Volume II, Current Text

FASAB

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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Contents

Accounts Payable—A10	1
Advances and Prepayments—A30	3
Budgetary Information—B60	5
Cash—C20	13
Cleanup Costs—C40	15
Consolidated Financial Report of the U.S. Government—C60	53
Deferred Maintenance—D20	68
Entity and Non-Entity Assets—E30	77
Federal Debt—F10	79
Fund Balance with Treasury—F50	85
General Property, Plant, and Equipment—G20	91
Goods Held under Price Support and Stabilization Programs—G40	109
Governmental and Intragovernmental Assets and Liabilities—G60	114
Heritage Assets—H20	116
Human Capital—H60	128
Insurance and Guarantee Programs—I40	135
Interest Payable—I50	150
Inventories Including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory—I60	151
Investment in Treasury Securities—I80	160
Land—L10	179
Leases—L20	186
Liabilities—L40	191
Loans and Loan Guarantees—L60	218
Management's Discussion and Analysis—M10	360
Managerial Cost Accounting—M20	364
Non-Federal Physical Property—N60	417
Non-Recourse Loans & Purchase Agreements—N80	420
Operating Materials and Supplies—O20	423
Other Current Liabilities—O40	430

Pensions, Other Retirement Benefits, and Other Post-Employment Benefits—P20 432

Software—S50 650

Stewardship Land—S60 671

Stewardship Reporting—S70 680

Stockpile Materials—S80 697

Transactions Not Recognized As Revenue, Gains, or Other Financing Sources—T30 700

Appendix A: Topical Index 708

Appendix B: Effective Dates of Statements, Interpretations, and Technical Releases 731

Appendix C: 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 733

Appendix D: Federal Accounting and Auditing Resources 737

Appendix E: Cross-Reference Table Original Pronouncements to Current Text 738

Foreword

The *Statements of Federal Financial Accounting Standards*, *Current Text ("Current Text")* is a FASAB Staff document that compiles the original text that currently constitutes the body of accounting standards for the U.S. government in a major topic format.

The *Current Text* incorporates the following documents published through June 30, 2004:

- Statements of Federal Financial Accounting Standards 1-25,
- Interpretations 1-6,
- Technical Bulletin 2003-1 and
- Technical Releases 1-6.

Origins of the Documents

The standards, interpretations, technical bulletins, and technical releases presented in the *Current Text* were issued in accordance with policies and procedures approved by the Department of the Treasury (Treasury), the Office of Management and Budget (OMB), and the Government Accountability Office (GAO) at the time of their issuance. These three central agencies, referred to collectively as the "sponsors," established the Federal Accounting Standards Advisory Board (FASAB) in 1990. The mission of the FASAB is to develop accounting standards and principles for the federal government, after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information.

Standards

Using a due process and a consensus building approach, the Board promulgates accounting standards after considering the financial and budgetary information needs of Congress, executive agencies, other users of federal financial information, and comments from the public. The Memorandum of Understanding dated May 7, 2003, is included in Appendix C and describes the Board's authorities and processes.

Interpretations

Interpretations clarify original meaning, add definitions, and provide other guidance for existing SFFAS. They are narrow in scope. FASAB will respond to requests for guidance by providing technical assistance, including, in some cases, interpretations. When drafting an interpretation the FASAB staff submits the request to the Board and reviews applicable literature and consults with knowledgeable persons, as appropriate. FASAB will consider the draft interpretation at an open meeting. Proposed interpretations are exposed for public comment for at least 30 days. Interpretations approved by a majority of the Board and not objected to by a Board member representing a principal within 45 days are published by FASAB.

Technical Bulletins

Technical bulletins provide guidance for applying statements and interpretations and resolving issues not directly addressed by them. Technical bulletins are used when the nature of an issue does not warrant more extensive due process. They are generally in question and answer format.

Technical Releases

The Accounting and Auditing Policy Committee (AAPC) provides implementation guidance for accounting standards, for the OMB's *Form and Content* guidance, and for audit issues. The AAPC provides guidance through technical releases that are reviewed and published by the FASAB and announced originally in the Federal Register.

GAAP Documents

When adopted and issued, these documents become federal accounting standards and implementation guidance. It is expected that FASAB will continue to issue guidance through the documents described above. As new documents are adopted, the *Current Text* will be updated. Individual documents issued between updates are available through a variety of sources.

Purpose of the *Current Text*

FASAB Staff provides the *Current Text* (also referred to as Volume II) as a compilation of the currently effective guidance promulgated by the FASAB. The Current Text presents the authoritative portions of the *Original Pronouncements* in a topical arrangement. Volume II also includes some non-authoritative portions of the FASAB guidance (i.e., illustrations, appendices, etc.). The *Current Text* is a resource for preparers and auditors, but is not an authoritative reference since it does not undergo Board level review for accuracy. Included in the *Current Text* are several appendices, such as an extensive topical index (Appendix A) and a cross-reference table to the *Original Pronouncements* (Appendix E).

Organization of the Current Text

The *Current Text* combines the FASAB guidance according to the major subject areas to which they apply. The subject areas are arranged in alphabetical sections and each section of the *Current Text* has been designated with a corresponding alphanumeric code. The numeric part of the code has been arbitrarily selected to allow space for future subject areas. Each section includes the source of the guidance included as well as other related Volume II references. Paragraphs in each section are numbered consecutively, using the following format:

Paragraphs .100 - .999: Standards
Paragraphs .1000 - .1999: Interpretations
Paragraphs .2000 - .2999: Technical Bulletins
Paragraphs .3000 - .3999: Technical Releases
Paragraphs .4000 - .4999: Non-authoritative guidance

Each paragraph of the *Current Text* taken from the original pronouncements includes a reference back to the guidance, including the paragraph number of the original pronouncement. All amended and superseded guidance has been deleted and replaced with the new language and a reference noting the changes.

Each topical section includes a separate glossary of terms as used in the original pronouncements compiled into the section.

The *Current Text* includes the following appendices:

Appendix A: Topical Index
Appendix B: Effective Dates of Statements, Interpretations, Technical Bulletins, and Technical Releases
Appendix C: Memorandum of Understanding
Appendix D: Federal Accounting and Auditing Resources
Appendix E: Cross-Reference Table - Original Pronouncement to *Current Text*
Appendix F: Consolidated List of Acronyms

The *Current Text* does not include the FASAB *Statements of Federal Financial Accounting Concepts*. The concept statements can be found in the *Original Pronouncements* document. Also excluded from the *Current Text* are the background sections of the original documents and their basis for conclusions sections.

Materiality

The Board intends that the standards' 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. Presented below is the Board's position on the issue of materiality at this time.

> 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.

Hierarchy of Generally Accepted Accounting Principles

The term "generally accepted accounting principles" has a specific meaning for accountants and auditors. The AICPA *Code of Professional Conduct* prohibits members from expressing an opinion or stating affirmatively that financial statements or other financial data "present fairly... in conformity with generally accepted accounting principles," if such information contains any departures from accounting principles promulgated by a body designated by the AICPA Council to establish such principles. The AICPA Council has designated FASAB as the body that establishes accounting principles for federal entities. The AICPA's hierarchy of generally accepted accounting principles in Statement of Auditing Standards (SAS) No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*, governs what constitutes GAAP for all U.S. government reporting entities. The hierarchy lists the priority sequence of sources that an entity should look to for accounting and reporting guidance.

The FASAB standards provide GAAP covering most transactions for the federal government. However, agencies may engage in transactions that are not addressed by these standards. In that event, agencies should view the hierarchy as providing sources of GAAP for the federal government.

Accounts Payable—A10

Source: SFFAS1

Related Reference(s): G60 Governmental and Intragovernmental Assets and Liabilities; O40 Other Current Liabilities; L40 Liabilities

Summary

Accounts Payable are to be recognized for an entity's liability for goods and services received, or work progress made by a contractor, for which payment has not been made. Accounts Payable for intragovernmental transactions are reported separately from amounts owed to the public.

Accounts Payable

.100 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. [SFFAS1, ¶74]

.101 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 O40.) [SFFAS1, ¶75]

.102 Amounts owed for goods or services received from federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public. [SFFAS1, ¶76]

.103 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. [SFFAS1, ¶77]

.104 When a contractor provides the government with goods that are also suitable for sale to others, the 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. [SFFAS1, ¶78]

.105 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. [SFFAS1, ¶79]

.106 The reporting entity should disclose accounts payable not covered by budgetary resources. [SFFAS1, ¶80]

Advances and Prepayments—A30

Source: SFFAS1

Related Reference(s): G60 Governmental and Intragovernmental Assets and Liabilities; O40 Other Current Liabilities; L40 Liabilities

Summary

Advances and prepayments are cash outlays made before expenses are incurred. They should be recorded as assets and reduced when the goods and services are received and expenses incurred.

Advances and Prepayments

.100 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 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. [SFFAS1, ¶57]

.101 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. [SFFAS1, ¶58]

.102 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. [SFFAS1, ¶59]

.103 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 O40 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). [SFFAS1, ¶60]

.104 Advances and prepayments made to federal entities are intragovernmental items and should be accounted for and reported separately from those made to nonfederal entities. [SFFAS1, ¶61]

Budgetary Information—B60

Source: SFFAS7; SFFAS22

Related Reference(s): R40 Revenue, Gains & Losses, and Other Financing Sources

Summary

Both budget information and operating performance (i.e., proprietary) information is required 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. 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. FASAB, therefore, amended Concept Statement 2, "*Entity and Display*" 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. [1] As a result of the amendments, budgetary Information is recognized and reported in both the Statement of Budgetary Resources and the new statement, the Statement of Financing.

This section includes the provisions of SFFAS7 that relate to budgetary information and a glossary of budgetary terms used in this and other sections of this volume. For further information, see SFFAC 2.

Budgetary Information

.100 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:

[1] SFFAS7 amends the FASAB's Concepts Statement 2 by adding Concepts for Reconciling Budgetary and Financial Accounting. See SFFAC 2's Section, "Displaying Financial Information."

(a) total budgetary resources available to the reporting entity during the period;

(b) the status of those resources (including “obligations incurred”);

(c) outlays. [SFFAS7, ¶77]

.101 Recognition and measurement of budgetary resources should be based on budget concepts and definitions contained in OMB Circulars A-11, *Preparation and Submission of Budget Estimates*. 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. [SFFAS7, ¶78]

.102 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 .103 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. [SFFAS7, ¶79]

.103 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-11. 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. [SFFAS7, ¶80, as amended by SFFAS22, ¶6]

.104 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). [SFFAS7, ¶81]

.105 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. [SFFAS7, ¶82]

Reconciling Budgetary and Financial Accounting

.106 The Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display*[2], 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[3] 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. [SFFAS7, ¶88]

[2] See SFFAC 2, Entity and Display.

[3] SFFAC 2 includes example formats for the Statement of Financing.

Glossary

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-11, Preparation and Submission of Budget Estimates)

Appropriation – In most cases, appropriations are a form of budget authority provided bylaw 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.

Authority To Borrow – Authority to borrow is a subset of budget authority. (See budget authority.)

Basic Financial Statements – As used in SFFAS7, 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 collections) and net (with reductions of offsetting collections). (OMB Circular A-11; 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, Paragraphs 45-46, 112-114, and 186-191.)

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. (GAO Budget Glossary)

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. (Budget Glossary.)

Contract Authority – Contract authority is a subset of budget authority. (See budget authority.)

Expended Appropriations – The dollar amount of appropriations used to fund goods and services received or benefits or grants provided.

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)

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)

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.)

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. (GAO Budget Glossary)

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

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)

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 Budget Glossary)

Unobligated Balances – Balances of budgetary resources that have not yet been obligated. 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. (JFMIP Standardization Project and Budget Glossary)

Cash—C20

Source: SFFAS1

Related Reference(s): E30 Entity and Non-Entity Assets; F50 Fund Balance with Treasury; G60 Governmental and Intragovernmental Assets and Liabilities

Summary

Cash, including imprest funds, should be recognized as an asset.

Cash

.100 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. [SFFAS1, ¶27]

Entity Cash

.101 Entity cash is the amount of cash that the reporting entity holds and is authorized by law to spend. [SFFAS1, ¶28]

Non-Entity Cash

.102 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. [SFFAS1, ¶29]

Restricted Cash

.103 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. [SFFAS1, ¶30]

Cleanup Costs—C40

Source: SFFAS5, SFFAS6; TR2

Related Reference(s): L40 Liabilities; G20 General Plant, Property, and Equipment

Summary

Cleanup costs are the costs associated with hazardous waste removal, containment, or disposal. In some instances, the Federal Government incurs liabilities[1] 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 FASAB's standards for liabilities (SFFAS5) which address liabilities for environmental cleanup resulting from an accident, natural disaster, or other one-time occurrence do not address inter-period cost allocation when cleanup relates to operations that span many periods. Therefore, the Board chose to provide additional guidance relative to cleanup costs in SFFAS6. The additional standards in SFFAS6 provide for the timing of recognition of the liability and related operating expense.

