments to the exposure draft and interested party views, noting the time needed for reporting entities to:

(1) develop and implement related policies and procedures,

(2) establish estimates of acres and acres by predominant use sub-category as of the beginning of the first year of implementation,

(3) develop and maintain supporting documentation,

(4) develop and implement systems and processes for capturing and recording acreage information (balances and transactions during the year by predominant use sub-category), design and implement appropriate internal controls, and update such systems, processes, and controls as necessary for any updated guidance, and

(5) validate that the required information is independently verifiable or auditable.

Additionally, the Board considered the time needed for:

- The Board to consider implementation issues (e.g. preparation and audit challenges, updated preparation and audit cost information), and through Board deliberations, determine how to best respond to those issues, and
- Developing and issuing preparer and audit guidance relative to non-financial information.

The Board considered concerns from several respondents and members with respect to the uncertainty of costs associated with preparing and auditing the non-financial information, and the need to obtain better information on implementation challenges and costs.

The Board also considered the potential impacts of the COVID-19 pandemic on agencies' ability to implement this Statement.

In light of the considerations noted above, the Board recognized that additional implementation time was needed to present information in RSI and before transitioning the RSI requirements to the notes. Therefore, the Board extended the presentation in RSI to fiscal year 2022 and the transition of RSI requirements to the notes and the removal of G-PP&E land and permanent land rights from the balance sheet from fiscal year 2024, as proposed in the ED, to fiscal year 2026. The Board believes that the extension should allow adequate time to identify and address implementation challenges, including any cost-benefit considerations, while it is reported as RSI.

Given the potential implementation challenges related to this Statement, the Board agreed to include a separate project on its technical agenda to monitor implementation challenges, and to assess the need, as appropriate, for actions to address those challenges prior to transition of the RSI requirements to the notes. Consistent with Board principles and practice, such actions may include, among other things, staff guidance, AAPC guidance, interpretations, or additional standards, as determined appropriate based on Board deliberations. The Board intends to

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establish working groups, comprising stakeholders, including major landholding agencies and users to conduct these assessment and research activities.

In addition, the Board discussed the following proposed timetable, including actions to be taken by preparers and auditors and potential actions to be taken by the Board as well as other entities, as appropriate:

- Fiscal Years 2022 and 2023: Presentation of total acreage and acreage by predominant use sub-categories as RSI, as well as identification of implementation issues and, as appropriate, Board actions to address them.
- Fiscal Years 2022 and 2023: GAO plans to develop and issue audit guidance, in cooperation with the Council of the Inspectors General on Integrity and Efficiency (CIGIE), for auditing total acreage and acreage by predominant use sub-categories.
- Fiscal Years 2023 and 2024: Presentation of total acreage and acreage by predominant use sub-categories as RSI, application of audit procedures to RSI and identification of preparation and audit challenges, and as appropriate, Board actions to address them.
- Fiscal Year 2025: The Board plans to complete its assessment of remaining implementation issues associated with preparation and audit of the RSI (both total acreage and predominant use sub-categories), and, as appropriate, take actions to address them, before the RSI requirements transition to the notes.

Board Approval

A40. This Statement was approved with a vote of 7 members in favor of its issuance. Ms. Kearney and Mr. Bell dissented to the issuance of this statement. Their dissents are presented below. Written ballots are available for public inspection at FASAB's offices.

A41. Ms. Kearney dissents to the issuance of this Statement. She agrees with the goal of the Statement, which is to promote transparency into and accountability for the use of Government land. However, Ms. Kearney shares concerns expressed by major landholding agencies in response to the exposure draft and in subsequent discussions with the Board. Ms. Kearney's concerns are that this Statement does not include an option to classify land acreage as having multiple uses and that this Statement would require reporting and auditing that has not been demonstrated to be cost-beneficial.

Over two thirds of all of the Government's land[20] is required by law[21] to be managed under principles of multiple use. Requiring agencies to specify a single predominant use for multi-use land would put large land management agencies in the untenable

[20] See, *Federal Land Ownership: Overview and Data*, the Congressional Research Service, February 21, 2020, which provides information about land acreage managed by the Department of Interior's Bureau of Land Management and the Department of Agriculture's Forest Service, https://crsreports.congress.gov/product/pdf/R/R42346.

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[21] See, for example, the Federal Land Management and Policy Act of 1976 and the Multiple Use and Sustained Yield Act of 1960.

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position of having to identify and report a predominant use for land that is inconsistent with the use of the land as specified in statute.

At any particular time, land acreage may have multiple uses. It may be used simultaneously for ranching or logging (commercial), a wildlife habitat (preservation/conservation), and a staff office (operational). In addition, one or more of these uses can change over time, especially following catastrophic events, such as wildfires or hurricanes. Requiring agencies to assign a single predominant use to multi-use land would seem to frustrate rather than further the goals of transparency and accountability.

Ms. Kearney appreciates that the Board intends to monitor implementation of this Statement, including the ability to classify land according to a single predominant use. Ms. Kearney also appreciates that the Board intends to assess the need for further guidance to address any implementation challenges that may arise prior to transitioning the reporting from RSI to basic information. However, Ms. Kearney shares concerns expressed by major landholding agencies that the intended transition from RSI to basic reporting together with the challenges associated with assigning a single predominant use would create a burden on agencies that does not fully justify the cost of collecting, reporting, and auditing the information. Ms. Kearney shares these concerns particularly in light of: (1) the availability to the public of reliable Government land information (e.g., the Bureau of Land Management's Official Federal Land Records website and the U.S. Geological Survey's Protected Areas Database) and (2) the broad range of financial information that is currently reported as RSI under existing FASAB standards, including information about natural resources and deferred maintenance and repairs.

A42. Mr. Bell dissents to the issuance of this Statement. Mr. Bell commends FASAB for its thorough examination of the issue, which encompassed several years. In particular, Mr. Bell acknowledges and appreciates that the Board intends to include a separate project on its technical agenda to monitor implementation challenges, and to assess the need, as appropriate, for actions to address those challenges prior to transition of the RSI requirements to basic reporting as note disclosure.

Mr. Bell supports enhanced transparency in financial reporting, whether such transparency takes the form of financial or non-financial information. However, Mr. Bell shares concerns expressed by some agencies in response to the exposure draft and in subsequent discussions with the Board that the disclosures required by this Statement could potentially create a burden that does not fully justify the cost required to collect, analyze, report, and audit the information needed to comply with this Statement. Of particular concern among these agencies is that this Statement does not include an option to classify land acreage for which a single predominant use cannot practically be: (1) determined or (2) distinguished from other, simultaneous predominant uses across multiple categories ("multi-use"). Certain agencies indicated that substantial acres of federally-owned land are or can be subject to multiple, concurrent uses for different purposes, on both perpetual and periodic bases. As such, in these cases, complying with this Statement's requirement to assign a single "predominant use" could be cost-prohibitive, precipitate undue preparation burden, and result in reporting that is not reasonably reflective of the land's actual use.

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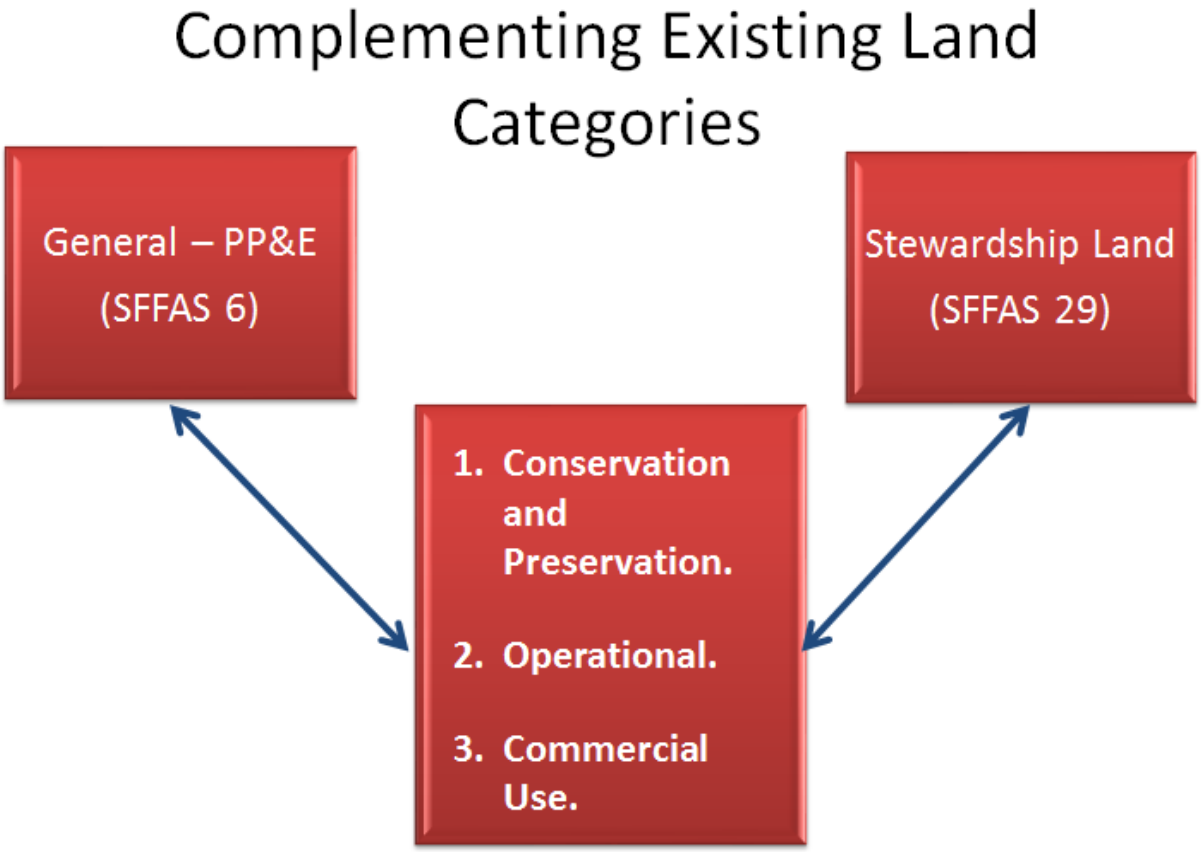
APPENDIX B: ILLUSTRATIONS

Sub-Categorizing Land – Predicated on Predominant Land-use

This appendix illustrates the application of certain key provisions of this Statement to assist in clarifying their meaning. The following partial sample illustrations at Appendices B-1 through B-2 are intended to aid in the application of these key provisions and not illustrate compliance with all of the disclosure requirements.