For cleanup costs associated with general PP&E, probable[2] and measurable cleanup costs shall be allocated to operating periods benefiting from operations of the general PP&E. This 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.

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[1] 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.

[2] 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 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.

For cleanup costs associated with stewardship PP&E,[3] 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.

This section also includes non-authoritative guidance related to recognition and reporting of cleanup costs.

Cleanup Costs

.100 Cleanup costs are the costs of removing, containing, and/or disposing of (1) hazardous waste (See paragraph .101) from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. [SFFAS6, ¶85]

.101 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, 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. [SFFAS6, ¶86]

.102 Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post closure costs. [SFFAS6, ¶87]

.103 SFFAS6 provisions related to cleanup costs apply 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).[4] These cleanup costs meet the

[3] Stewardship PP&E, consists of heritage assets (Section H20), and stewardship land (Section S60).

[4] 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. FASAB plans to monitor these changes and revisit these standards as needed.

definition of liability provided in Statement of SFFAS5, *Accounting for Liabilities of the Federal Government. (See Volume 2, L40.)* [SFFAS6, ¶88]

.104 However, due to the nature of the liability and the timing associated with cleanup costs, additional guidance is provided in SFFAS6 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. [SFFAS6, ¶89]

.105 The guidance in SFFAS6 is intended to supplement the accounting requirements for liabilities in SFFAS5. That standard defines liabilities as a "probable future outflow or other sacrifice of resources as a result of past transactions or events." Further, SFFAS5 requires recognition of liabilities that are probable and measurable. Measurable means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable. [SFFAS6, ¶90]

.106 The recognition and measurement standards provided in SFFAS6 are subject to the criteria for recognition of liabilities included in SFFAS5.[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,[6] and
- the future outflow or sacrifice of resources is measurable.[7] [SFFAS6, ¶91]

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[5] SFFAS5 guidance applies to Government-related events including 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. See Section L40, paragraphs 109-.112 in this Volume.

[6] Probable means that the future confirming event or events is more likely than not to occur.

[7] 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.

.107 SFFAS5 also provides for disclosure of liabilities that do not meet all of the above criteria; these standards apply to cleanup costs as well. [SFFAS6, ¶92]

.108 Certain 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 SFFAS6. SFFAS6's 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.[8] [SFFAS6, ¶93]

Recognition and Measurement

Estimation Methods

.109 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. [SFFAS6, ¶94]

.110 The estimate shall contemplate:

- the cleanup plan, including level of restoration to be performed, current legal or regulatory requirements,[9] 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. [SFFAS6, ¶95]

[8] 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.

[9] Laws and regulations approved as of the balance sheet date, regardless of the effective date of those laws and regulations, shall be considered.

.111 Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology.[10] New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing. [SFFAS6, ¶96]

Cleanup Cost for General PP&E

.112 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. [SFFAS6, ¶97]

.113 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. [SFFAS6, ¶98]

.114 As re-estimates (See paragraph .115) are made, 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. [SFFAS6, ¶99]

.115 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. [SFFAS6, ¶100]

[10] SFFAS4, Managerial Cost Accounting, discusses costs related to facility abandonments in paragraph 104 of the statement: "A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. … Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that 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. (See Subject Area Section M20.141.)

Cleanup Cost for Stewardship PP&E

.116 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. [SFFAS6, ¶101]

.117 The liability shall be adjusted when the estimated total cleanup costs are re-estimated as described in paragraph .115. Adjustments to the liability shall be recognized in expense as "changes in estimated cleanup costs from prior periods." [SFFAS6, ¶102]

.118 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. [SFFAS6, ¶103]

Implementation Guidance

.119 Two implementation approaches have been provided for liabilities related to general PP&E in service at the effective date of SFFAS6:

- A liability shall be recognized for the portion of the estimated total cleanup 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 .116 through .118.
- 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 re-estimates occur and the liability balance adjusted. The provisions for cost allocation provided in paragraphs .116 through .118 shall not apply under this implementation method. [SFFAS6, ¶104]

.120 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. [SFFAS6, ¶105]

.121 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. [SFFAS6, ¶106]

Disclosure Requirements

.122 The sources (applicable laws and regulations) of cleanup requirements. [SFFAS6, ¶107]

.123 The method for assigning estimated total cleanup costs to current operating periods (e.g., physical capacity versus passage of time). [SFFAS6, ¶108]

.124 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). [SFFAS6, ¶109]

.125 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. [SFFAS6, ¶110]

.126 The nature of estimates and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. [SFFAS6, ¶111]

Revenue Recognition

.127 SFFAS7 addresses reimbursement for cleanup costs and provides that "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." [SFFAS7, ¶292]

Cleanup Costs—Technical Guidance

Federal Financial Accounting and Auditing Technical Release No. 2: Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government

.3000 Federal agencies are required to recognize a liability when a future outflow or other sacrifice of resources as a result of past transactions or events is "probable" and "reasonably estimable." Technical Release is intended to assist federal agencies in determining probable and reasonably estimable liabilities related to their environmental cleanup responsibilities.

.3001 This technical release includes two sections and an appendix. Section 1 will help an agency determine whether its environmental contamination meets the definition of probable (i.e., a future outflow of resources will be required to clean up the contamination). Section 2 offers guidance in quantifying an agency's liability for cleanup. Appendix I lists key laws and regulations relating to environmental contamination.

Section 1: Determining "Probable" Environmental Liabilities

Description of Issue

.3002 An agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable.

.3003 Concerns have been raised about when costs associated with environmental damage meet the probable and reasonably estimable criteria. Probable is related to whether a future outflow will be required.[11] This section[12] addresses only the “probable” part of this requirement; reasonably estimable will be addressed in Section 2.

Key Determinants and Positions

.3004 Various key factors (tests) must be considered in determining whether a future outflow of resources from a federal agency for environmental cleanup is probable. The factors are:

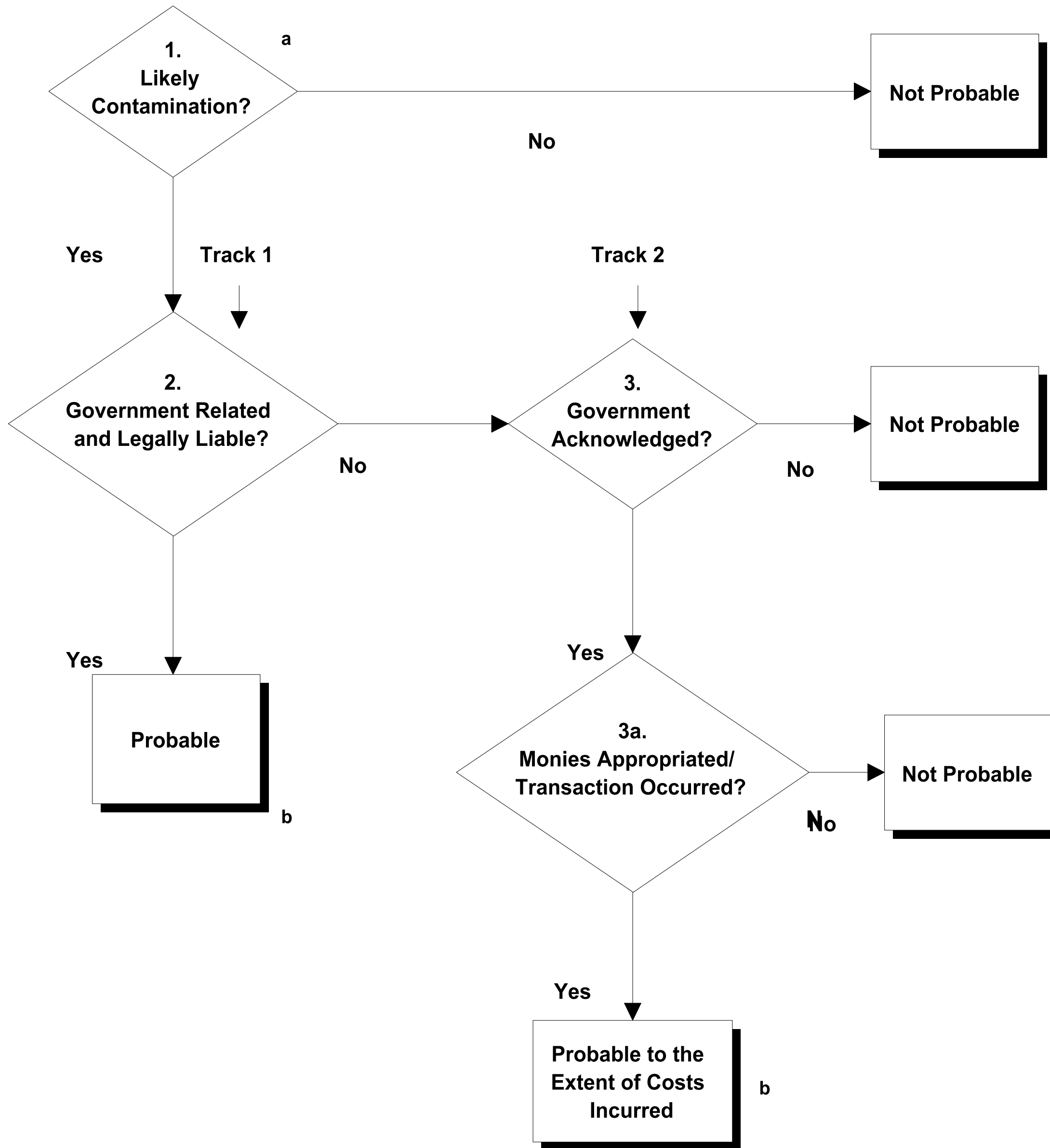
1. Likely Contamination,
2. Government Related and Legally Liable,
3. Government Acknowledged Financial Responsibility, 3a. Monies Appropriated/Transaction Occurred, and
4. No Known Remediation Technology Exists.

[11] SFFAS4, Managerial Cost Accounting, discusses costs related to facility abandonments in paragraph 104 of the statement: “A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. … Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that 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. (See Subject Area Section M20.141.)

[12] SFFAS4, Managerial Cost Accounting, discusses costs related to facility abandonments in paragraph 104 of the statement: “A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. … Other non-production costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that 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. (See Subject Area Section M20.141.)

.3005 Diagram 1.1 illustrates the above tests. These tests for probability assume that a past transaction or event has occurred (i.e., past or present operation, contribution and/or transportation of waste), and apply to both active and closed sites. A narrative discussion of each of these tests for probability follows on Diagram 1.1.

Diagram 1.1: Determination of Probable Environmental Liabilities



a. See discussion on “due care”.

b. If *no known technology exists*, then it would be probable to the extent of any required study costs,costs associated with containment, or any other monies obligated or spent. However, given that the actual remediation is not feasible, the actual remediation costs would not meet the probable criteria.

.3006 Diagram 1.1 shows that there are two primary tracks for determining whether a federal agency's environmental responsibilities meet the probable criterion. The first track is when contamination is known, is related to federal government operations, and represents a legal liability. The second track is when the federal government knows of contamination, and although the contamination is not government related and the government is not legally liable, the government acknowledges financial responsibility for cleanup. For both tracks, if no known technology exists, then the probability criterion is met only to the extent of likely expenditures (e.g., for study costs and containment). A more detailed discussion of the various components of Diagram 1.1 follows.

1. **Likely Contamination**: If the agency has exercised due care in determining the presence of contamination and as a result, believes it is unlikely that contamination (for which it is responsible) exists, then the probability criterion is not met. However, if the relevant agency is aware of contamination, having used the due care criteria (see below), then the agency must determine whether the contamination is government related and the federal government (i.e., the agency) is legally liable.

   Due care refers to a reasonable effort to identify the presence or likely presence of contamination. Due care is considered to be exercised if an agency has effective policies and procedures in place to routinely attempt to identify contamination and forward that information to the responsible agency official. Procedures that are evidence of the exercise of due care may include, but are not limited to, the following:

   - review of recorded chain-of-title documents (including restrictions, covenants and any possible liens) and good faith inquiry and investigation into prior uses of the property
   - investigation of aerial photographs *that are available through government agencies* that may reflect prior uses;
   - analyses to estimate the existence of uninvestigated sites based on information from known sites;
   - inquiry into records *that are available* from federal, state, and/or local jurisdictions that show whether

there has been a release or potential release of hazardous substances on the property (and adjacent property, if suspected contaminators exist);
- visual site inspection of any portions of the property where environmental contamination is likely or suspected, and
- investigation of complaints regarding abnormal health conditions.