The Board has noted the potential need to have additional sub-categories predicated on predominant land-use to complement the land categories currently in use: SL and G-PP&E land. Illustrations demonstrating how the Board envisions the sub-categories complementing the existing requirements follow:



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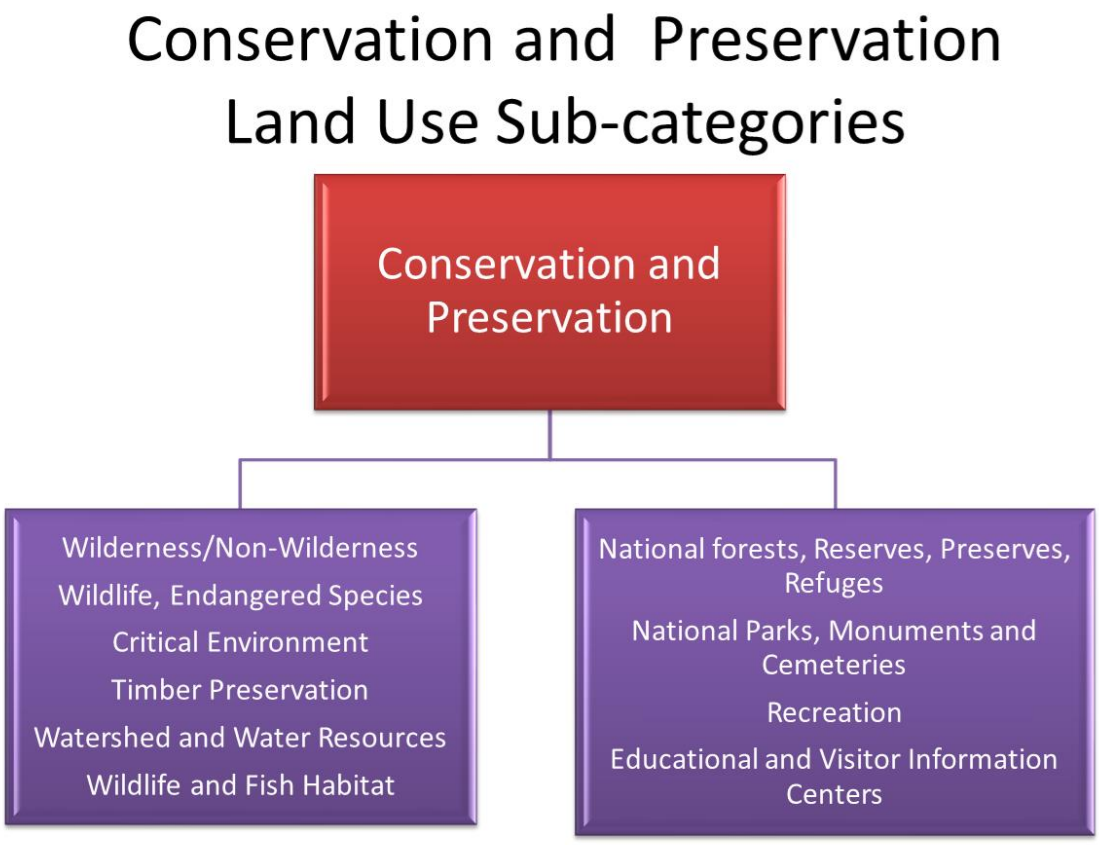
Conservation and Preservation Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the conservation and preservation land use sub-category.



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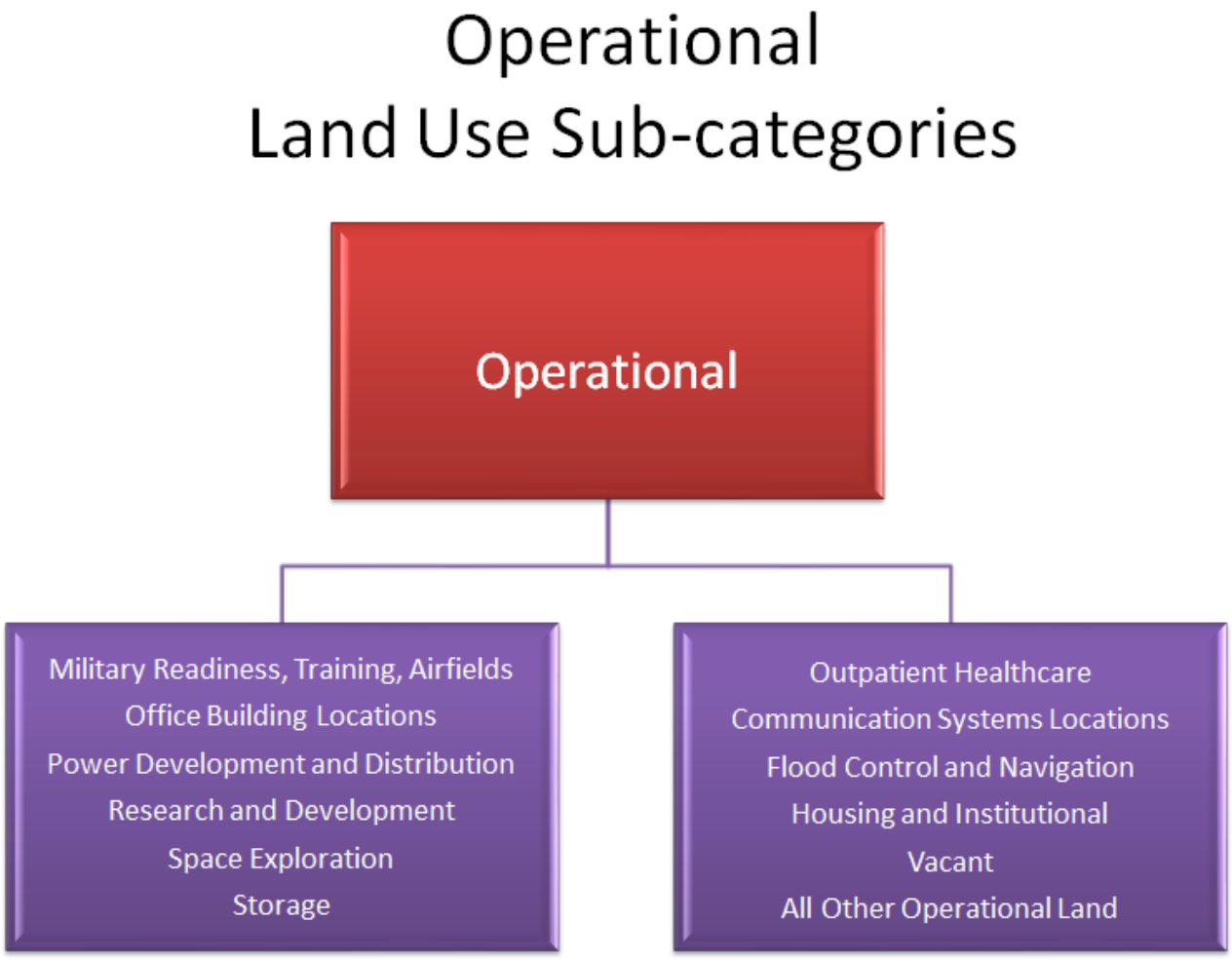
Operational Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the operational land use sub-category.



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Commercial Use Land Use Sub-categories

The following illustration shows what sub-categories or activities could be included within the commercial use land use sub-category.

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Partial Sample Illustration: Appendix B-1: Component Entity G-PP&E Note Disclosure (Amendment to SFFAS 6, paragraph 45)

	Categorized by Purpose or Intent at Acquisition	Sub-categorized by Predominant Use				
Entity	General PP&E Land Acres	Conservation and Preservation	Operational	Commercial Use	Total Land Acres	Explanatory Comments
Agency X	6,563,954	2,600,000	3,963,954	0	6,563,954	1
Bureau A	2,219,324	0	2,219,324	0	2,219,324	2
Bureau B	863,343	0	863,343	0	863,343	2
G-PP&E Total - Department B	9,646,621	2,600,000	7,046,621	0	9,646,621	

Explanatory Comments

1 - **Agency X** has reclaimed 2,600,000 acres of its operational land for conservation/preservation purposes. Although some of the agency's operational land generates commercial revenue, it is incidental to the land's predominant use and its reporting does not change. All land is managed by 12 regional offices and the agency's land is considered to be active (in current use).

2 - **Bureaus A and B** maintain land strictly for operational purposes. Bureau A's land portfolio is managed by 2 district offices (DO's) and all land is considered to be active (in current use). Bureau B's land portfolio is managed by a single district office. Pursuant to statutory requirements, 7,200 acres of Bureau B's managed land located in the district's northwest corridor are held for disposal or exchange. All remaining land managed by Bureau B is considered to be inactive (not in current use) awaiting Congressional reviews.