2. **Government Related and Legally Liable[13]:** As it relates to environmental damage/contamination, government related events are those where a governmental entity either *caused* contamination (i.e., contribution of waste)or is otherwise related to it in such a way that it is legally liable to clean up the contamination. If the agency believes it is more likely than not that it will be legally liable, then the probability criterion is met.[14]

3. **Government Acknowledged Financial Responsibility:** If environmental contamination is not government related, then the agency, under its statutory programmatic authority, must determine whether it is authorized to formally accept financial responsibility for cleanup.[15] If the government does not accept financial responsibility, then the probability criterion is not met.

[13] Legally liable is defined, generally, as any duty, obligation or responsibility established by a statute, regulation, or court decision, or where the agency has agreed, in an interagency agreement, settlement agreement, or similar legally binding document, to assume responsibility for cleanup costs. Legal liability should be determined in consultation with the entity's legal counsel. [See American Bar Association's (ABA) Statement of Policy Regarding Lawyers Responses to Auditors' Request for Information (December 1975). Also see American Institute of Certified Public Accountants (AICPA) Professional Standards, Auditing Standards (AU) Section 337C — source SAS No. 12.] See Subject Area Section L40 in this Volume.

[14] Federal entities should consider the Environmental Protection Agency's (EPA) National Priorities List [which identifies "potentially responsible parties" (PRP)] when determining probability.

[15] 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. SFFAS5,¶ 30.

3a. **Monies Appropriated/Transaction Occurred:** If an agency accepts financial responsibility under No. 3 above,[16] then the agency determines the extent of probability based on appropriation or authorization legislation and whether a transaction has occurred causing another party to expect payment (e.g., contractor has performed cleanup of a site). For example, if the federal government has acknowledged responsibility for cleaning up a site, the cost of which is at $10 million, and $2 million has been appropriated but only $1 million in services have been rendered, probable is only met to the extent of $1 million. In the case of government acknowledged events, both conditions (i.e., appropriations or authorization and transaction executed) must exist for the probability criterion to be met.

4. **No Known Remediation Technology Exists:** In the case of a government related event, where there is no known technology to clean up a particular site, then known costs, for which the entity is responsible, such as a remedial investigation/feasibility study (RI/FS) and/or costs to contain the contamination, meet the probability test. With no known remediation technology, actual remediation is not feasible and therefore the outflow of resources for remediation is not probable.

[16] This Technical Release does not propose a position regarding environmental contamination caused by natural disasters which may become the responsibility of the Federal Emergency Management Agency (FEMA).

Section 2: Determining "Reasonably Estimable" Environmental Liabilities

Description of Issue

.3007 An agency is required to recognize a liability for environmental cleanup costs resulting from past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. Concerns have been raised about *when* costs associated with environmental damage meets the probable and reasonably estimable criteria. Reasonably estimable relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required. This section addresses only the "reasonably estimable" part of this requirement; probable was addressed in Section 1.[17]

Key Determinants and Positions

.3008 Various key factors (tests) should be considered in determining whether future outflows of resources can be reasonably estimated. The factors are:

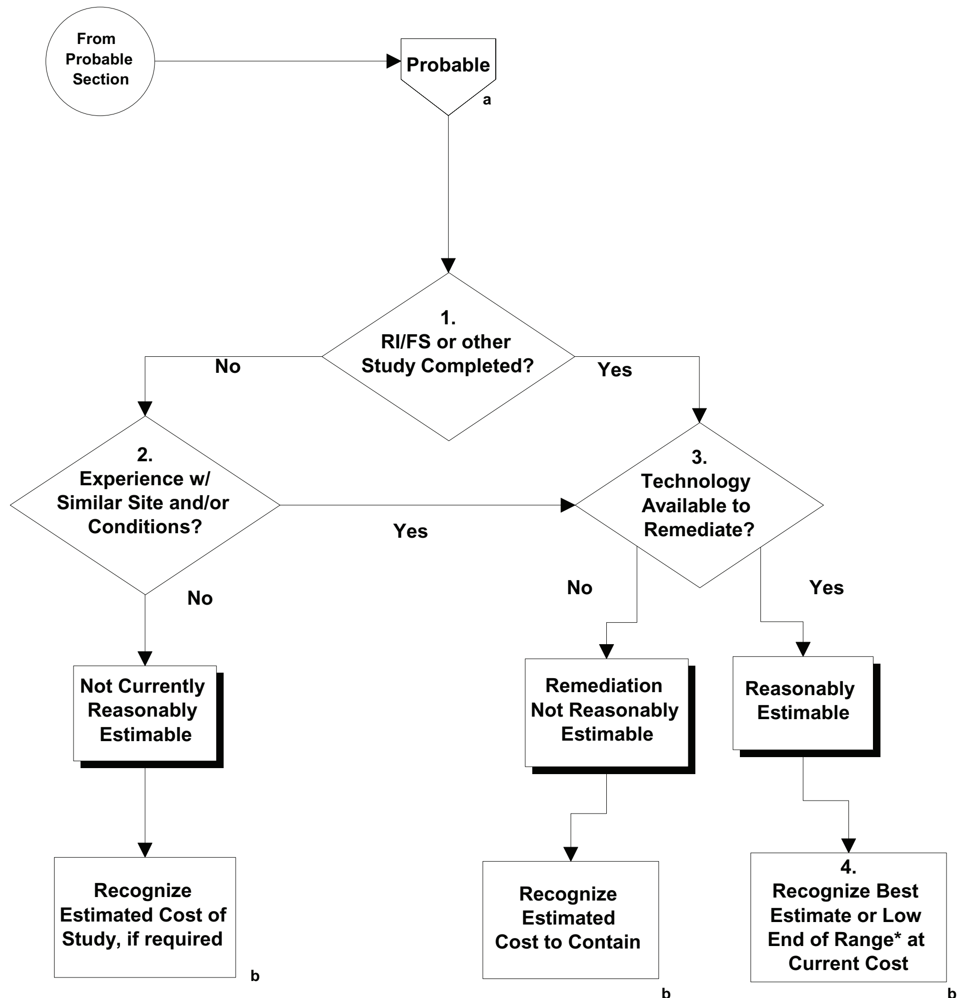
1. Completion of a Remedial Investigation/Feasibility Study (RI/FS)[18] or other Study,
2. Experience with Similar Site and/or Conditions, and
3. Availability of Remediation Technology.

[17] Disclosure requirements when the criteria for reasonably estimable are not met are as follows:
- the nature of the environmental damage 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.

[18] A remedial investigation/feasibility study (RI/FS) is a comprehensive environmental data collection and site characterization study (RI) that evaluates alternative cleanup actions and recommends one (FS).

.3009 These tests for reasonably estimable are applied after a transaction or event has occurred that meets the definition of "probable" as discussed in Section 1; tests apply to both active and closed sites. The analysis should consider all significant sites, with the information rolled up into an entity wide estimate. Cost estimates should be based on current technology. Diagram 2.1, below, illustrates the application of these tests. A discussion of each of the three tests follows Diagram 2.1. The discussion concludes with issues related to quantification of the estimate and guidance for active sites. Overall, it must be emphasized that every effort should be made to develop an estimate.

Diagram 2.1: Determination and Quantification of Reasonably Estimable Environmental Liabilities



[a] Probable refers to track 1 (government related) which is found in Section 1. Track 2 (government acknowledged) is not applicable.

[b] With all tracks, see SFFAS #6 PAR. 107-111 and SFFAS #5 par. 40-42 for disclosure requirements.

.3010 Diagram 2.1 begins with the assumption that costs associated with environmental damage has already met the test for probable. This is a direct continuation of the left-side track of Diagram 1.1 on the definition of probable (i.e., the agency has met probable under government related and is legally liable; see Section 1). As it relates to the "probable" second track (i.e., government acknowledged), probable is only met to the extent that monies have been appropriated or authorized (through authorization legislation) and costs have been incurred (e.g., services rendered). In these situations, a definitive dollar figure has already been determined and an estimate is not required. Therefore, the following discussion refers to determining whether something is "reasonably estimable" only as it relates to government related and legally liable.

1. **Completion of RI/FS or other Study:** The first test in determining whether costs are reasonably estimable is to ascertain whether there is a completed study upon which to base an estimate. For example, if a remedial investigation/ feasibility study (RI/FS) has been completed for a particular site, the RI/FS would form the basis upon which to begin estimating the liability.

   The fact that an agency does not have a *department- wide* comprehensive study completed does not exempt an agency from making its best effort to estimate a liability for financial statement purposes, or for recognizing a liability for that portion of its obligation that can be estimated.

   If the results of the study indicate that no contamination exists, then probability is not met and the decision process of Diagram 2.1 should be considered complete.

2. **Experience With Similar Site and/or Conditions**: If no study has been completed, the next test is to determine whether a site appears to be similar to any other site or condition where experience has been gained through either a completed study or actual remediation. Similar sites or conditions could be related to other federal entities or private sector corporations. A "site" is defined as a physical place where contamination has occurred. A "location" can be composed of many sites; a site can contain many "conditions." It may be practical for an agency to combine similar conditions or sites into one large site or location.

If there is a similar site or condition with experience gained (through actual cleanup and/or a completed study to compare), the estimate for recognizing a liability for a site could be based on the similar experience or conditions. In addition, the estimated cost of a future study (if required) should be recognized. Future studies could result in improved estimates. If there is no comparable site and/or condition, remediation costs for a site would not be considered reasonably estimable at that time, but the agency would recognize the anticipated cost of conducting a future study, if required, plus any other identifiable costs.

3. **Availability of Remediation Technology**: Assuming a study has been completed, or an agency or other entity has experience with a similar site and/or condition as noted above, the next test is whether there is technology available to remediate a site. If no remediation technology exists, then remediation costs would not be reasonably estimable, but the agency would be required to recognize the costs to contain the contamination and any other relevant costs, such as costs of future studies. If technology is available, then remediation costs are reasonably estimable, and the agency would recognize the best estimate at current cost. If no amount within a range of estimates is a better estimate than any other amount, the minimum amount in the range would be recognized. If the estimate is based on similar site criteria, the agency would also recognize the anticipated cost of its own RI/FS or other study, if required.

In certain instances, the RI/FS or other study may conclude that even though technology *does* exist to remediate, containment should be considered as one of the options by the agency. If the agency has yet to make a decision and they may in fact choose containment rather than remediation, and assuming containment is not precluded by other involved parties (i.e., by EPA, individual states and/or local jurisdictions), the agency would consider the estimated cost of containment when calculating the estimated costs to be recognized or disclosed. The agency would calculate an amount to be recognized based on the type and length of containment required.[19]

If management has not determined what remedial action should be taken for a contaminated *active* site, the cost of containment at the end of the facility's useful life, plus the cost of a study, if not yet done, should be considered as the low end of the range of future estimated cleanup costs.

4. **Quantification of the Estimate**: According to paragraph 39 of the SFFAS5 on contingent liabilities, 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. According to SFFAS6, ¶95, estimated costs should be based on the cleanup plan, assuming current technology and current cost.

   Changes in environmental liability estimates related to PP&E should be accounted for in accordance with SFFAS6. For general PP&E, SFFAS6 requires that the portion of the re-estimate related to current and prior periods be recognized as an expense in the period of the change. For stewardship PP&E, SFFAS6

[19] RCRA (Resource Conservation and Recovery Act) regulations require owners of hazardous waste disposal facilities to implement post-closure maintenance and monitoring activities for a minimum of 30 years. When developing estimates of these operation and maintenance (O&M) costs, EPA generally assumes that O&M activities will be required for 30 years. In most instances, containment costs should be determined on the basis of a minimum of 30 years. It would be expected that in the case of nuclear contamination, different tri-party agreements, technical problems, or other circumstances may lead to the use of a substantially longer time frame than for typical RCRA or CERCLA (Comprehensive Environmental Response Compensation and Liability Act of 1980) sites.

requires that the change in estimate be expensed for the incremental costs identified in the re-estimate and the liability adjusted in the period of the change.

Where an agency is one of several potentially responsible parties (PRP's) under CERCLA and management has determined that more likely than not the agency is legally liable, the agency should include an estimated liability for its:

1. allocable share of the liability for a specific site, and

2. share of amounts related to the site that will not be paid by other PRP's.[20]

If an agency shares responsibility with nongovernmental PRP's for a government related event, the agency should recognize the share that management believes it is more likely than not the agency is legally liable for.[21] Where the federal government shares responsibility with nongovernmental PRP's and agency management has decided to accept the nongovernmental PRP's share of the responsibility for the damage (i.e., a government acknowledged event), the agency would *also* recognize a liability for the PRP's share once the criteria of appropriation or authorization legislation and a transaction have occurred, causing another party to expect payment (e.g., contractor has performed site cleanup).

[20] AICPA Statement of Position (SOP) 96-1, Environmental Remediation Liabilities, page 43 par. 6.2.

[21] If management determines that an agency should assume responsibility for a portion of another PRP's share of the liability, the agency may recognize a receivable from the other PRP when the federal entity establishes a claim to cash or other assets against the other PRP based on the related legal provisions (i.e., a legal instrument, such as a settlement agreement, or other objective, verifiable information). Losses on receivables should be recognized when it is more likely than not that the receivables will not be collected in total.