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Partial Sample Illustration: Appendix B-2: Component Entity SL Note Disclosure (Amendment to SFFAS 29, paragraph 40)

Entity	Categorized by Purpose or Intent at Acquisition: Stewardship Land Acres	Sub-categorized by Predominant Use: Conservation and Preservation	Operational	Commercial Use	Total Land Acres	Explanatory Comments
Agency X	96,251,797	89,507,814	0	6,743,983	96,251,797	1
Bureau A	46,932,741	44,512,434	0	2,420,307	46,932,741	2
Bureau B	40,101,267	40,101,267	0	0	40,101,267	3
SL Total - Department B	183,285,805	174,121,515	0	9,164,290	183,285,805	

Explanatory Comments

1 - **Agency X** has reclaimed 2,600,000 acres of its operational land for conservation/preservation purposes (see Appendix B-1). Note that the reclaimed land retains its G-PP&E distinction and accordingly, is NOT added to the SL category illustrated above in this Appendix; that is, the land's predominant use is reflected within the G-PP&E category.

The agency been granted authority to generate revenue on additional SL currently sub-categorized as Conservation and Preservation land and as a result, has placed such land in a revenue-generating operating mode. However, because the land only generates an immaterial amount of revenue sporadically during the year, its predominant use is not re-categorized to Commercial Use. All land is managed by 12 regional offices and the agency's land is considered to be active (in current use).

2 - **Bureau A** has been granted authority to generate revenue on all of its SL and required to increase commercial uses where practical.
During the year additional SL has been placed in a revenue generating status and appropriately added to the existing Commercial Use sub-category balance.
All land is managed by 2 regional offices that oversee 100 different watershed projects (e.g., drainage basins and catchments).
Pursuant to statutory requirements, 10,200 acres of Conservation and Prerservation land located at 3 different sites are held for disposal or exchange.

3 - **Bureau B** maintains land strictly for conservation/preservation purposes. Any operational use of the land is incidental and is not considered to be a predominant use.
All land is managed by 2 regional offices that oversee 20 different energy projects (e.g., nuclear, solar, and water).

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Partial Sample Illustration: Appendix B-3: Consolidated Financial Report of the U.S. Government (Amendments to SFFAS 29, paragraph 42 and SFFAS 32, paragraph 23)[22]

	Categorized by Purpose or Intent at Acquisition			Sub-categorized by Predominant Use				
Entity	Stewardship Land Acres	General PP&E Land Acres	Total Land Acres	Conservation and Preservation	Operational	Commercial Use	Total Land Acres	Explanatory Comments
Department A	234,889,617	12,362,611	247,252,228	223,145,136	12,362,611	11,744,481	247,252,228	1
Department B	183,285,805	9,646,621	192,932,426	176,721,515	7,046,621	9,164,290	192,932,426	2
Agency 1	84,626,746	4,454,039	89,080,785	84,626,746	4,454,039	0	89,080,785	3
Agency 2	75,666,349	3,982,439	79,648,788	37,833,174	3,982,440	37,833,174	79,648,788	4
Bureau 1	5,871,628	8,528,076	14,399,704	5,871,628	6,396,057	2,132,019	14,399,704	5
Total	584,340,145	38,973,786	623,313,931	528,198,199	34,241,768	60,873,964	623,313,931	

Explanatory Comments

1 - **Department A** has been granted authority to generate revenue on most of its SL. However, only 11.7 million acres is actively devoted to commercial use. SL which generates intermittent or insignificant revenues has been excluded because such land maintains its predominant use as conservation or preservation land. For related details please refer to Department A's annual financial report.

2 - **Department B** has also been granted authority to generate revenue on some of its SL but it has also reclaimed 2,600,000 acres of its operational land for conservation or preservation purposes. In addition, 17,400 acres (Bureau A 10,200 conservation and preservation acres and Bureau B 7,200 operational acres) of land are held for disposal or exchange pursuant to statutory requirements. For related details please refer to Department B's annual financial report.

3 - **Agency 1** has not been granted any commercial use authority and operates under a strict mandate to preserve land under its care. For related details please refer to Agency 1's annual financial report.

4 - **Agency 2** has been granted authority to generate revenue on all of its SL. However, only half or 37.8 million acres is actively devoted to commercial use at any point in time during the reporting period. Although the remaining half is eligible for commercial use it remains in a conservation status because revenues generated are intermittent or insignificant and do not meet the predominant use requirement. For related details please refer to Agency 2's annual financial report.

5 - **Bureau 1** maintains buffer zones for national security purposes on land withdrawn from the public domain and also via acquisition from surrounding communities. It has been granted authority to lease, sell or otherwise dispose of operational land. One-quarter or 2.1 million acres of G-PP&E land is predominantly used for commercial purposes. For related details please refer to Bureau 1's annual financial report.

[22] For ease of illustration purposes only, G-PP&E land and SL presentations are combined in the above format. Disaggregated displays are permissible.

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APPENDIX C: ABBREVIATIONS

CFR	Consolidated Financial Report of the U.S. Government
DM&R	Deferred Maintenance and Repairs
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
G-PP&E	General Property, Plant, and Equipment
GIS	Geographic Information System
M&R	Maintenance and Repairs
NFI	Non-financial Information
OCS	Outer Continental Shelf
PP&E	Property, Plant, and Equipment
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SL	Stewardship Land
TR	Technical Release

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APPENDIX D: GLOSSARY

Acres of land held for disposal or exchange include land for which the entity has satisfied the statutory disposal authority requirements specific to the land in question.[25] Disposal includes conveyances of federal land to non-federal entities not limited to sale, transfer, exchange, lease, public-private partnership, and donation or any combination thereof.

> FN 24.1 – Entity decisions to identify and classify land as held for disposal or exchange often require public participation and diverse clearances, such as environmental and economic impact studies, surveys, and appraisals.

Commercial use land includes land or permanent land rights that are predominantly used to generate inflows of resources (such inflows may be derived from the land itself or activities performed on the land and regardless of whether the use or activity is intended to produce a profit) from non-federal third parties, usually through special use permits, right-of-way grants, and leases. Such inflows may arise from exchange or non-exchange activities and may or may not be considered dedicated collections. Examples include revenue or inflows derived from

- concession arrangements;
- grants for a specific project such as electric transmission lines, communication sites, roads, trails, fiber optic lines, canals, air rights, flumes, pipelines, reservoirs and dams;
- land sales or land exchanges;
- leases;
- permits for public use such as commercial filming and photography, advertising displays, agriculture, recreation residences and camping, recreation facilities, temporary use permits for construction equipment storage and assembly yards, well pumps, and other such uses;
- forest product sales such as timber, or sales arising from national forests and grasslands; and/or
- public-private partnerships.

Conservation and preservation land includes land or permanent land rights that are predominantly used for conservation or preservation purposes. Conservation and preservation, although closely linked, are distinct terms. Each term involves a certain type or degree of protection. Specifically, conservation is generally associated with the protection and proper use of natural resources, whereas preservation is associated with the protection of buildings, objects, and landscapes from use. Examples of land conserved or preserved for significant natural, historic, scenic, cultural, and recreational resources include the following:

- National parks
- Geological resource sites
- Wildlife and plant life refuges
- Archeological resource sites
- Local Native American or ethnic cultural sites

G-PP&E land – Land and permanent land rights[28.1] acquired for or in connection with other general PP&E[29] ~~shall be included in~~ are considered general PP&E but are not to be capitalized

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on the balance sheet. General PP&E land shall exclude (1) withdrawn public lands[29.1] or (2) land restricted for conservation, preservation, historical, or other like restrictions. Such land shall remain categorized as stewardship land. ~~unless the reporting entity made the election to implement the provisions of paragraph 40.f.i.. In some instances, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.~~

FN 28.1 – Land rights, such as easements or rights-of-way, that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

FN 29 – "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

FN 29.1 – To the extent consistent with statutory authorities, an entity may withdraw public lands from the public domain for specific uses. For example, an entity may withdraw public land from sale, settlement, or recreational use to expand buffer zones for security or training needs.

Operational land includes land or land rights predominantly used for general or administrative purposes. For example, the following functions performed by entities would be included in this sub-category:

- **Military** functions include preparing for the effective pursuit of war and military operations short of war; conducting combat, peacekeeping, and humanitarian military operations; and supporting civilian authorities during civil emergencies.
- **Scientific** functions include conducting and managing research, experimentation, exploration, and operations (including the development of commercial capabilities). Broad scientific fields of study generally include (1) physical sciences (physics, astronomy, chemistry, geology, metallurgy), (2) biological sciences (zoology, botany, genetics, paleontology, molecular biology, physiology), and (3) social sciences (psychology, sociology, anthropology, economics).
- **Nuclear** functions include managing or regulating the use of nuclear energy, power plants, radioactive materials, radioactive material shipments, nuclear storage, and nuclear reactor decommissioning.
- **Other related** functions include those that are administrative or other mission related in nature. For example, land used for readiness and training, office building locations, storage, or vacant properties fall under this category.

Predominant Use of land is the major or primary current use of an asset during the reporting period and does not include incidental or infrequent uses of the asset. Moreover, predominant use can change between reporting periods. An asset's predominant use should be consistent with the entity's authorizing legislation but may not always be consistent with the original intent or reason why the asset was initially acquired.

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Stewardship land ~~is~~ includes both public domain[14.1] and acquired land and land rights[15] owned by the Federal Government intended to be held indefinitely. ~~but not acquired for or in connection with[16] items of general PP&E~~. Examples of stewardship land include land reserved, managed, planned, used, or acquired for[16] ~~as forests and parks, and land used for wildlife and grazing.~~

a. forests and parks;

b. recreation and conservation;

c. wildlife habitat and grazing;

d. historic landmarks and/or the preservation of pre-historic and historic structures (those listed on or eligible for listing on the National Register of Historic Places);

e. multiple purpose ancillary revenue generating activity (for example, special use permits, mineral development activities, and timber production); and/or

f. buffer zones for security, flood management, and noise and view sheds.

FN 14.1 – Public domain land is land that was originally ceded to the United States by treaty, purchase, or conquest in contrast to acquired lands, which have been purchased by, given to, exchanged with, or transferred through condemnation proceedings to the federal government.

FN 15 – Land rights are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land. Land rights such as easements or rights-of-way that are for an unspecified period of time or unlimited duration are considered permanent land rights. Temporary land rights are those land rights that are for a specified period of time or limited duration.

FN 16 – ~~"Acquired for or in connection with" is defined as including land used acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.~~ Land used or acquired for or in connection with items of general PP&E but meeting the definition of stewardship land should be classified as stewardship land.

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APPENDIX E: TASK FORCE MEMBERS

Task Force Member Agencies

Air National Guard, 113th Wing, Base Civil Engineer

Department of Agriculture, U.S. Forest Service, Office of the CFO

Department of Agriculture, U.S. Forest Service, Minerals and Geology

Department of Defense, Office of the Secretary of Defense

Department of Defense, Comptroller

Department of Energy, Office of the CFO

Department of the Interior, Fish and Wildlife Service

Department of the Interior, Office of the Deputy CFO

Department of the Interior, National Park Services

Department of Labor, Office of the Inspector General

Department of the Navy, Naval Facilities Engineering Command

Department of State, Overseas Buildings Operations, Financial Management

Department of the Treasury, Office of the Fiscal Assistant Secretary

General Services Administration, Office of Financial Management

Government Accountability Office, Financial Management and Assurance

National Aeronautics and Space Administration, Office of the CFO

Task Force Members

Checco Communications

Cotton and Company

Deloitte

Dennis M. Giaimo, MBA

EY

Helwig, LLC

Kearney

Management Analysis Incorporated

National Council for Public Private Partnerships

Navigant Capital Advisors

Patawomeck Indian Tribe of Virginia

University of Tennessee, Department of Ecology & Evolutionary Biology

Viaggio Corporation

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FASAB Members

George Scott, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Sallyanne Harper

Regina Kearney

Patrick McNamee

Terry Patton

Graylin E. Smith

FASAB Staff

Monica R. Valentine, Executive Director

Project Staff

Domenic Nicholas Savini

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

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Federal Accounting Standards Advisory Board

OMNIBUS AMENDMENTS 2021

LEASES-RELATED TOPICS

Statement of Federal Financial Accounting Standards 60

November 4, 2021

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement of Federal Financial Accounting Standards (SFFAS) amends paragraphs in SFFAS 54, *Leases*; SFFAS 57, *Omnibus Amendments 2019*; SFFAS 5, *Accounting for Liabilities of the Federal Government*; *and* SFFAS 6, *Accounting for Property, Plant, and Equipment*.

In August 2019, the Accounting and Auditing Policy Committee (AAPC)—which operates under the general oversight of the Federal Accounting Standards Advisory Board (FASAB or "the Board")—undertook a project to develop proposed implementation guidance for SFFAS 54 as a Technical Release. During the course of the project, implementation issues were identified that are best addressed through omnibus amendments to leases guidance, mostly clarifying in nature, rather than through a Technical Release. The issues noted required modifications to the existing Statements to provide clarity and address areas of concern.

This Statement addresses those issues by clarifying and improving consistency throughout SFFAS 54, SFFAS 57, SFFAS 5, and SFFAS 6 with omnibus amendments. It also amends and rescinds certain requirements in SFFAS 54 that were determined to be less likely to yield meaningful information.

MATERIALITY

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial.[i] A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[i] Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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TABLE OF CONTENTS

Summary **1**

Standards **3**

Scope 3

Amendments to SFFAS 54 3

Amendments to SFFAS 57, SFFAS 5, and SFFAS 6 9

Effective Date 10

Appendix A: Basis for Conclusions **11**

Appendix B: Abbreviations **16**

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement amends SFFAS 54, *Leases*; SFFAS 57, *Omnibus Amendments 2019;* SFFAS 5, *Accounting for Liabilities of the Federal Government*; and SFFAS 6, *Accounting for Property, Plant, and Equipment;* by providing necessary technical corrections and clarifications, along with other omnibus changes.

AMENDMENTS TO SFFAS 54

3. Paragraph 5.a of SFFAS 54 is amended as follows:

   5. This Statement does not apply to

      5.a accounting for leases of assets prior to the commencement of the lease term, such as during ~~under~~ construction periods or [2A]

   FN 2A - For leases other than short-term leases and intragovernmental leases, the lessee would account for payments prior to commencement of the lease term as advances paid in contemplation of the future receipt of the lease asset. The lessor would account for receipts prior to commencement of the lease term as advances received. These advances would be accounted for in a manner consistent with SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-61, prior to the lease commencement date. Such advances would be considered assets of the lessee and liabilities of the lessor. At lease commencement, the lessee would then reclassify the asset and include it in the measurement of the lease asset in accordance with SFFAS 54 par. 49, and the lessor would reclassify the advances received as unearned revenue in accordance with par. 64.b.

4. Paragraph 7 of SFFAS 54 is amended as follows:

   7. **Short-Term Lease** – A short-term lease is a non-intragovernmental lease with a lease term (as defined in par. 14-21) of 24 months or less.

5. Paragraph 10 of SFFAS 54 is amended as follows:

   10. **Lease Concessions** – Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. For example, ~~L~~ lease concessions may include rent holidays/free rent periods~~,~~ or reduced rents~~, or commission credits~~.

6. Paragraph 20 of SFFAS 54 is amended as follows:

   20. At the commencement of a lease term, lessors and lessees should assess all factors relevant to the likelihood that the lessee or lessor will exercise options identified

in paragraphs 15-19, whether these factors are contract or agreement based, underlying asset based, market based, or federal specific. The assessment often will require the consideration of a combination of these interrelated factors. Examples of factors to consider include, but are not limited to, the following: …

7. Paragraph 21.d of SFFAS 54 is added as follows:

   21. Lessors and lessees should reassess the lease term only if one or more of the following events occur:

      21.d A lease modification that amends the noncancelable period and results in remeasurement in accordance with paragraphs 85-86.

8. Paragraph 22 of SFFAS 54 is amended as follows:

   22. A short-term lease is a non-intragovernmental lease with a lease term (as defined in par. 14-21) of 24 months or less.

9. Paragraph 23 of SFFAS 54 is amended as follows:

   23. A lessee should recognize short-term lease payments as an expense based on the payment provisions of the contract or agreement and standards regarding recognition of accounts payable and other related amounts. The lessee should recognize an asset if payments are made in advance of the reporting period to which they relate or a liability for rent due ~~if payments are made subsequent to that~~ and unpaid at the end of the reporting period to which they relate. Rental increases, rental decreases, lease incentives, and lease concessions should be recognized when incurred as increases/reductions to lease rental expense. ~~The lessee should recognize lease incentives and lease concessions (for example, a rent holiday period of one or more months free) as reductions of lease rental expense on a straight-line basis over the lease term.~~

10. Paragraph 24 of SFFAS 54 is amended as follows:

    24. A lessor should recognize short-term lease payments as revenue based on the payment provisions of the contract or agreement and standards regarding recognition of accounts receivable and other related amounts. The lessor should recognize a liability if payments are received in advance of the reporting period to which they relate or an asset for rent due and to be received subsequent to the ~~if payments are received subsequent to that~~ reporting period to which they relate. Rental increases, rental decreases, lease incentives, and lease concessions should be recognized when incurred as increases/reductions to lease rental income. ~~The lessor should recognize any lease incentive or concession (for example, a rent holiday period with one or more months free) as reductions of lease rental income on a straight-line basis over the lease term.~~

11. Paragraph 25 of SFFAS 54 is amended as follows:

    25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to

terminate (par. 14-19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of that asset by the lessee or as a financed sale of the asset by the lessor.[5]

FN 5 – See SFFAS 6, Accounting for Property, Plant, and Equipment, par. 26A.

12. Paragraph 29 of SFFAS 54 is amended as follows:

29. Rental increases/decreases may be fixed in the lease and take place with the passage of time (for example, be based on such factors as anticipated increases/decreases in costs or anticipated appreciation/depreciation in property values, but the amount of the increase/decrease is specified in the lease) or they may be contingent on future events.

13. Paragraph 30 of SFFAS 54 is amended as follows:

30. Rental increases/decreases may also be variable and based on future changes in specific economic factors on which lease payments are based, for example, future sales or usage activity levels or future inflation/deflation (tied to a specific economic indicator where the specific amount of the change is not known).

14. Paragraph 31 of SFFAS 54 is amended as follows:

31. ~~If the lease provides for rental increases, a lessee~~ Rental increases, rental decreases, lease incentives, and lease concessions should be recognized by the lessee and lessor when incurred ~~the expense in the period~~ as increases/reductions to lease rental expense and income, respectively ~~of the increase~~.

15. Paragraphs 32-33 of SFFAS 54 are rescinded.

16. Paragraph 37.b of SFFAS 54 is amended as follows:

37. Lessees should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

37.b Annual lease expense in total and by major underlying asset ~~leased PP&E~~ category.