Guidance for Active Sites

.3011 Thus far, this technical release has dealt with costs for *past* environmental contamination of property, plant, and equipment (PP&E) related to active and closed sites. In addition, SFFAS6 outlines accounting treatment for *future* environmental contamination of PP&E at active sites. The following shows how environmental cleanup costs[22] for active sites should be recognized for general and stewardship PP&E under SFFAS6.

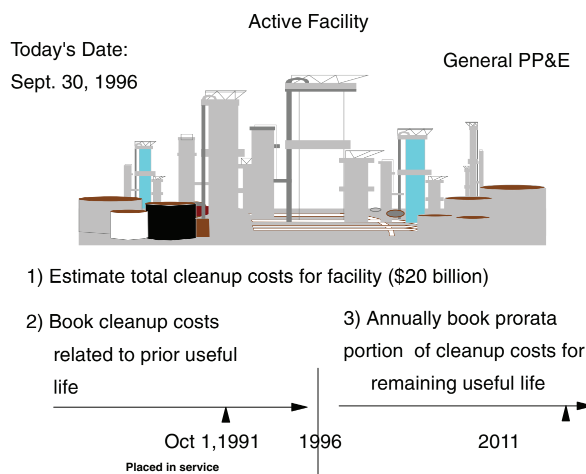
General PP&E

.3012 There are two implementation methods for general PP&E in service at the effective date of the standard. Under the first method, the agency would estimate the total cleanup costs (based on current cost to perform the cleanup[23]) that will be required at the end of the PP&E's useful life. The agency would recognize the estimated cost as a prior period adjustment for the portion of the total estimated cleanup costs related to that portion of the *PP&E's useful life that has already expired.*

.3013 To illustrate, assume implementation of SFFAS6 on October 1, 1996. Using the illustration below, and assuming a facility was placed in service at the beginning of fiscal year 1992 with a 20-year useful life, the agency would first estimate the total costs (based on current cost) required to clean up the contaminated facility at the presumed plant closure at the end of fiscal year 2011 ($20 billion). From that estimate (as of October 1, 1996), the amount that relates to that portion of the PP&E's useful life that has already expired (4/20 of $20 billion, or $4 billion) would be charged to net position and the fiscal year 1996 prorata portion would be charged to expense.

[22] Costs referred to in this section are for decontamination and decommissioning (D&D) only, not operating costs. D&D costs are those incurred after plants or equipment become inactive and require cleanup. Operating costs are period costs that flow through the Statement of Operations and Changes in Net Position. A liability is not recognized for operating costs.

[23] Current cost should be based on existing laws, technology and management plans (SFFAS6, ¶188).



.3014 Beginning with fiscal year 1997, the agency would annually recognize a prorata portion of the estimated total cleanup costs based on the remaining useful life of the subject PP&E. In our example, for fiscal year 1997, for this plant (with an estimated remaining useful life of 15 years), the agency would recognize 1/15 of the total estimated remaining cleanup cost of $15 billion, or $1 billion. The probable criterion was met under Diagram 1.1 once the PP&E was placed in service. The reasonably estimable criterion was met with the agency's development of an overall estimate of total cleanup costs using the process indicated in Diagram 2.1. Consequently, each years' allocation of cleanup costs is both probable and reasonably estimable, thus requiring the agency to recognize a liability. The allocation method used for cleanup costs, as described above, is similar to depreciation of general PP&E.

.3015 Changes in estimates of cleanup costs should be accounted for in accordance with the SFFAS6, which requires that the cumulative effect of changes in total estimated cleanup costs related to current and past operations be recognized as expense, and the liability adjusted in the period of the change in estimate.

.3016 SFFAS6 allows a second method for recognizing cleanup cost related to general PP&E in service at the effective date of the standard. The alternative method provides that "if costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total [ultimate] cleanup cost as a liability upon implementation of the standard."[24]

.3017 For general PP&E placed in service after the effective date of the standard, the agency should estimate the total cleanup costs[25] related to the PP&E and recognize annually a prorata portion of the costs over the life of the asset. Expense recognition shall begin on the date that the PP&E is placed into service.

.3018 Because contaminated land does not have a useful life and is not depreciated, it should be treated the same as the facility that is located on the land. For land contaminated in the past, a liability should be recognized for the total estimated cleanup costs. For land expected to be contaminated in the future due to ongoing operations, a portion of estimated total cleanup costs shall be recognized as expense during each period that the associated general PP&E is in operation. If no facility is associated with the land, the land should be treated as stewardship PP&E. SFFAS6 provides guidance for stewardship PP&E (see the following paragraph for a brief summary of stewardship PP&E).

Stewardship PP&E

.3019 Stewardship PP&E includes heritage assets, and stewardship land. For stewardship PP&E *already in service*, according to SFFAS6, on the day the standard is adopted or upon early implementation, the agency would charge net position through a prior period adjustment and recognize a liability for the full amount of the estimated ultimate cleanup costs. For new stewardship PP&E, the agency would

[24] SFFAS6, ¶104

[25] According to SFFAS6, ¶95 the estimate shall contemplate:
the cleanup plan, including
–level of restoration to be performed,
–current legal or regulatory requirements, 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.

recognize an expense and a liability for the total amount of estimated ultimate cleanup costs when the PP&E is placed in service. As with general PP&E, the probable criteria would be determined under Diagram 1.1 at the time the standard is adopted or new PP&E is placed in service. Likewise, the reasonably estimable criteria for the total ultimate cleanup costs would be determined based on Diagram 2.1. However, unlike general PP&E, stewardship PP&E is fully expensed once acquisition costs are incurred. SFFAS6 calls for the entire ultimate cleanup costs to be expensed when the PP&E is placed in service.

Appendix I -Relevant Laws

.3020 This appendix lists some of the laws that relate to environmental cleanup. It is not intended to be a comprehensive list of all pertinent laws. Federal agencies should check with their Office of General Counsel to determine which laws are applicable to their agency.

I. Principal Environmental Laws to Which Federal Facilities Are Subject

A. Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA, or Superfund), and subsequent amendments

1. Administered by EPA

2. Established a program to identify sites (National Priorities List)

   a. Typically abandoned or inactive sites

   b. Can be applied to sites still in operation

3. Set up trust fund to cover costs (with attempts to recover)

4. Detailed standards for remediation and settlement provisions and authorized criminal sanctions

5. Entities may have “joint and several” liability for cleanup

B. Resource Conservation and Recovery Act (RCRA)

1. Permits issued by EPA for facilities used or being used to manage hazardous waste (includes generating, treatment, storage, and disposal)

2. Covers both closed and active facilities

C. Clean Air Act

D. Clean Water Act

II. Other Environmental Laws

A. Safe Drinking Water Act

B. Toxic Substances Control Act

C. Federal Insecticide, Fungicide, and Rodenticide Act

D. Pollution Prevention Act 1990

E. Federal Facilities Compliance Act

F. Nuclear Regulatory Act and its amendments

G. Emergency Planning and Community Right-to-Know Act

IV. State laws

A. For federal cleanup activities, state standards can apply, which are at least as stringent as Federal laws

V. Foreign Laws

Cleanup Costs—Non-Authoritative Guidance

Illustration of Cleanup Cost [SFFAS6, Appendix D]

.4000 This guidance, which is in included in SFFAS6 as Appendix D, illustrates one method of complying with SFFAS5's standards 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 standard (e.g., nuclear facilities, landfills, or laboratories). Applying this standard may require consideration of estimated cost components other than those shown here. [SFFAS6, ¶234]

.4001 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. [SFFAS6, ¶235]

.4002 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[26]

c = total estimated capacity[27]

[26] 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.

[27] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

d = amount previously recognized as expense-beginning of period

e = cleanup expense recognized in the current period [SFFAS6, ¶236]

.4003 To calculate the appropriate expense amount, the following formula is used:

$$(a \times b / c) - d = e$$

[SFFAS6, ¶237]

.4004 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. [SFFAS6, ¶238]

.4005 Illustration 1: Hazardous Waste Disposal Site

Operating Assumptions

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 for 1995

Estimated Total Cleanup Cost[28] Based on Current Cost in 1995 (Dollars in thousands)	
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

SFFAS6 requires 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:

$$(a \times b / c) - d = e$$

$$(\$7{,}400 \times 15{,}000 / 100{,}000) - 0 = e$$

$$\$7{,}400 \times .15 = e$$

$$\$1{,}110 = e$$

[28] 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.

where:

a = total cleanup cost estimated as of end of period

b = cumulative capacity used at end of period[29]

c = total estimated capacity[30]

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	$1,110	
Cr. Cleanup liability		$1,110

To recognize estimated cleanup costs.

Recognition of Expense and Liability Amounts for 1996

Estimated Total Cleanup Cost Based on Current Cost in 1996 (Dollars in thousands)	
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

[29] 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.

[30] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

Estimated Total Cleanup Cost Based on Current Cost in 1996 (Dollars in thousands)	
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:

$$(a \times b / c) - d = e$$

$$(\$7{,}475 \times 25{,}000 / 100{,}000) - \$1{,}110 = e$$

$$\$7{,}475 \times .25 - \$1{,}110 = e$$

$$\$759 = e$$

where:

a = total cleanup cost estimated as of end of period

b = cumulative capacity used at end of period[31]

c = total estimated capacity[32]

d = amount previously recognized as expense-beginning of period

e = cleanup expense recognized in the current period

[31] 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.

[32] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

The following journal entry would be required:

Dr. Cleanup expense	$759	
Cr. Cleanup liability		$759

To recognize estimated cleanup costs.

In addition, the standard requires 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

Estimated Total Cleanup Cost Based on Current Cost in 1997 (Dollars in thousands)	
1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$115
Sealing site	740
Erosion and control facilities	500
2. Monitoring Cost (for a period of 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**

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:

$$(a \times b / c) - d = e$$

$$(\$5{,}605 \times 35,000 / 100,000) - (\$1{,}110 + 759)$$

$$\$5{,}605 \times .35 - \$1{,}869 = e$$

$$\$1{,}962 - \$1{,}869 = e$$

$$\$93 = e$$

where:

a = total cleanup cost estimated as of end of period

b = cumulative capacity used at end of period[33]

c = total estimated capacity[34]

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 standard requires 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 disclosed.

Changes in estimated cleanup costs from prior periods are:

$$f = (a \times b_1 / c) - d$$

[33] 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.

[34] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

$$f = (\$5,605 \times 25,000 / 100,000) + (\$1,110 + 759)$$

$$f = \$5,605 \times .25 - \$1,869$$

$$f = \$1,401 - \$1,869$$

$$f = \$(468)$$

where:

a = total cleanup cost estimated as of end of period

b_1 = cumulative capacity used at end of period[35]

c = total estimated capacity[36]

d = amount previously recognized as expense-beginning of period

f = cleanup expense recognized in the current period

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

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[35] 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.

[36] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

Summary:

Financial Statement	1995	1996	1997
Operating expense	$1,110	$ 759	$ 93
Liability	$1,110	$1,869	$1,962

[SFFAS6, ¶239]

.4007 Illustration 2: Nuclear Facility Qualifying as General PP&E

Operating Assumptions

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

Recognition of Liability Amounts for 1995

Estimated Total Cleanup Cost Based on Current Cost in 1995 (Dollars in thousands)	
1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$1,000
Sealing site	3,000
2. Monitoring Cost (for a period of 30 years):	
Inspection	6,000
Sampling & Testing	3,000
Maintenance of facilities	600

Estimated Total Cleanup Cost Based on Current Cost in 1995 (Dollars in thousands)	
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

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:

$$(a \times b / c) - d = i$$

$$(\$15{,}600 \times 15/30) - (\$0) = i$$

$$\$15{,}600 \times .5 - \$0 = i$$

$$\$7{,}800 = i$$

where:

a = total cleanup cost estimated as of end of period

b = cumulative capacity used at end of period[37]

c = total estimated capacity[38]

d = amount previously recognized as expense-beginning of period

i = liability to be recognized at the end of 1995

[37] 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.

[38] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

The following journal entry would be required:

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 Statement	1995
Prior Period Adjustment	$7,800
Liability	$7,800

[SFFAS6, ¶240]

Consolidated Financial Report of the U.S. Government—C60

Source: SFFAS24

Related Reference(s): B60 Budgetary Resources; R40 Revenue, Gains & Losses, and Other Financing Sources

Summary

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.

In addition, certain requirements of SFFAS7, *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). SFFAS7 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.

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.

Consolidated Financial Report of the U.S. Government

Standards for the Consolidated Financial Report of the U.S. Government

.100 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. [SFFAS24,¶8]

Budgetary Information Not Required for the Government as a Whole

.101 SFFAS7, ¶77-82, (See B 60) 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. [SFFAS24,¶9]

Reconciliation Information

.102 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). [SFFAS24,¶10]

.103 SFFAS24, Appendix B (¶.4000 of this section) provides an illustration of how the reconciliation data could be displayed. The illustration is not intended to be prescriptive. [SFFAS24,¶11]

Information about the Unified Budget Surplus or Deficit and Cash

.104 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:

[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*.

- 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. [SFFAS24,¶12]

.105 SFFAS24, Appendix E provides an illustration of how this information could be displayed.The illustrations are not intended to be prescriptive. [SFFAS24,¶13]

Principal Financial Statements Presented on a Comparative Basis

.106 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. [SFFAS24,¶14]

Consolidated Financial Report of the U.S. Government—Non-Authoritative Guidance

Non-Authoritative Guidance—Reconciliation

.4000 Illustrative Statement: Reconciliation [SFFAS 24, Appendix B]

Reconciliation of Net Operating Revenue (or Cost)
and Unified Budget Surplus (Or Deficit)
for the period ending September 30, 20×2
(in billions of dollars)
[Hypothetical Data]
[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]

	FY 20×2	FY 20×1
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:		

	FY 20×2	FY 20×1
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

.4001 Illustrative Statement: Statement of Changes in Cash Balance [SFFAS 24, Appendix C]

Statement of Changes in Cash Balance from Unified Budget and Other Activities for the Years Ended September 30, 20×2 and 20×1
(in billions of dollars)
[Hypothetical Data]
[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]

	FY 20×2	FY 20×1
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:		

	FY 20×2	FY 20×1
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)/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

.4002 Illustrative Statement of Budgetary Resources (from OMB Bulletin 01-09, September 25, 2001) [SFFAS 24, Appendix D]

Department/Agency/Reporting Entity Combined Statement of Budgetary Resources for the Years Ended September 30, 20×2 and 20×1

Dollars in millions

	20×2 Budgetary	20×2 Non-Budgetary Credit Program Financing Accounts	20×1 Budgetary	20×1 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

(Continued From Previous Page)

Dollars in millions

	20×2 Budgetary	20×2 Non-Budgetary Credit Program Financing Accounts	20×1 Budgetary	20×1 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	
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

.4003 Consolidated Statement of Financing [SFFAS24, Appendix E]

Department/Agency/Reporting Entity CONSOLIDATED STATEMENT OF FINANCING
For the Years Ended September 30, 20×2 and 20×1 (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

	20x2	20x1
Components of the Net Costs of Operations that will not Require or Generate Resources in the Current Period	xxx	xxx
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 required or generate resources in the current period	xxx	xxx
30. Net Cost of Operations	x,xx	x,xxx
	xxx	xxx

Glossary

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."]

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.

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.]*

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 SFFAS7, *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."]

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

Deferred Maintenance—D20

Source: SFFAS6; SFFAS14

Related Reference(s): G60 General Property, Plant, and Equipment; L10 Land; S60 Stewardship Land; S70 Stewardship Reporting

Summary

The deferred maintenance standards require disclosures related to the condition and the estimated cost to remedy deferred maintenance of PP&E. The requirements apply to all PP&E whether reported on the balance sheet or through supplementary stewardship reporting. The required 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.

The standards recognize that there are many variables in estimating deferred maintenance amounts. They also acknowledge that condition rating is a management function 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.

Deferred Maintenance

Definition

.100 "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. [SFFAS6, ¶77]

.101 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.[1] Maintenance excludes activities aimed at expanding

[1] 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.

the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended. [SFFAS6, ¶78]

Measurement

.102 Amounts reported for deferred maintenance may be measured using:

a. condition assessment surveys, or

b. life-cycle cost forecasts.[2] [SFFAS6, ¶80 as amended by SFFAS14, ¶6]

.103 *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.[3] [SFFAS6, ¶81]

.104 *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. [SFFAS6, ¶82]

Required Supplementary Information [SFFAS14, ¶7]

.105 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).

[2] 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.

[3] 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.

- Identification of each major class[4] 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[5] and a range or a point 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 amounts deemed necessary by the managers of the PP&E,[6] and

[4] "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.

[5] 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.

[6] 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.

- the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance. [SFFAS6, ¶83 amended by SFFAS14, ¶8]

Optional Information

.106 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 critical and noncritical amounts, the information shall include management's definition of these categories. [SFFAS6, ¶84 as amended by SFFAS14, ¶9]

Deferred Mainenance—Non-Authoritative Guidance

Deferred Maintenance Illustrations

.4000 The example shown in this section is for illustrative purposes only. Different entities may develop different asset categories, condition codes and descriptive terminology. The Board intended that the deferred maintenance standards provide reporting 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 been no material changes in these standards in recent years.

The following chart presents information on deferred maintenance on major categories of PP&E experiencing material amounts of deferred maintenance:

Category	Method	Asset Condition[1]	Cost to Return to Acceptable Condition[2]	Critical	Non-Critical
Buildings	Condition Assessment Survey	4	$100,000 – 125,000	$75,000	$25 – 50,000
Communication Equipment/ Systems	Condition Assessment Survey	4, 5	$10,000 – 15,000	$2,000	$ 8 – 13,000
Laboratory Equipment	Condition Assessment Survey	5	$500,000 – 550,000	$300,000	$200 – 250,000
Heating & Air Conditioning Equipment	Condition Assessment Survey	5	$40,000 – 42,000	$5,000	$35 - 37,000

Note 1: Condition rating scale	
Excellent	1
Good	2
Fair	3
Poor	4
Very poor	5

Note 2: Acceptable Condition is "fair" or "3"

[SFFAS6, ¶233 Appendix C as amended by SFFAS14]

Heritage Assets – Deferred Maintenance Reporting Example

.4001 Heritage assets are PP&E that possess one or more of the following characteristics: historical or natural significance; cultural, educational or aesthetic value; or significant architectural characteristics. The cost of heritage assets is not often relevant or determinable. In addition, the useful life of heritage assets is generally not reasonably estimable for depreciation purposes. The most relevant information about heritage assets is their existence and condition. Therefore, heritage assets are reported in terms of physical units. Various agencies operate and maintain heritage assets. During the period, maintenance expense is recognized as incurred. However, certain maintenance was deferred over the past

several years. Below is information on deferred maintenance on stewardship assets.

Summary of Deferred Maintenance as of September 30, 199Z

Dollars in millions

Category	Method	Asset condition	Cost to Return to Acceptable Condition
Buildings	CAS[a]	4	$350-$450
Memorials/Monuments	CAS	4	$100-$150
Parks	CAS	4	$200-$300
Collection-type Heritage Assets	CAS	5	$25-$30

[a] Condition Assessment Survey (CAS).

[SFFAS8, Appendix B]

Glossary

Condition assessment surveys – Periodic inspections of PP&E performed to determine their current condition and estimated cost to correct any deficiencies.

Deferred maintenance – 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.

Disclosure – Reporting information in notes regarded as an integral part of the basic financial statements.

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)

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 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.

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.

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.

Entity and Non-Entity Assets—E30

Source: SFFAS1

Related Reference(s): A30 Advances and Prepayments; C20 Cash; G60 Governmental and Intragovernmental Assets and Liabilities; R10 Receivables;

Summary

Assets available to an entity to use in its operations are entity assets while those assets held by but not available to an entity, are non-entity assets. While both entity and non-entity assets are to be reported in entity statements, the standards require the segregation of entity and non-entity assets. In addition, a liability (due to Treasury or other entities) must be recognized in an amount equal to non-entity assets.

Entity Assets vs. Non-entity Assets

.100 Entity Assets are those assets which the reporting 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. [SFFAS1, ¶25]

.101 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. [SFFAS1, ¶26]

Glossary

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 FASB Concepts Statement No. 6 and Kohler's Dictionary.)

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.

Federal Debt—F10

Source: SFFAS5

Related Reference(s):

Summary

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). 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 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.

Federal Debt

.100 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.[1] [SFFAS5, ¶47]

.101 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 in a way that fairly expresses the federal government's liability. [SFFAS5, ¶48]

[1] 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.

Accounting for Federal Debt Securities

.102 Federal debt securities fall into two major categories for accounting purposes: fixed value securities and variable value securities.[2] [SFFAS5, ¶49]

Fixed Value Securities

.103 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.[3] 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. [SFFAS5, ¶50]

.104 In all other cases, the interest method for amortizing any discount or premium should be used. [SFFAS5, ¶51]

Variable Value Securities

.105 Variable value securities 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. These securities should be originally valued and periodically revalued at their current value, on the basis of the regulations or offering language. [SFFAS5, ¶52]

Related Interest Cost

.106 The related interest cost of the federal debt includes:

[2] Section F10.3000 lists various categories and examples of federal debt securities.

[3] For an explanation and an example of the interest method of amortization, see I80 Investments in Treasury Securities, paragraphs .111 and the accompanying non-authoritative guidance at I80.4000 et seq.

- 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. [SFFAS5, ¶53]

Retirement Prior to Maturity

.107 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. [SFFAS5, ¶54]

Old Currencies Issued by the Federal Government

.108 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 bear any interest.[4] [SFFAS5, ¶55]

[4] 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.

Federal Debt—Non-Authoritative Guidance

.4000 Various Categories and Examples of Federal Debt Securities[5]

Federal Debt Instruments

Debt Category	Subcategory	Term	Redeemable	Accounting Method
Marketable Debt	Treasury Bills	Up to 1 yr	At maturity	Liability at face value net of unamortized discount Straight line method of amortization of discount
	Treasury Notes	2 to 10 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
	Treasury Bonds	10 to 30 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
Non-Marketable Debt	**Government Account Series:**			
	Par Values	Various	On demand	Par value, no discount or premium to be amortized
	Market Based	Various	On demand	Liability at face value net of unamortized discount and premium Interest method of amortization of discount and premium
	U.S. Savings Bonds:			
	E/EE bonds	10 to 40 yrs	On demand after 6 months	Current value
	H/HH bonds	10 to 30 yrs	On demand after 6 months	Par value, no discount or premium to be amortized
	State & Local Government Securities	Various	On demand	Par value, no discount or premium to be amortized
	Domestic Series:			
	Zero-Coupon bonds	20 to 40 yrs	At maturity	Liability at face value net of unamortized discount Interest method of amortization of discount

[5] These tables are intended to illustrate current practice only and are not to be considered authoritative.

Debt Category	Subcategory	Term	Redeemable	Accounting Method
	Foreign Series:			
	Treasury bills	Up to 1 yr	On demand	Liability at face value net of unamortized discount Straight line method of amortization of discount
	Zero-Coupon bonds	20 to 30 yrs	At maturity (1 bond)	Liability at face value net of unamortized discount Interest method of amortization of discount
			On demand (2 bonds)	Current value

[SFFAS5, Figure 2]

.4001 Liability Recognition and Measurement - Federal Debt

Federal Program Categories		Expense	Liability
Federal debt	• Treasury debt to federal agencies • Federal agency debt to the Treasury • Federal debt to the public	Recognize accrued (prorated) share of the nominal interest incurred during the accounting period, amortized discount or premium, and the amount of any change in current value for the accounting period for variable-value securities.	Recognize a liability at the par value of the security net of any unamortized discount or premium.

[SFFAS5, Appendix B]

Glossary

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 Sections I60, Interest Payable; I80 Investment in Treasury Securities, and R10 Receivables)

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.

Fund Balance with Treasury—F50

Source: SFFAS1

Related Reference(s): C20 Cash; B60 Budgetary Information; G60 Governmental and Intragovernmental Assets and Liabilities

Summary

An agency's Fund Balance with Treasury is an intragovernmental asset created by budget authority. 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, and amounts invested in securities, amounts of appropriations cancelled or rescinded, and amounts transferred to other agencies or to the Treasury. An entity's fund balance does not necessarily equate to an entity's budgetary resources; for example, an agency's fund balance with Treasury does not include contract authority and unused authority to borrow.

Fund Balance with Treasury

.100 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. [SFFAS1, ¶31]

.101 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 also includes balances for direct loan and loan guarantee activities held in the credit reform program, financing, and liquidating accounts. [SFFAS1, ¶32]

.102 An entity's fund balance with Treasury is increased by (a) receiving appropriations, re-appropriations, 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. [SFFAS1, ¶33]

.103 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 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.[1] 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. [SFFAS1, ¶34]

.104 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 fund balance with Treasury only to the extent that funds are actually borrowed under the authority. [SFFAS1, ¶35]

.105 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. [SFFAS1, ¶36]

.106 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

[1] Source of definition: OMB Circular A-11

balance not yet disbursed is the amount of funds against which budgetary obligations have been incurred, but disbursements have not been made. [SFFAS1, ¶37]

.107 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. [SFFAS1, ¶38]

.108 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. [SFFAS1, ¶39]

Glossary

Allocations – In the context of budgetary accounting, 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)

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 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-11.], 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 collections credited to an appropriation or fund account, (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations, 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. (Budget Glossary.)

Contract Authority – Contract authority is a subset of budget authority. (See budget authority.)