17. Paragraph 38.a of SFFAS 54 is amended as follows:

38. Lessors should disclose the following regarding intragovernmental lease activities (which may be grouped for purposes of disclosure):

38.a A general description of significant leases~~, including a breakdown of the number of leases with federally-owned assets and privately-owned assets~~

18. Paragraph 39 of SFFAS 54 is amended as follows:

39. At the commencement of the lease term, a lessee should recognize a lease liability and a ~~PP&E~~ right-to-use lease asset (hereinafter referred to as the lease asset), except

as provided in paragraphs 22-24 (short-term leases), paragraph 25 (contracts or agreements that transfer ownership), and paragraphs 26-38 (intragovernmental leases).

19. Paragraph 42 of SFFAS 54 is amended as follows:

42. The future lease payments should be discounted using the interest rate the lessor charges the lessee~~, which may be the interest rate implicit in the lease~~. If the interest rate is not stated in the lease ~~cannot be reasonably estimated by the lessee~~, the **lessee's estimated incremental borrowing rate**[7] (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used.

FN 7 - A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

20. Paragraph 51 of SFFAS 54 is amended as follows:

51. If a lease contains a purchase option that the lessee has determined is probable of being exercised, the lease asset should be amortized over the useful life of the underlying asset. ~~In that circumstance~~ However, if the underlying asset ~~is~~ will be capitalizable and nondepreciable in the reporting period the purchase option is expected to be exercised, ~~such as land,~~ the lease asset should not be amortized. If the underlying asset will be non-capitalizable in the reporting period the purchase option is expected to be exercised, the lease asset should be amortized over the remaining lease term.[8A]

FN 8A - Once SFFAS 59, *Accounting and Reporting of Government Land*, becomes fully effective, underlying assets that are general PP&E land will become non-capitalizable. For reporting periods prior to this, general PP&E land is capitalizable and nondepreciable.

21. Paragraphs 52-53 of SFFAS 54 are amended as follows:

52. The lease asset generally should be adjusted by the same amount when the ~~corresponding~~ lease liability is remeasured based on paragraphs 44-48. However, if this change reduces the carrying value of the lease asset to zero, any remaining amount should be reported in the statement of net cost as a gain. Changes arising from amendments to a lease contract or agreement should be accounted for under the provisions of paragraphs 80-86 for lease terminations and modifications.

53. Leased assets ~~classified as PP&E~~ are subject to SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*. The presence of impairment indicators (described in par. 8-15 of SFFAS 44) with respect to the underlying asset may result in a change in the manner or duration of use of the lessee's rights to obtain and control access to economic benefits and services derived from the underlying asset and the application of SFFAS 44. The change in the manner or duration of use of the underlying asset is an indicator that the ~~right of use~~ lease asset may be impaired ~~(SFFAS 44, par.12). If the underlying asset is impaired, it~~ If impaired, the lease asset should be reduced first for any change in the ~~corresponding~~ lease liability resulting from remeasurement under paragraphs 44-48 of SFFAS 54 or terminations or modifications under paragraphs 80-86 of SFFAS 54. Any remaining amount should be recognized as an impairment loss. Paragraphs 16-25 of SFFAS 44 provide criteria for

testing for impairment, along with recognizing, reporting, and disclosing impairment losses. This guidance should be applied to lease assets to the extent that impairment losses exceed any reduction to the lease liability and lease asset that may stem from the impairment.

~~FN 9 - SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, par. 18-25.~~

22. Paragraph 54 of SFFAS 54 is amended as follows:

54. Lessees should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: …

23. Paragraph 54.a of SFFAS 54 is amended as follows:

54.a A general description of its leasing arrangements, including ~~i.~~ the basis, terms, and conditions on which variable lease payments not included in the lease liability are determined

~~ii. the existence, terms, and conditions of residual value guarantees provided by the lessee~~

24. Paragraph 54.b of SFFAS 54 is amended as follows:

54.b The total amount of lease assets and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets

25. Paragraph 59 of SFFAS 54 is amended as follows:

59. The future lease payments to be received should be discounted using the rate the lessor charges the lessee~~, which may be the interest rate implicit in the lease~~. ~~Lessors are not required to apply imputed interest but may do so as a means of determining the interest rate implicit in the lease.~~ If the interest rate is not stated in the lease, the lessor's estimated incremental borrowing rate should be used.[9A]

FN 9A - A federal lessor's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.

26. Paragraphs 64-65 of SFFAS 54 are amended as follows. The term "deferred revenue" is also replaced by "unearned revenue" elsewhere in SFFAS 54, including paragraphs 55, 83, 86, and 90.

Unearned ~~Deferred~~ Revenue

64. A lessor initially should measure the unearned ~~deferred~~ revenue to include the following: …

65. A lessor subsequently should amortize ~~recognize~~ the unearned ~~deferred~~ revenue, recognizing it as earned revenue, in a systematic and rational manner over the term of

the lease. The unearned ~~deferred~~ revenue generally should be adjusted using the same amount as the change resulting from the remeasurement of the lease receivable as discussed in paragraphs 61–63. However, if the change reduces the carrying value of the unearned revenue to zero, any remaining amount should be reported in the statement of net cost as a loss.

27. Paragraph 67 of SFFAS 54 is amended as follows:

67. Lessors should disclose the following regarding lease activities (which may be grouped for purposes of disclosure), other than short-term leases, contracts or agreements that transfer ownership, and intragovernmental leases: …

28. Paragraph 69.b of SFFAS 54 is amended as follows:

69. If applicable, the financial report of the U.S. Government should disclose the following regarding its lease activities:

b. The total amount of lease assets, and the related accumulated amortization, to be disclosed separately from ~~other~~ PP&E assets …

29. Paragraph 70 of SFFAS 54 is amended as follows:

Lease incentives include lessor payments made to or on behalf of the lessee to entice the lessee to sign a lease. Lease incentives may include up-front cash payments to the lessee, for example, moving costs, termination fees to lessee's prior lessor, or lessor's assumption of the lessee's lease obligation under a different lease with another lessor. Lease concessions are rent discounts made by the lessor to entice the lessee to sign a lease. For example, ~~L~~ lease concessions may include rent holidays/free rent periods~~,~~ or reduced rents~~, or commission credits~~.

30. Paragraph 71 of SFFAS 54 is amended as follows:

71. Lease incentives and lease concessions reduce the amount that a lessee is required to pay for a lease. For leases other than short-term leases and intragovernmental leases, ~~L~~ lease incentives and lease concessions that provide payments to, or on behalf of, a lessee at or before the commencement of a lease term are included in initial measurement by directly reducing the amount of the lease asset (par. 49). Lease incentive and lease concession payments to be provided after the commencement of the lease term should be accounted for by lessees and lessors as reductions of lease payments for the periods in which the incentive or concession payments will be provided. Those payments should be measured by lessees consistently with the lessee's lease liability (par. 40-48) and by lessors consistently with the lessor's lease receivable (par. 56-63). Accordingly, lease incentive and lease concession payments to be provided after the commencement of the lease term are included in initial measurement and any remeasurement if they are fixed or fixed in substance, whereas variable or contingent lease incentive or lease concession payments are not included in initial measurement. Lessor improvements that are made to or on behalf of the lessee without additional cost to the lessee should be accounted for by the lessee and the lessor consistent with other lease incentives and lease concessions. As leasehold improvements are paid for

(financed) by the lessee, leasehold improvements would not be considered a lease incentive or concession received from the lessor.[10A]

FN 10A - The treatment of lease incentives and lease concessions is addressed in par. 23-24 for short-term leases and par. 31 for intragovernmental leases.

31. Paragraph 93 of SFFAS 54 is amended as follows:

93. In a lease-leaseback transaction, an asset is leased by one party (first party) to another party and then leased back to the first party. The leaseback may involve an additional asset (such as leasing a building that has been constructed by a developer on land owned by and leased back to a federal entity) or only a portion of the original asset (such as leasing back only one floor of a building to the owner). A lease-leaseback transaction should be displayed in the financial statements ~~accounted for~~ as a net transaction. Both parties to a lease-leaseback transaction should disclose the amounts of the lease and the leaseback separately.

AMENDMENTS TO SFFAS 57, SFFAS 5, AND SFFAS 6

32. Paragraphs 7 and 8 of SFFAS 57, *Omnibus Amendments 2019,* are rescinded.

33. Paragraph 15 of SFFAS 57 is amended as follows:

15. Paragraphs 3 through 6 ~~8~~, 11, and 12 of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

34. Paragraph 43A is added to SFFAS 5, *Accounting for Liabilities of the Federal Government*, as follows:

Contracts or Agreements That Transfer Ownership[20A]

43A. The amount to be recorded as a liability under a contract or agreement that transfers ownership shall be equal to the amount that would otherwise be recognized as a lease liability at the commencement of the lease term (see SFFAS 54, par. 40-48).

FN 20A – See SFFAS 54, par. 25.

35. Paragraph 18 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, is amended as follows:

18. Property, plant, and equipment also includes:

- ~~assets acquired through capital leases (See paragraph 20), including leasehold improvements;~~ Leasehold improvements;

- Property owned by the reporting entity in the hands of or leased to others (e.g., state and local governments, colleges and universities, or Federal contractors);

- Land rights that do not meet the definition of a lease;[18] and

- Contracts or agreements that transfer ownership[18A]

FN 18 - "Land rights" are interests and privileges held by the entity in land owned by others, such as ~~leaseholds,~~ easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

FN 18A – See SFFAS 54, par. 25.

36. Paragraph 19A is added to SFFAS 6 as follows:

19A. Property, plant, and equipment also excludes lease assets and land rights that meet the definition of a lease under SFFAS 54, *Leases*.