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)

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.)

Re-appropriation – Enacted legislation that continues the availability of unexpended funds that expired or would otherwise expire. (JFMIP Standardization Project)

Reimbursements – Sums received as payment or advance payment for goods or services furnished either to the public or to 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. 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. (JFMIP Standardization Project and Budget Glossary)

General Property, Plant, and Equipment—G20

Source: SFFAS6, as amended by SFFAS10, SFFAS14, SFFAS16, and SFFAS23

Related Reference(s): C40 Cleanup Costs; D20 Deferred Maintenance; H20 Heritage Assets; L10 Land; L20 Leases; N60 Non-federal Physical Property; S60 Stewardship Land

Summary

General PP&E category consists of items 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; or
- are used by entities in activities whose costs can be compared to other entities (e.g., Federal hospitals compared with other hospitals).

The category General PP&E also includes land acquired for or in connection with other general PP&E.

General PP&E shall be reported in the basic financial statements: the balance sheet, and the statement of net cost. The acquisition cost of general PP&E shall be recognized as an asset. Subsequently, except for land which is a nondepreciable asset, that acquisition cost shall be charged to expense through depreciation. The depreciation expense shall be accumulated in a contra asset account—accumulated depreciation.

General Plant, Property, and Equipment

Definitions

.100 Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives 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. [SFFAS6, ¶17]

.101 Property, plant, and equipment also includes:

- assets acquired through capital leases, 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.[1] [SFFAS6, ¶18]

.102 Property, plant, and equipment excludes items (1) held in anticipation of physical consumption such as operating materials and supplies[2] and (2) the Federal entity has a reversionary interest in.[3] [SFFAS6, ¶19]

[1] "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.

[2] Accounting for operating materials and supplies is addressed in Statement of Federal Financial Accounting Standards No. 3 Accounting for Inventory and Related Property. (See Section I50 Inventories.)

[3] 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. (See N60 Non-federal Physical Property.)

Standards and Categories for Plant, Property and Equipment

.103 The following paragraphs provide recognition and measurement principles,[4] and disclosure requirements for categories of plant, property and equipment.[5] The categories identified are:

- general PP&E (including land acquired for or in connection with other general PP&E),
- heritage assets, and
- stewardship land (i.e., land not included in general PP&E). SFFAS6, ¶21, as amended by SFFAS23, ¶9]

[4] In SFFAS6, the FASAB states that capitalization thresholds should be established by Federal entities rather then 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. (SFFAS6, ¶13)

[5] Prior to the adoption of SFFAS23, categories of military plant, property, and equipment were subject to discrete reporting criteria. However, with the adoption of SFFAS23, military plant, property, and equipment is included in and recognized as general plant, property, and equipment. (See paragraphs .129 - .133.) Also, prior to the adoption of SFFAS10, internally developed computer software was subject to SFFAS6 requirements. SFFAS10 (See S50 Software.) modified those requirements.

.104 In determining which category PP&E should be placed in, it will be necessary to identify the "base unit"[6] 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).[7] SFFAS6, ¶22]

General Property, Plant and Equipment

.105 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 services, or to support the mission of the entity, or
- it is used in business-type activities,[8] or
- it is used by entities in activities whose costs can be compared[9] to those of other entities performing similar activities (e.g.,

[6] "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 SFFAS6 is limited to that specified above.

[7] 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 less detail considered does not necessarily mean that (1) accounting systems or (2) property records must follow the same level of detail.

[8] 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.

[9] FASAB 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.

Federal hospital services in comparison to other hospitals). [SFFAS6, ¶23]

.106 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. [SFFAS6, ¶24]

.107 Land and land rights acquired for or in connection with other general PP&E[10] 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. [SFFAS6, ¶25 & 68]

.108 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 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;

[10] "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.

- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.[11] [SFFAS6, ¶26]

.109 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[12] unless the net present value exceeds the fair value of the asset). [SFFAS6, ¶29]

.110 The cost of general PP&E acquired through donation, devise,[13] or judicial process excluding forfeiture (See paragraph .113) shall be estimated fair value at the time acquired by the government. [SFFAS6, ¶30]

.111 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. [SFFAS6, ¶31]

.112 The cost of general PP&E acquired through exchange[14] shall be the fair value of the PP&E surrendered at the time of exchange.[15] 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

[11] "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.

[12] See SFFAS5, Accounting for Liabilities of the Federal Government (Volume 2, Subject Area Section L40 Liabilities).

[13] A will or clause of a will disposing of property.

[14] 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 .111).

[15] 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 (See paragraph .112) and subsequently reduced to its fair value. A loss shall be recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value.

net of any accumulated depreciation or amortization. Any difference between the net recorded amount of the PP&E 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. [SFFAS6, ¶32]

.113 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* (SFFAS3).[16] Amounts recorded for forfeited assets based on SFFAS3 shall be recognized as the cost of general PP&E when placed into official use. [SFFAS6, ¶33]

.114 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. [SFFAS16, ¶9]

.115 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 SFFAS7, *Accounting for Revenue and Other Financing Sources* (Section R40 in this Volume.) . [SFFAS16, ¶11]

.116 General 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.[17] In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service,

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[16] SFFAS3 requires that forfeited real and personal property be valued at market value less an allowance for any liens or claims from a third party.

[17] 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.

at which time the balance shall be transferred to general PP&E. [SFFAS6, ¶34]

Expense Recognition

.117 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[18], except land and land rights of unlimited duration.[19] [20]

- 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 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.
- A composite or group depreciation methodology,[21] whereby the costs of PP&E are allocated using the same allocation rate, is permissible. [SFFAS6, ¶35 as amended by SFFAS23, ¶9]

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[18] 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.

[19] Land rights that are for a specified period of time shall be depreciated or amortized over that time period.

[20] SFFAS4, Managerial Cost Accounting, paragraph 102 provides the following guidance as to the recognition and reporting of depreciation expense,

> "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."

[21] 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.

.118 Depreciation expense shall be accumulated in a contra asset[22] account—accumulated depreciation. Amortization expense shall be accumulated in a contra asset account—accumulated amortization. [SFFAS6, ¶36]

.119 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. [SFFAS6, ¶37]

.120 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[23] 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. [SFFAS6, ¶38]

.121 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 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. [SFFAS6, ¶39]

[22] 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.

[23] For example, amounts realized may include cash received for scrap materials or fair value of items received in exchange for PP&E removed from service.

Implementation Guidance

.122 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). [SFFAS6, ¶40]

.123 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[24] and depreciation/amortization charged over the remaining life based on that net remaining cost. [SFFAS6, ¶41]

.124 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:

- 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). [SFFAS6, ¶42]

.125 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. [SFFAS6, ¶43]

[24] *Net remaining cost* is the original cost of the asset less any accumulated depreciation/amortization to date.

Disclosure Requirements

.126 In the period that these standards are implemented, disclosure of the adjustments, by major class[25] of PP&E, made to general PP&E and accumulated depreciation/amortization is required. [SFFAS6, ¶44]

.127 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 convertibility of general PP&E. [SFFAS6, ¶45]

.128 A footnote shall explain that financial information for multi-use heritage assets is presented in the principal statements. [SFFAS16, ¶18]

Implementation Guidance for General PP&E previously reported as "National Defense PP&E"

Initial Capitalization

.129 The initial capitalization amount for assets previously considered National Defense PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS6, as amended, and should be the initial historical cost for the items, including any major improvements or modifications. [SFFAS23, ¶10]

[25] "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.

.130 SFFAS23 recognizes that determining initial historical cost may not be practical for items acquired many years prior to the effective date of the standard in an environment in which the historical records were not required to be retained and may therefore be inadequate. [SFFAS23, ¶11]

.131 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. [SFFAS23, ¶12]

.132 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. [SFFAS23, ¶13]

.133 A contra asset account—accumulated depreciation—for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS6, as amended. (See .123-.125 above.) [SFFAS23, ¶14]

.134 For military equipment that is in service upon implementation of SFFAS23, cleanup cost liabilities should be adjusted, as needed.[26] [SFFAS23, ¶15]

Adjustment to Cumulative Results of Operations

.135 The cumulative effect of adopting SFFAS23 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

[26] Under the provisions of SFFAS6, 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 Department of Defense may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS6, as amended. (See Subject Area Section C40, Cleanup Costs in this Volume.)

statement of changes in net position, for the period the change is made. [SFFAS23, ¶16]

.136 Prior year financial statements presented for comparative purposes should be presented as previously reported. [SFFAS23, ¶17]

.137 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.[27] [SFFAS23, ¶18]

Implementation Guidance for General PP&E previously reported as "Multi-Use Heritage Assets"

.138 Implementation guidance for general PP&E, in paragraphs .122 through .126 above, is applicable to multi-use heritage assets. Entities that implemented the multi-use heritage asset standard in SFFAS8 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.[28] [SFFAS16, ¶15]

[27] SFFAS21, Reporting Corrections of Errors and Changes in Accounting Principles, paragraphs 12 and 13. (See Subject Area Section P40 Prior Period Adjustments in this Volume.)

[28] SFFAS7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, Subject Area Section R40 in this Volume).

Revenue, Gains & Losses Resulting from Property, Plant, and Equipment Transactions[29]

Sales of property, plant, and equipment

.139 SFFAS7 provides that sales of property, plant and equipment are exchange transactions, 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. [SFFAS7, ¶295]

.140 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,[31] for which the entire cost is expensed when the asset is purchased.[32] [SFFAS7, ¶296]

[29] SFFAS7 provides additional guidance related to Property, Plant and Equipment transactions; see Section R40, Revenue, Gains & Losses, and Other Financing Sources.

[30] The sales price may include the fair value of items received in exchange.

[31] The exception, stewardship PP&E, consists of heritage assets (See Section H20), and stewardship land (See Subject Area Section S60 in this Volume).

[32] SFFAS6, Accounting for Property, Plant, and Equipment, as amended by SFFAS23has divided property, plant, and equipment (PP&E) into two basic categories: general PP&E and stewardship PP&E (which consists of 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.)

Acquisition of property, plant, and equipment through exchange

.141 SFFAS6[33] and SFFAS7 provide that 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). [SFFAS7, ¶297]

.142 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.[34] 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. [SFFAS7, ¶298]

.143 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.[35] [SFFAS7, ¶299]

[33] See G20.112

[34] Ibid

[35] Ibid

Glossary

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)

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.

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.

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)

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.

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 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.

Multi-Use Heritage Assets – To clarify the meaning of the term "multi-use heritage assets," SFFAS16 defines "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."

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.

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.

Write-off – An action to remove an amount from an entity's assets or financial resources.

Goods Held under Price Support and Stabilization Programs—G40

Source: SFFAS3

Related Reference(s): I50 Inventories; L40 Liabilities; N80 Non-recourse Loans

Summary

Items acquired, held, sold or otherwise disposed of to stabilize or support market prices are to be recognized as an asset upon receipt, valued at the lower of cost or net realizable value. A loss is to be recognized If the items' net realizable value is less than cost at acquisition. Revenue is recognized upon their sale; expense is recognized upon their disposal, use or transfer.

Goods Held under Price Support and Stabilization Programs

Definition

.100 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. [SFFAS3, ¶92]

.101 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. [SFFAS3, ¶93]

.102 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. [SFFAS3, ¶94]

.103 Because nonrecourse loans and purchase agreements[1] are closely associated with the acquisition of the actual commodities, the three components of the price support program were addressed in SFFAS3. [SFFAS3, ¶95]

Recognition

.104 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. [SFFAS3, ¶99]

.105 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. [SFFAS3, ¶100]

.106 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. [SFFAS3, ¶101]

.107 At the time of acquisition and for financial statement purposes, all commodities shall be valued at the lower of cost or net realizable value. [SFFAS3, ¶104]

.108 The cost for commodities acquired via a nonrecourse loan settlement is the amount of the loan principal (excluding interest), processing and packaging costs incurred after acquisition, plus other costs (e.g., transportation) incurred in taking title to the commodity. [SFFAS3, ¶105]

.109 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. [SFFAS3, ¶106]

[1] See Subject Area Section N80 Non-recourse Loans and Purchase Agreements.

.110 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. [SFFAS3, ¶107]

.111 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. [SFFAS3, ¶108]

Disclosure Requirements

.112 Disclosure Requirements:

- 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 loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments. [SFFAS3, ¶109]

Glossary

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)

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.

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)

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)

Selling expense (cost) – Expenses incurred in selling or marketing, e.g., salaries, commissions, and promotion expenses. (Kohler's Dictionary for Accountants)

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)

Governmental and Intragovernmental Assets and Liabilities—G60

Source: SFFAS1

Related Reference(s): A10 Accounts Payable; A30 Advances and Prepayments; C20 Cash; E30 Entity and Non-entity Assets and Liabilities; F50 Fund Balance with Treasury; I50 Interest Payable; L40 Liabilities; R10 Receivables

Summary

Federal accounting 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 (persons and organizations outside the U. S. Government, either foreign or domestic). 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

Intragovernmental vs. Governmental Assets and Liabilities

Intragovernmental Assets and Liabilities

.100 Intragovernmental assets and liabilities arise from transactions among federal entities. Intragovernmental assets are claims of a federal entity against other federal entities. Intragovernmental liabilities are claims against the entity by other federal entities. [SFFAS1, ¶18]

.101 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. [SFFAS1, ¶19]

.102 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. [SFFAS1, ¶20]

Governmental Assets and Liabilities

.103 Governmental assets and liabilities 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. [SFFAS1, ¶21]

.104 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. [SFFAS1, ¶22]

.105 Governmental liabilities include accounts and interest payable to nonfederal entities, other liabilities due to nonfederal entities, and advances and prepayments received from nonfederal entities. [SFFAS1, ¶23]

.106 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. [SFFAS1, ¶24]

Heritage Assets—H20

Source: SFFAS6, SFFAS8, SFFAS16

Related Reference(s): G20 General Plant, Property, and Equipment; L10 Land; S60 Stewardship Land; S70 Stewardship Reporting

Summary

Heritage assets include PP&E that have historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are those assets possessing significant educational, cultural, or natural characteristics.

SFFAS8 *Supplementary Stewardship Reporting* requires that Heritage assets 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 are to be reported in terms of physical units rather than cost, fair value, or other monetary values.

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 – In 1999 the FASAB issued SFFAS16 *Amendments to Accounting for Property, Plant, and Equipment – Measurement and Reporting for Multi-Use Heritage Assets*. SFFAS16 amended certain standards for heritage assets in Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment*, (SFFAS6), which was issued in November 1995; and, Statement of Federal Financial Accounting Standards No. 8, *Supplementary Stewardship Reporting*, which was issued in June 1996. Specifically, the SFFAS16 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.

In SFFAS6 and SFFAS8, 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."

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.

To alleviate this inconsistency, the FASAB 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 resulting in consistent accounting for the cost of PP&E predominantly used in general government operations.

Nonetheless, in approving SFFAS16, the FASAB observed 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 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 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. (See S70 Stewardship Reporting) [SFFAS16¶27-28]

Heritage Assets

Definitions

.100 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. [SFFAS6, ¶57; SFFAS8, ¶43]

.101 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. [SFFAS6, ¶58; SFFAS8, ¶44]

.102 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. 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. [SFFAS8, ¶45]

Implementation

.103 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. [SFFAS16, ¶14]

.104 For published financial statements presenting prior year information, no prior year amounts shall be restated. [SFFAS6, ¶65]

Measurement

.105 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. [SFFAS8, ¶46]

.106 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 incurred. The cost[1] shall include all costs[2] incurred during the period to bring the item to its current condition at its initial location.[3] [SFFAS8, ¶47 as amended by SFFAS16, ¶8]

.107 With the exception of multi-use heritage assets, as stated in paragraph .110 below, no amounts for heritage assets acquired through donation or devise[4] 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. [SFFAS16, ¶10]

.108 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). [SFFAS6, ¶64]

Multi-Use Heritage Assets

.109 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

[1] For a full discussion of cost, including full cost, direct cost and indirect cost, see SFFAS4, Managerial Cost Accounting Concepts and Standards for the Federal Government (M20 in this Volume). Also, see Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

[2] 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 SFFAS6 (Subject Area Section G20 in this Volume.).

[3] See G20.108 for examples of the costs to be considered.

[4] A will or clause of a will disposing of property.

all multi-use heritage assets shall be capitalized as general PP&E and depreciated. [SFFAS16, ¶6]

Multi-Use Heritage Assets—Recognition and Measurement

.110 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. [SFFAS16, ¶9]

.111 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 SFFAS7, *Accounting for Revenue and Other Financing Sources* (Section R40 in this Volume.) . [SFFAS16, ¶11]

Multi-Use Heritage Assets – Implementation Guidance

.112 Implementation guidance for general PP&E, SFFAS6, (See Section G20, paragraphs .122.-125) is applicable to multi-use heritage assets. Entities that implemented the multi-use heritage asset standard in SFFAS8 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.[5] [SFFAS16, ¶15]

[5] SFFAS7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting. (See Subject Area R40 in this Volume.)

Minimum Reporting – Heritage Assets and Multi-Use Heritage Assets

.113 The determination of the most relevant information to be presented should be made by the preparer; however, reporting at the entity level[6] shall be more specific than at the government-wide 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) non-collection-type heritage assets, such as, parks, memorials, monuments, and buildings.

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[6] SFFAS8, ¶40 provides guidance to government corporations and other entities who may follow accounting standards promulgated by standard setting bodies other than the FASAB. For those entities, SFFAS8 indicates the following:

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 (SFFAS8) 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 Government Accountability 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.

- Description of the methods of acquisition and withdrawal of heritage assets.
- Condition[7] of the assets unless it is already reported in with the deferred maintenance information included elsewhere in the report in which case a reference to the information will suffice.
- A reference to the information if deferred maintenance is reported for the assets.[8]
- A footnote shall explain that financial information for multi-use heritage assets is presented in the principal statements. [SFFAS8 ¶50 as amended by SFFAS14¶10-11 and SFFAS16, ¶18]]

[7] 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.

[8] For guidance relating to deferred maintenance reporting, see the Deferred Maintenance standard in Accounting for Property, Plant, and Equipment SFFAS6 as amended by SFFAS14 Amendments to Deferred Maintenance Reporting. . . . (Subject Area Sections G20 and D20 in this Volume.)

Heritage Assets— Non-Authoritative Guidance

Heritage Assets – Annual Stewardship Information [SFFAS8, Appendix B]

.4000 The following are examples of heritage asset stewardship reporting included as non-authoritative guidance in SFFAS8.

Heritage Assets – Deferred Maintenance Reporting Example

.4001 Heritage assets are PP&E that possess one or more of the following characteristics: historical or natural significance; cultural, educational or aesthetic value; or significant architectural characteristics. The cost of heritage assets is not often relevant or determinable. In addition, the useful life of heritage assets is generally not reasonably estimable for depreciation purposes. The most relevant information about heritage assets is their existence and condition. Therefore, heritage assets are reported in terms of physical units. Various agencies operate and maintain heritage assets. During the period, maintenance expense is recognized as incurred. However, certain maintenance was deferred over the past several years. Below is information on deferred maintenance on stewardship assets.

Summary of Deferred Maintenance as of September 30, 199Z

Dollars in millions

Category	Method	Asset condition	Cost to Return to Acceptable Condition
Buildings	CAS[a]	4	$350-$450
Memorials/Monuments	CAS	4	$100-$150
Parks	CAS	4	$200-$300
Collection-type Heritage Assets	CAS	5	$25-$30

[a]Condition Assessment Survey (CAS).

Heritage Assets – Annual Stewardship Information Example

Heritage Assets[b] Annual Stewardship Information for the Fiscal Years Ended September 30, 199Y and 199Z

	Balance[c] 9/30/9X	Additions[d]	Deletions	Balance 9/30/9Y	Additions	Deletions	Balance 9/30/9Z
Collection-type (in thousands)							
Museum Collections	859	8	N/A[e]	867	11	N/A	878
Art Collections	327	4	N/A	331	7	N/A	338
Library Collections	96,473	2,718	554	98,637	3,180	421	101,395
Total	**97,659**	**2,730**	**554**	**99,835**	**3,198**	**421**	**102,611**
Noncollection-type							
Buildings and Structures	3,155	95	0	3,250	65	0	3,315
Memorials	22	1	0	23	1	0	24
Monuments	76	0	0	76	2	1	77
Parks	129	2	0	131	1	0	132
Battlefields	11	0	0	11	0	0	11
Preserves	10	0	0	10	2	0	12
Sea/Lakeshores	13	0	0	13	1	0	14
Parkways	4	0	0	4	0	0	4
Rivers and Systems	31	0	0	31	0	0	31
Recreational Areas	19	0	0	19	1	0	20
Other Historical Areas	27	1	0	28	2	0	30
Total	**3,497**	**99**	**0**	**3,596**	**75**	**1**	**3,670**

[b] See accompanying notes to the financial statement for the reporting of condition of Heritage Assets.

[c] Many paintings were refurbished at a cost of $5 million. Refurbishment was required because of deficient climate-control equipment.

[d] During the fiscal year, three complete collections of manuscripts and historical papers with an estimated value of $17 million were donated to the library collection.

[e] The number of deletions was negligible.

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 SFFAS4, *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.

Disclosure – Reporting information in notes or narrative regarded as an integral part of the basic financial statement. (*Revenue and Other Financing Sources*, SFFAS7)

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*)

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. (*Accounting for Selected Assets and Liabilities*, SFFAS1)

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. (SFFAS4, *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) – P&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, SFFAS6.

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.

Human Capital—H60

Source: SFFAS8

Related Reference(s): S70 Stewardship Reporting

Summary

Expenses included in calculating net cost for education and training programs that are intended to increase or 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. [SFFAS8, Chapter 6 Intro.]

Human Capital

Definition

.100 "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. [SFFAS8, ¶89]

.101 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. [SFFAS8, ¶90]

Measurement

.102 "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.[1] Amounts shall be reported in nominal dollars. [SFFAS8, ¶91]

.103 Expenses incurred for programs, contracts, or grants with split purposes[2] 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. [SFFAS8, ¶92]

.104 For years beginning after September 30, 2000,[3] 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.[4]

- "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

[1] See Managerial Cost Accounting Standards for the Federal Government, SFFAS4, (Subject Area Section M20 in this Volume) for a full discussion of Federal cost accounting principles and standards.

[2] 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.

[3] SFFAS8 was issued June 11, 1996 and made effective for years ending September 30, 1997. However, agencies were allowed three years after the Statement's effective date to implement these provisions.

[4] 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.

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. [SFFAS8, ¶93]

Minimum Reporting

.105 Minimum reporting shall consist of:

- The annual investment[5] 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 government-wide 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

[5] As defined in SFFAS8, "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, SFFAS4 (Subject Area Section M20 in this Volume).

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. [SFFAS8, ¶94]

Recommended Reporting

.106 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. [SFFAS8, ¶95]

Human Capital—Non-Authoritative Guidance

Human Capital - Annual Stewardship Information [SFFAS8, Appendix B]

.4000 The following are examples of human capital stewardship reporting included as non-authoritative guidance in SFFAS8.

Federal investment in human capital comprises those expenses for education and training programs for the general public that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal Federal education and training. Expense data are expressed in nominal dollars for the fiscal year being reported upon and the preceding 4 fiscal years.

Following is a summary of stewardship data for the program entitled, Transition Training for Former Navy Contractor Personnel[6], for the 5 fiscal years ending September 30, 199V through 199Z:

Program: Transition Training for Former Navy Contractor Personnel

Program Expenses ($000s)[a]	199V	199W	199X	199Y	199Z[b]
Counseling	$ 373	$ 508	$ 740	$ 980	$ 1,053
Education	786	2,381	3,860	5,621	7,053
Administration[c]	847	1,165	1,224	1,367	1,584
Total	**$ 2,009**	**$ 4,054**	**$ 5,824**	**$ 7,968**	**$ 9,690**
Program Outputs					
Participants Counseled	310	415	592	784	823
Participant Years of Training Delivered	162	486	787	1,147	1,432

[a] Expenses are reported on an accrual basis, including contractual amounts due for counseling services delivered and educational costs incurred by participants.

[b] Included as expenses in calculating net cost.

[c] Expenses of administration include an appropriate allocation of agency overhead costs.

Program Outcomes

Preliminary data appear to confirm that the services provided by the program accelerate the transition of participants into alternative employment; some savings are realized in the Unemployment Insurance Fund. A follow-up survey of the 415 participants in the year 199W showed that 80% were earning at least as much as they were earning in their Navy contractor positions. A more extensive evaluation, including an assessment of effects on long-term earnings, is currently planned for completion in 1999.

[6] This hypothetical program is for illustration only.

Narrative Discussion

This program was authorized in 19XX (by P.L. XX-XXX) to ease the transition into other civilian positions of skilled technical, administrative, and managerial personnel who are no longer needed in certain shipyards because of declining orders for Navy ship construction.

Eligibility is limited to those who have been employed at designated shipyards for at least 5 years, but who are not yet eligible for retirement benefits. Participants receive intensive counseling to help them develop individual transition plans. This counseling is provided by a private job placement service under contract. Participants are then reimbursed up to $5,000 per year for up to 2 years, not to exceed 80 percent of the cost of the cost of tuition, fees, books, and other student materials required for attendance at approved educational institutions.

An additional increment of education or technical training is expected to reduce the period of transitional unemployment and increase the subsequent earnings of participants.