37. Paragraph 26A is added to SFFAS 6 as follows:

26A. The cost of general PP&E acquired through a contract or agreement that transfers ownership shall be equal to the amount that would otherwise be recognized as a lease asset at the commencement of the lease term (see SFFAS 54, par. 49).

EFFECTIVE DATE

38. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* chapter 7, titled *Materiality,* for a detailed discussion of the materiality concepts.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. The authoritative sections of the Statements are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

A1. Statement of Federal Financial Accounting Standards (SFFAS) 54, *Leases*, was issued in April 2018 with an effective date for reporting periods beginning after September 30, 2020. The effective date was later amended by SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, to reporting periods beginning after September 30, 2023.

A2. In August 2019, the Federal Accounting Standards Advisory Board (FASAB or "the Board") and the Accounting and Auditing Policy Committee (AAPC or "the Committee") commenced projects on their technical agendas to identify implementation challenges and develop guidance related to SFFAS 54.

A3. The AAPC assembled a large group of task force members—over 100 stakeholders—as a means of crowdsourcing the identification and analysis of a wide breadth of potential SFFAS 54 implementation topics. The task force provided input to project staff by:

a. Reviewing project staff's content analysis of questions and answers contained in Governmental Accounting Standards Board (GASB) *Implementation Guide 2019-3, Leases*, and determining the extent to which each question and answer contained therein was applicable in the federal context.[1]

b. Suggesting implementation topics not addressed in GASB 2019-3.

c. Identifying and discussing potential omnibus SFFAS amendment candidates that may need to be issued in tandem with the implementation guidance for purposes of providing clarification or closing loopholes. Such candidates were then relayed to FASAB for its consideration.

d. Providing editorial and technical comments and illustrative examples on draft versions of implementation guidance questions and answers developed by staff. The working

[1]The GASB material is copyrighted by the Financial Accounting Foundation (FAF), 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, and was used with permission. Complete copies of the documents are available from the FAF.

drafts were developed and reviewed, by topic area, over the course of several task force meetings organized by project staff.

A4. In June and August 2020, the Board discussed omnibus amendments candidates identified by project staff and the task force to include in the exposure draft. The major points of discussion included:

a. Clarifying the treatment of assets under construction, including payments prior to the commencement of the lease term, in the context of the scope exclusion enumerated in paragraph 5.a. of SFFAS 54. The Board agreed to make clarifying edits to the scope exclusion in the proposal.

b. Potential options for amending paragraph 19.a of SFFAS 54 to require detailed analyses of those cancelable periods that are, in substance, unlikely to be canceled by either the lessee or the lessor. After additional research and discussions, the Board concluded that paragraph 19.a should remain unamended. Board members noted that revising the paragraph would likely result in undue costs and preparer burdens. Moreover, the Board believes that reporting entities and their counterparties often have sufficient disincentives that deter them from prevalently engaging in significant off-balance-sheet financing through use of cancelable periods.

c. The Board agreed to propose clarifying amendments to address step rent decreases throughout the Statement.

d. The Board agreed to propose the rescission of certain disclosure requirements reflected in paragraphs 38.a and 54.a.ii of SFFAS 54 to alleviate the associated challenges and costs in implementing such requirements. After additional research and deliberations, members agreed that those requirements did not generally meet the qualitative characteristics of useful financial information. For example, members believed that the compilation and presentation of such information would not be consistent, comparable, or provide sufficient feedback or predictive value to decision-makers.

e. The Board agreed to maintain the current discount rate guidance in paragraph 42 of SFFAS 54 and to propose the addition of comparable language for lessors in paragraph 59 with respect to use of estimated incremental borrowing rates when the interest rate of a lease cannot be reasonably estimated.

f. The Board agreed to propose numerous clarifying amendments to paragraph 53 of SFFAS 54 to facilitate consistent and correct application of the requirements in SFFAS 54 and SFFAS 44, *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, when impairment indicators are present with respect to assets underlying a lease.

g. The Board agreed to propose clarifying amendments related to the classification of lease assets by striking the term “PP&E” in SFFAS 54 and SFFAS 57, *Omnibus Amendments 2019*, in certain locations where use of the term implies that lease assets—rather than the underlying assets—are PP&E. The Board discussed the potential benefits to defining intangible assets but agreed that the most appropriate mechanism for doing so would be in a separate project focused on intangibles. The

Board also agreed to propose amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment*, to clarify that PP&E would not include lease assets or land rights that meet the definition of a lease.

SUMMARY OF OUTREACH AND RESPONSES

A5. The Board released an exposure draft (ED) proposal on November 2, 2020, for public comment, with comments requested by February 5, 2021. The proposal was released as a joint ED in tandem with an ED for a proposed Federal Financial Accounting Technical Release (TR) to provide implementation guidance on leases. Upon release of the ED, FASAB notified constituents through the FASAB website and listserv, the Federal Register, and FASAB newsletter. FASAB also provided news releases to its press contacts, including various news organizations and committees of professional associations generally commenting on EDs in the past. To encourage responses, a reminder notice was provided to FASAB's listserv near the comment deadline.

A6. Twenty-five comment letters were received in response to the joint ED. Respondents were generally supportive of the proposed Statement. In response to comment letters, the Board identified and agreed upon several improvements and changes to the proposal. Board comments and changes were coordinated between the Accounting and Auditing Policy Committee (AAPC) and the Board where appropriate to ensure consistency across the concurrent projects.

A7. Improvements and additional omnibus changes included:

a. Clarifying that short-term leases (par. 22-24 of SFFAS 54) are non-intragovernmental leases with a lease term of 24 months or less. For intragovernmental leases with a lease term of 24 months or less, paragraphs 26-38 of SFFAS 54 apply.

b. Clarifying the definition of lease concessions in paragraphs 10 and 70 of SFFAS 54. The Board also elected to remove the requirements to straight-line lease incentives and lease concessions for short-term and intragovernmental leases.

c. Removing the implicit requirement in paragraphs 42 and 59 of SFFAS 54 for lessees and lessors to impute interest rates for lease liabilities and lease receivables in response to concerns raised by the task force and respondents. The Board concluded that allowing agencies to use their estimated incremental borrowing rates when an interest rate is not stated in the lease agreement was preferable; particularly in light of implementation and audit challenges that could stem from complex calculations to impute interest rates implicit in leases.

d. Clarifying paragraph 51 of SFFAS 54 and its future application as it relates to general PP&E land, as affected by SFFAS 59, *Accounting and Reporting of Government Land*. At the time the Board issued SFFAS 54, general PP&E land was a capitalizable and nondepreciable asset. Once fully effective, SFFAS 59 will result in general PP&E land being non-capitalizable.

e. Changing the term "deferred revenue" to "unearned revenue" in paragraphs 64-65 and elsewhere throughout SFFAS 54. Although reporting entities may ultimately elect to use either term depending on guidance provided by central agencies, the Board

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elected to signal a preference in terminology by modifying the term. Some respondents, members of the Board, and the Board's technical staff viewed the term "unearned revenue" as being more understandable to general users.

f. Implementing minor clarifying edits to paragraph 93 of SFFAS 54 regarding the treatment of lease-leasebacks.

g. Explicitly including leasehold improvements paid for (financed) by lessees in the definition of property, plant, and equipment.

h. Providing a valuation basis in SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6 for contracts or agreements that transfer ownership.

A8. The Board considered other input provided by respondents that did not result in further modifications to the Statement, but may result in alternative Board actions:

a. Some respondents mentioned the differences in lease criteria under SFFAS 54 for proprietary accounting purposes and Office of Management and Budget (OMB) Circular A-11 for budgetary funding and scoring purposes. In light of these comments, the Board acknowledges that there are differences between proprietary and budgetary accounting. Budgetary and financial accounting information are complementary, but the timing and method of recognition of accounting events are different. Users of general purpose federal financial reports often rely on sources of information other than budgetary information to make decisions. For example, the criteria under SFFAS 54 provides useful financial information regarding the efficiency and effectiveness of the government's management of its assets and liabilities and how those assets are financed, whether through ownership and purchase or through lease contracts and agreements.

b. Some respondents and task force members requested additional guidance on intragovernmental leasehold improvements, reimbursable work authorizations, and incremental borrowing rates estimates. Some task force members also requested illustrations. The Board appreciates these requests and intends to address these requests through other pronouncements, such as Interpretations of Federal Financial Accounting Standards and/or through Staff Implementation Guidance.

c. One respondent and one Board member suggested that the Board consider clarifying whether SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* as amended, should be applied to intragovernmental leases and, if so, how it should be applied in circumstances when a lessee does not fully reimburse the lessor's full cost. The Board recently reexamined inter-entity cost provisions and amended SFFAS 4 when it issued SFFAS 55, *Amending Inter-entity Cost Provisions*, in May 2018. The Board may elect to revisit the requirements of SFFAS 4, as amended by SFFAS 55, at a later time if deemed necessary and appropriate. Thus far, Board research and outreach have indicated that such circumstances in which an intragovernmental lessee does not fully reimburse the lessor's full cost are infrequent and immaterial. In light of this, along with the need for the preparer community to receive timely implementation guidance and clarifying omnibus amendments to SFFAS 54, the Board elected to forgo additional reexaminations or omnibus actions surrounding this topic at this time.