Insurance and Guarantee Programs—I40

Source: SFFAS5; SFFAS7; SFFAS25

Related Reference(s): L40 Liabilities

Summary

All federal insurance and guarantee programs[1] (except social insurance and loan guarantee programs[2]) should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. Insurance and guarantee programs 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 information (RSI) the expected losses that are based on risk inherent in the insurance and guarantee coverage in force.

Insurance and Guarantee Programs

Nature of Federal Insurance and Guarantee Programs

.100 Insurance and guarantee programs[3] 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

[1] Social insurance is considered to be a separate program type not included within insurance and guarantee programs. See Section S40 Social Insurance.

[2] Accounting for federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees. See Section L60 Loans and Loan Guarantees in this Volume.

[3] In the federal government, the aspects of insurance and guarantees are frequently commingled within the same program. Therefore, SFFAS5 treats the terms as a single type of activity.

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. [SFFAS5, ¶97]

.101 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 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. [SFFAS5, ¶98]

.102 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. [SFFAS5, ¶99]

.103 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. [SFFAS5, ¶100]

.104 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. Companies with defined benefit pension plans must participate, but may (and sometimes do) elect to terminate their defined benefit pension plans. [SFFAS5, ¶101]

.105 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. [SFFAS5, ¶102]

.106 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. [SFFAS5, ¶103]

Accounting for Liabilities of Federal Insurance and Guarantee Programs

.107 All federal insurance and guarantee programs (except social insurance and loan guarantee programs) 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.) [SFFAS5, ¶104]

.108 Risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs). Originally considered Required Supplementary Stewardship Information in the context of Stewardship reporting, risk assumed information must be reported as required supplementary information (RSI) for period beginning after September 30, 2002.[4] 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. [SFFAS5, ¶105 as amended by SFFAS 25, ¶4.]

.109 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. [SFFAS5, ¶114]

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[4] See also Subject Area L 40 Liabilities, S70 Stewardship Reporting and S40 Social Insurance Programs. FASAB addressed Risk Assumed in SFFAS 5, *Accounting for Liabilities*, SFFAS 8, *Supplementary Stewardship Reporting*, SFFAS 17, *Accounting for Social Insurance*, and SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment.* SFFAS25 reclassified "Risk Assumed" information as required supplementary information (RSI), effective for period beginning after September 30, 2002. Prior to the implementation t of SFFAS 25, "Risk Assumed" information was classified as Required Supplementary Stewardship Information, RSSI.

Accounting for Revenues of Federal Insurance and Guarantee Programs

.110 SFFAS7 paragraph 284 states in part, that 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. [SFFAS7, ¶284]

Additional Disclosures for Insurance and Guarantee Programs Administered by Government Corporations

.111 When financial information pursuant to the Financial Accounting Standards Board's (FASB) 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 RSI what amounts and periodic change in those amounts would be reported under the "risk assumed" approach referred to in this section (see par. 108). 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 RSI risk assumed information. [SFFAS5, ¶106 as amended by SFFAS25, ¶4]

Whole Life Policies

.112 Some VA life insurance programs are whole life policies.[5] These programs operate in a manner similar to private sector mutual life insurance enterprises,[6] 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

[5] Whole life policies provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of the insured. A level premium is usually paid for policies of this type. The premium may be paid annually or more frequently.

[6] 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.

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. [SFFAS5, ¶115]

.113 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. [SFFAS5, ¶116

Accounting for Liabilities of Federal Whole Life Insurance Programs

.114 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.[7] [SFFAS5, ¶117]

.115 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.[8] [SFFAS5, ¶118]

.116 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 economic conditions, the nature and the mix of current and expected investments should be considered with expected long-term yields. [SFFAS5, ¶119]

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[7] 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 the above conditions, SOP 95-1 should be followed.

[8] 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]

.117 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. [SFFAS5, ¶120]

Additional Whole Life Insurance Disclosure

.118 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). [SFFAS5, ¶121]

Insurance and Guarantee Programs—Non-Authoritative Guidance

Non-Authoritative Guidance – Liability Recognition, Disclosure, and Supplementary Reporting

.4000 The following table 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.[9] 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

[9] 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.

guarantee program is included as an example of noncancelable insurance. Pension 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. [SFFAS5, ¶107]

.4001 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. [SFFAS5, ¶108]

.4002 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. [SFFAS5, ¶109]

.4003 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. [SFFAS5, ¶110]

.4004 Illustrations of Various Federal Programs and How Various Liabilities Would Be Determined.

Liability Recognition, Supplementary Information and Disclosure

(1) Type of Insurance	(2) Example of Program	(3) Insured Event Has Occurred	(4) Risk Assumed
Fixed Period, Annual	National Flood Insurance	CLAIMS + IBNR FOR FLOODS TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage
Fixed Period, Annual	Federal Crop Insurance	CLAIMS + IBNR FOR DAMAGE TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage
Fixed Period, Annual	Federal Deposit Insurance	CLAIMS + PV OF COST FOR DEPOSITORIES IN PROCESS OF CLOSURE BY THE END OF THE REPORTING PERIOD; AND THE ESTIMATED LOSS FOR THE PROBABLE COST FOR INSTITUTIONS THAT HAVE NOT YET FAILED BUT THE REGULATORY PROCESS HAS IDENTIFIED AS EITHER EQUITY INSOLVENT OR IN-SUBSTANCE EQUITY INSOLVENT OR LIKELY TO BECOME IN-SUBSTANCE EQUITY INSOLVENT WITHIN THE FORESEEABLE FUTURE	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Fixed Period, Multi-year	Overseas Investment Insurance	CLAIMS + IBNR FOR LOSSES TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Noncancelable or renewable	Pension Benefit Guarantee	CLAIMS + IBNR: PV OF UNFUNDED GUARANTEED BENEFITS FOR PLANS TERMINATED OR MORE LIKELY THAN NOT TO BE TERMINATED	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.

(Continued From Previous Page)

(1) Type of Insurance	(2) Example of Program	(3) Insured Event Has Occurred	(4) Risk Assumed
Noncancelable or renewable	VA Life Insurance	CLAIMS + IBNR (PLUS RESERVE FOR CURRENT CASH VALUE, IF NECESSARY)	LIABILITY FOR FUTURE POLICY BENEFITS (NET APV OF POLICIES IN FORCE). All components of the liability for future policy benefits 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 to reducing federal support in the form of appropriations related to administrative cost or subsidies).

Present Value (PV)

Actuarial Present Value (APV)

Note: Liability recognition includes any contingent liability that meets the criteria for recognition.

[SFFAS5, Table 9]

.4005 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. [SFFAS5, ¶111]

.4006 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 financial condition will in the future face bankruptcy with pension assets too small to cover the vested benefits that were guaranteed. [SFFAS5, ¶112]

.4007 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. [SFFAS5, ¶113]

Glossary

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)

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]

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.

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. (SFFAS1, *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]

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 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)

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 the insured.

Interest Payable—I50

Source: SFFAS1

Related Reference(s): G60 Government and Intragovernmental Assets and Liabilities; L 40 Liabilities; O40 Other Current Liabilities

Summary

Interest payable should be recorded for the amount of interest expense incurred and unpaid.

Interest Payable

.100 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 (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. [SFFAS1. ¶81]

.101 Interest payable to federal entities is an intragovernmental liability and should be accounted for separately from interest payable to the public. [SFFAS1. ¶82]

Inventories Including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; Inventory Held for Repair—I60

Source: SFFAS3

Related Reference(s): G40 Goods Held Under Price Support and Stabilization Programs; L60 Loans and Loan Guarantees (including Foreclosed Property); O40 Operating Materials and Supplies; S30 Seized and Forfeited Property; S80 Stockpiled Materials;

Summary

The standards require reporting of inventory by categories as follows: (1) inventory held for sale, (2) inventory held in reserve for future use, (3) excess, obsolete, and unserviceable inventory, and (4) inventory held for repair. The standards require historical cost or latest acquisition cost valuation of inventory held for sale and inventory held in reserve for future sale. The standards permit use of any other valuation method (e.g., standard cost) which reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. When latest acquisition cost valuation is used the inventory is revalued periodically and an allowance account is established for unrealized holding gains and losses. Excess, obsolete and unserviceable inventory is to be valued at net realizable value. Inventory held for repair is to be valued at either historical cost or latest acquisition cost less an allowance for the estimated repair cost.

Inventory

Definition

.100 "Inventory" is defined as 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. [SFFAS3, ¶17]

.101 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 SFFAS3, paragraphs 17, 27, 29, and 32 respectively (See I60, paragraphs. 100 .109, .111, and .114). [SFFAS3, ¶18]

Recognition

.102 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. [SFFAS3, ¶19]

Valuation

.103 Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost. [SFFAS3, ¶20]

.104 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. [SFFAS3, ¶21]

.105 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). [SFFAS3, ¶22]

.106 The latest acquisition cost method provides that the last invoice price[1] (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[2] 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. [SFFAS3, ¶23]

.107 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. [SFFAS3, ¶24]

.108 The cost of goods sold for the period shall be computed as follows:

[1] This unit value is referred to as the latest acquisition cost for the remainder of this Subject Area Section.

[2] "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.

- 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
- 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
- Cost of Goods Sold [SFFAS3, ¶25]

Exception to Valuation

.109 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. [SFFAS3, ¶26]

Other Categories of Inventory

Inventory Held in Reserve for Future Sale

.110 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. [SFFAS3, ¶27]

.111 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. [SFFAS3, ¶28]

Excess, Obsolete, and Unserviceable Inventory

.112 "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. [SFFAS3, ¶29]

.113 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). [SFFAS3, ¶30]

.114 Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory. [SFFAS3, ¶31]

Inventory Held for Repair

.115 Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.

.116 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. [SFFAS3, ¶32]

.117 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. [SFFAS3, ¶33]

.118 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. [SFFAS3, ¶34]

Disclosure Requirements

.119 Disclosure Requirements include

- 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. [SFFAS3, ¶35]

Glossary

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)

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.

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.

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. 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)

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)

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.

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)

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.

Investment in Treasury Securities—I80

Source: SFFAS1, SFFAS7, SFFAS24

Related Reference(s): C60 Consolidated Financial Report of the U.S. Government; G60 Governmental and Intragovernmantal Assets and Liabilities; R40 Revenue, Gains & Losses, and Other Financing Sources

Summary

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.

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 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

The FASAB has addressed 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.

Investments in par value nonmarketable Treasury securities shall be reported at cost. The cost basis is appropriate for this type of security because the invested amounts will be fully recovered at redemption.

For the valuation of market-based Treasury securities and marketable Treasury securities that are to be held to maturity, the standards allow the cost or amortized cost basis. The Board believes that the cost basis is appropriate because the invested amounts can be fully 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. When an entity no longer intends to hold the Treasury securities to maturity, the affected securities should be reclassified as securities available for sale or early redemption (redemption before the security's maturity).[1]

Revenue from Treasury securities is normally classified as exchange revenue. 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. 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.

If Treasury 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.

[1] 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. SFFAS1 applies to marketable Treasury securities only to the extent that they are expected to be held to maturity.

Investments in Treasury Securities

Scope

.100 SFFAS1 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. It does not apply to investments by federal entities in securities (debt and equity) and other financial instruments issued by other than the U.S. Treasury. [SFFAS1, ¶62]

.101 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. [SFFAS1, ¶63]

.102 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. [SFFAS1, ¶64]

.103 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. [SFFAS1, ¶65]

Treasury Securities Held by Trust Funds

.104 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. [SFFAS7, ¶228]

.105 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. [SFFAS7, ¶229]

Treasury Securities Expected to be Held to Maturity

.106 Aside from nonmarketable par value Treasury securities, SFFAS1 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. [SFFAS1, ¶66]

Separate Accounting and Reporting for Federal and Nonfederal Securities

.107 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. [SFFAS1, ¶67]

Initial Recording

.108 The three types of Treasury securities covered by SFFAS1 (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. [SFFAS1, ¶68]

.109 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. [SFFAS1, ¶69]

Valuation Subsequent to Acquisition

.110 Subsequent to their acquisition, investments in Treasury securities should be carried at their acquisition cost, adjusted for amortization, if appropriate, as explained below. [SFFAS1, ¶70]

.111 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. The non-authoritative guidance (paragraphs .4000 et seq.) that accompanies this Subject Area Section provides an illustration of the interest method of amortization.) [SFFAS1, ¶71]

Disclosure of Market Value

.112 For investments in market-based and marketable Treasury securities, the market 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. [SFFAS1, ¶72]

Investment Reclassification

.113 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 the SFFAS1's requirements. [SFFAS1, ¶73]

Investment in Treasury Securities – Revenue Recognition

Classification of interest on Intragovernmental Balances

.114 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.[2] [SFFAS7, ¶154]

[2] 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.

.115 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 SFFAS7 and guidance in its accompanying appendices, "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.[3] 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. [SFFAS7, ¶155]

.116 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. [SFFAS7, ¶156]

.117 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

[3] See Subject Area Section R40 Revenue, Gains & Losses, and Other Financing Sources