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d. One respondent and one Board member suggested that the Board clarify whether sale-leaseback requirements under paragraphs 89-92 of SFFAS 54 apply to intragovernmental transactions. SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraph 295, which is cited in a footnote to SFFAS 54, paragraph 89 in defining the scope of transactions that qualify as a sale, is limited to transactions with the public under SFFAS 7. The Board elected to forgo additional omnibus actions surrounding intragovernmental transactions resembling sale-leasebacks at this time. The Board believes that such transactions are infrequent, but nevertheless intends to address this issue, as appropriate, in subsequent omnibus or other guidance actions after further research is completed.

e. Some respondents and one AAPC member asked that the Board consider opportunities to provide clarifying omnibus amendments related to the scope and applicability of paragraphs 70-93 of SFFAS 54. The Board carefully considered this input and determined that the scope and applicability of these paragraphs was sufficiently and appropriately clarified in the AAPC's leases implementation guidance under concurrent development for the time being. The Board remains mindful of the desire for clarity and consistent application in interpreting the scope and applicability of these paragraphs to various types of leases (short-term, intragovernmental, and lease assets). The Board agreed to address this topic at a later time. The Board will explore opportunities to address these requests through other guidance (potentially Staff Implementation Guidance) once the resolution of other narrow technical issues (such as paragraph A8.d, above) are determined and resolved.

A9. The Board is aware that additional omnibus amendments, reexaminations of existing Statements that interact with leases, and additional leases implementation guidance may need be undertaken as entities continue to implement SFFAS 54. The Board's technical staff, along with its leases implementation task force, will continue to identify, analyze, and elevate recommendations to the Board and determine the best course of action. With this in mind, the Board concluded that the omnibus amendments herein, coupled with leases implementation guidance developed by the AAPC, should greatly benefit internal users, external users, and preparers of general purpose financial reports, and address a substantial portion of implementation issues likely to arise as reporting entities prepare to implement SFFAS 54.

BOARD APPROVAL

A10. This Statement was approved for issuance by all members of the Board.

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APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
ED	Exposure Draft
FAF	Financial Accounting Foundation
FASAB	Federal Accounting Standards Advisory Board
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TR	Federal Financial Accounting Technical Release

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FASAB Members

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R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Sallyanne Harper

Deidre A. Harrison

Patrick McNamee

Terry K. Patton

Graylin E. Smith

FASAB Staff

Monica R. Valentine, Executive Director

Ricky A. Perry, Jr., Senior Analyst

Christi M. Dewhirst, Fellow

Federal Accounting Standards Advisory Board

441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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FASAB
THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

OMNIBUS AMENDMENTS 2023

LEASES-RELATED TOPICS II

Statement of Federal Financial Accounting Standards 61

April 7, 2023

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THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

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SUMMARY

This Statement of Federal Financial Accounting Standards (SFFAS) amends certain paragraphs in SFFAS 54, *Leases*, and SFFAS 60, *Omnibus Amendments 2021*.

In August 2019, the Accounting and Auditing Policy Committee—which operates under the general oversight of the Federal Accounting Standards Advisory Board (FASAB or "the Board")—undertook a project to develop proposed implementation guidance for SFFAS 54 as a Technical Release. During the course of the project, implementation issues were identified that are best addressed through omnibus amendments to clarify existing leases guidance rather than through a Technical Release. The issues require modifications to the existing Statements to provide technical clarifications and address areas of concern. A substantial majority of those issues were addressed in SFFAS 60; however, a few outstanding implementation issues required additional research and deliberations. This Statement addresses those outstanding issues by clarifying

- the treatment of purchase options and defaults on payments for purposes of (a) determining the lease term and (b) assessing contracts or agreements that transfer ownership for options to terminate;
- the Board's original intent for discounting lease liabilities and receivables, which should result in a more consistent and comparable application of SFFAS 54 requirements; and
- the applicability of paragraphs 89-92 of SFFAS 54 to intragovernmental sale-leasebacks and disclosure requirements applicable to them.

MATERIALITY

The provisions of this Statement need not to be applied to information if the effect of applying the provision(s) is immaterial.[1] A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[1] Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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TABLE OF CONTENTS

Summary....1
Standards....3
Scope....3
Amendments to SFFAS 54 and SFFAS 60....3
Effective Date....6
Appendix A: Basis for Conclusions....7
Appendix B: Abbreviations....11

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STANDARDS

SCOPE

1. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

2. This Statement amends SFFAS 54, *Leases*, and SFFAS 60, *Omnibus Amendments 2021*, by providing additional guidance, along with technical corrections and clarifications.

AMENDMENTS TO SFFAS 54 AND SFFAS 60

3. Paragraph 19.b of SFFAS 54 is amended as follows:

> 19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied: …
>
> > 19.b An option to terminate is an unconditional right that exists within the contract. A provision that gives a lessee or lessor the right to terminate the lease conditional upon certain circumstances or upon the occurrence of certain events, such as the action or inaction of the other party to the lease contract, should not be considered an option to terminate the lease for purposes of determining the lease term. For example, provisions that allow for termination of a lease due to a violation of lease terms and conditions, such as a default on payments, are not considered options to terminate the lease. ~~If the lease provisions allow for the termination of a lease due to (a) the purchase of the underlying asset, (b) the payment of all sums due, or (c) the default on payments, these provisions are not considered options to terminate.~~

4. Paragraph 19.d is added as follows:

> 19. In determining the lease term for both the lessee and lessor, the following specific provisions should be applied: …
>
> > 19.d If a lessee has the option to purchase the underlying asset during the lease term and the contract is not a contract that transfers ownership (required to be reported in accordance with par. 25), the lease term should exclude the period, if any, after the date at which the option is probable of being exercised.

5. Paragraph 25 of SFFAS 54 and the previously-issued amendment thereto (SFFAS 60, par. 11) are amended as follows:

> 25. A contract or agreement that (a) transfers ownership of the underlying asset to the lessee by the end of the contract or agreement and (b) does not contain options to terminate (par. 14-19), but that may contain an availability of funds or cancellation clause that is not probable of being exercised (par. 19.c), should be reported as a purchase of

that asset by the lessee or as a financed sale of the asset by the lessor.[5] For this purpose, options to purchase the underlying asset prior to the transfer of ownership are not considered options to terminate.

FN 5 - See SFFAS 6, par. 26A.

6. Paragraph 42 of SFFAS 54 and the previously-issued amendment thereto (SFFAS 60, par. 19) are amended as follows:

42. The future lease payments should be discounted using the interest rate the lessor charges the lessee. If the interest rate is not stated in the lease, the interest rate should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date in accordance with par. 44), with a similar maturity to the term of the lease ~~lessee's estimated incremental borrowing rate[7] (the estimated rate that would be charged for borrowing the lease payment amounts for the lease term) should be used~~.

~~FN 7 – A federal lessee's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.~~

7. Paragraphs 42A-42C are added to SFFAS 54 as follows:

42A. If the interest rate is based on marketable Treasury securities, it should be consistent with the interest rate on marketable Treasury securities at the commencement of the lease term, in accordance with paragraphs 40 and 42 (or the interest rate on marketable Treasury securities on the subsequent financial reporting date, in accordance with par. 46 and 48). The interest rate may be based on a recent interest rate on marketable Treasury securities or historical average interest rate on marketable Treasury securities of a similar maturity to the term of the lease, provided that the interest rate is consistent with the interest rate on marketable Treasury securities at the commencement of the lease term (or subsequent financial reporting date).

42B. When selecting an interest rate based on marketable Treasury securities of similar maturity to the term of the lease, reporting entities may round up or down to the nearest maturity or interpolate the interest rate for the period between two maturities. The methodology for selecting an interest rate based on marketable Treasury security maturities should be consistent from period to period.

42C. Reporting entities should not extrapolate beyond the longest Treasury maturity when the lease term exceeds it; rather, reporting entities should select the longest Treasury maturity. For example, if the longest Treasury maturity at commencement of the lease term is 30 years, reporting entities should select the 30-year rate as the discount rate for a lease with a 75-year term.

8. Paragraphs 47 and 48 of SFFAS 54 are amended as follows:

47. A lease liability is not required to be remeasured, nor is the discount rate required to be reassessed, solely for a change in the interest rate on marketable Treasury securities ~~lessee's estimated incremental borrowing rate~~.

48. If the discount rate is required to be updated based on the provisions in paragraph 46, the discount rate should be based on the revised interest rate the lessor charges the lessee at the time the discount rate is updated. If that interest rate cannot be readily determined, the interest rate on marketable Treasury securities with a similar maturity to the term of the lease ~~lessee's estimated incremental borrowing rate~~ at the time the discount rate is updated should be used (see par. 42-42C above).

9. Paragraph 59 of SFFAS 54 and the previously-issued amendment thereto (SFFAS 60 par. 25) are amended as follows:

59. The future lease payments to be received should be discounted using the interest rate the lessor charges the lessee. If the interest rate is not stated in the lease, the interest rate should be based on the interest rate on marketable Treasury securities at the commencement of the lease term (or at the subsequent financial reporting date in accordance with par. 61), with a similar maturity to the term of the lease ~~lessor's estimated incremental borrowing rate should be used~~.[9A]

~~FN 9A – A federal lessor's incremental borrowing rate would be the Department of the Treasury borrowing rate for securities of similar maturity to the term of the lease unless the entity has its own borrowing authority.~~

10. Paragraphs 59A-59C are added to SFFAS 54 as follows:

59A. If the interest rate is based on marketable Treasury securities, it should be consistent with the interest rate on marketable Treasury securities at the commencement of the lease term, in accordance with paragraphs 56 and 59 (or the interest rate on marketable Treasury securities on the subsequent financial reporting date, in accordance with par. 63). The interest rate may be based on a recent interest rate on marketable Treasury securities or historical average interest rate on marketable Treasury securities of a similar maturity to the term of the lease, provided that the interest rate is consistent with the interest rate on marketable Treasury securities at the commencement of the lease term (or subsequent financial reporting date).

59B. When selecting an interest rate based on marketable Treasury securities of similar maturity to the term of the lease, reporting entities may round up or down to the nearest maturity or interpolate the interest rate for the period between two maturities. The methodology for selecting an interest rate based on marketable Treasury security maturities should be consistent from period to period.

59C. Reporting entities should not extrapolate beyond the longest Treasury maturity when the lease term exceeds it; rather, reporting entities should select the longest Treasury maturity. For example, if the longest Treasury maturity at commencement of the lease term is 30 years, reporting entities should select the 30-year rate as the discount rate for a lease with a 75-year term.

11. Paragraph 61 of SFFAS 54 is amended (without amendment to its sub-paragraphs or footnote) as follows:

61. The lessor should remeasure the lease receivable at subsequent financial reporting dates ~~periods~~ if one or more of the following changes have occurred at or before that financial reporting date ~~period~~, based on the most recent lease contract or agreement

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before the changes,[10] and the changes individually or in the aggregate, are expected to significantly affect the amount of the lease receivable since the previous measurement:

12. Footnote 11 to paragraph 89 of SFFAS 54 is amended as follows:

89. Sale-leaseback transactions involve the sale of an underlying asset by the owner and a lease of the property back to the seller (original owner). A sale-leaseback should include a transaction that qualifies as a sale[11] to be eligible for sale-leaseback accounting. A sale-leaseback transaction that does not include a transaction that qualifies as a sale should be accounted for as a borrowing by both the seller-lessee and the buyer-lessor.

FN 11 – See SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* par. 295 (with the public) and par. 314-315 (intragovernmental).

13. Paragraph 92 of SFFAS 54 is amended as follows:

92. A seller-lessee should disclose the terms and conditions of sale-leaseback transactions as part of ~~in addition to~~ the disclosures required of a lessee (par. 37 or 54, as applicable). A buyer-lessor should disclose the terms and conditions as part of ~~provide~~ the disclosures required of a lessor (par. 38 or 67, as applicable).

EFFECTIVE DATE

14. The requirements of this Statement are effective for reporting periods beginning after September 30, 2023. Early adoption is not permitted.

The provisions of this Statement need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any Statements that affect this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect subsequent changes. The reader can review the basis for conclusions of amending Statements for the rationale for each amendment.

PROJECT HISTORY

A1. The Federal Accounting Standards Advisory Board (FASAB or "the Board") issued SFFAS 54, *Leases*, in April 2018 with an effective date for reporting periods beginning after September 30, 2020. The effective date was later amended by SFFAS 58, *Deferral of the Effective Date of SFFAS 54, Leases*, to reporting periods beginning after September 30, 2023.

A2. FASAB and the Accounting and Auditing Policy Committee (AAPC) commenced projects on their technical agendas to identify implementation challenges and develop guidance related to SFFAS 54.

A3. The AAPC assembled a large group of task force members—over 100 stakeholders—to identify and analyze numerous SFFAS 54 implementation topics.

A4. In June and August 2020, the Board discussed omnibus amendments candidates identified by project staff and the task force to include in the exposure draft (ED) of an initial omnibus amendments proposal (the proposal was eventually approved and issued as SFFAS 60, *Omnibus Amendments 2021*). The Board considered input provided by ED respondents and the task force during due process.

A5. Some respondents and task force members requested additional guidance on the selection and use of incremental borrowing rate estimates to discount lease liabilities and receivables. One respondent suggested that the Board clarify whether sale-leaseback requirements under paragraphs 89-92 of SFFAS 54 apply to intragovernmental transactions (see SFFAS 60, Basis for Conclusions, par. A8.b and A8.d). The Board decided to address those outstanding issues through subsequent actions.

A6. Following the issuance of SFFAS 60, the leases implementation task force recommended that the Board clarify numerous aspects of SFFAS 54, paragraphs 42 and 59, which provided for the use of estimated incremental borrowing rates to discount lease liabilities and receivables. These recommendations were consistent with those raised by respondents to the ED of SFFAS 60.

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A7. The Board considered numerous factors when evaluating paragraphs 42 and 59 of SFFAS 54 and developing omnibus amendments:

a. Elements identified by task force members as requiring additional clarification

b. Technical implementation issues for entities with independent borrowing authorities

c. Cost-benefit considerations and qualitative characteristics of information in financial reports

i. Paragraphs 152-153 of Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, provide that accounting standards can have many different kinds of effects that must be considered, including effects on the activities of accountants and auditors. It also provides that the Board must be aware of these potential effects when considering the costs and benefits of any given accounting alternative. In this particular context, the Board considered potential effects on costs of implementation, auditability, and consistent application when assessing the level of detail needed.

ii. Paragraph 160 of SFFAC 1 provides that reliability can be affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured.

iii. Paragraph 164 of SFFAC 1 provides that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting practices.

d. Approaches used in the following documents

i. SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits* (par. 28-32)

ii. Governmental Accounting Standards Board (GASB) Statement 87, *Leases*[2]

iii. Financial Accounting Standards Board Accounting Standards Update 2021-09, *Discount Rate for Lessees that Are Not Public Business Entities*

A8. The Board discussed its original intent to subject intragovernmental sale-leasebacks to the requirements of paragraphs 89-92 of SFFAS 54. The Board agreed that the original intent was not sufficiently clear due to an absence of references to intragovernmental transaction guidance, including paragraphs 314-315 of SFFAS 7 and paragraphs 37-38 of SFFAS 54.

A9. In light of these considerations, the Board agreed to propose omnibus amendments to clarify the discounting of lease liabilities and receivables (par. 42, 47-48, and 59 of SFFAS

[2] The GASB material contained in this document is copyrighted by the Financial Accounting Foundation (FAF), 801 Main Ave., P.O. Box 5116, Norwalk, CT 06856-5116, and was used with permission. Complete copies of the document are available from the FAF.

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54) and the scope and applicability of sale-leaseback requirements (par. 89-92 of SFFAS 54) to intragovernmental leases.

SUMMARY OF OUTREACH AND RESPONSES

A10. The Board released an ED proposal on May 9, 2022, for public comment, with comments requested by July 8, 2022. Upon release of the ED, FASAB notified constituents through the FASAB website and listserv, the Federal Register, and FASAB newsletter. FASAB also provided news releases to its press contacts, including various news organizations and committees of professional associations generally commenting on EDs in the past. To encourage responses, a reminder notice was provided to FASAB's listserv near the comment deadline.

A11. FASAB received 16 comment letters in response to the ED. Respondents were generally supportive of the proposed Statement. In response to comment letters, the Board identified and agreed upon further changes to improve the technical clarity of the proposal and the related guidance in SFFAS 54.

A12. After consultations with GASB staff regarding implementation issues with GASB Statement 87, *Leases*, the Board elected to implement additional clarifying omnibus amendments in paragraphs 19 and 25. The Board concluded that these amendments will assist reporting entities when determining whether an option to terminate exists and its effect, if any, on the lease term and the identification of contracts or agreements that transfer ownership. The omnibus amendments to these paragraphs are generally consistent with those implemented by the GASB under GASB Statement 99, *Omnibus Amendments 2022.*[3]

A13. Improvements and additional changes included the following:

a. Improving consistency in terminology and linkage across interacting paragraphs to enhance clarity of the original omnibus proposals

b. Clarifying the treatment of purchase options and defaults on payments for purposes of determining whether or not such provisions represent an option to terminate

c. Aligning phrasing in paragraphs 44 and 61 of SFFAS 54

A14. The Board considered other input provided by respondents that did not result in further modifications to the Statement:

a. A few respondents expressed concerns that paragraph 42B and 59B guidance may not be applied consistently to the leases in reporting entities' respective lease portfolios. The Board considered these comments and decided that the criteria for entities to follow *methodologies* consistently from period to period (as provided for under par. 42B and 59B) sufficiently provides for such consistency. The discounting of future lease payments under paragraphs 42-42C and 59-59C inherently involves the application of sound, objective, and reasonable professional judgments when developing and implementing accounting procedures or practices. The Board concluded that these paragraphs help inform those professional judgments, while

[3] Ibid.

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providing reasonable guardrails in support of the qualitative characteristics of reliability, consistency, and comparability (see SFFAC 1, par. 160, 163-164).

b. One respondent noted that the options for selecting interest rates could lead to inconsistencies in values between sub-components within larger reporting entities. Inconsistencies between sub-component valuation methods exist in other areas and are not unique to leases. These differences stem from other reasonable differences in sub-component accounting and valuation policies and procedures. As previously mentioned, the Board concluded that this guidance provides sufficient criteria. Additionally, consolidated reporting entities and their sub-components may manage and harmonize their accounting policies at their discretion.

c. A few respondents requested that the Board directly reference or hyperlink to a source of marketable Treasury securities to facilitate compliance with the requirements. It is not the role of the Board to provide this information in its pronouncements. The Board must be mindful that information sources and hyperlinks can change, thus it cannot provide such information in its pronouncements.

BOARD APPROVAL

A15. The Statement was approved for issuance by all members of the Board.

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APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FAF	Financial Accounting Foundation
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GPFFR	General Purpose Federal Financial Report
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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FASAB Members

George A. Scott, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

Sallyanne Harper

Carol S. Johnson

Patrick McNamee

Terry K. Patton

Raymond Vicks

FASAB Staff

Monica R. Valentine, Executive Director

Ricky A. Perry, Jr., Senior Analyst

Federal Accounting Standards Advisory Board

441 G Street, NW

Suite 1155

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov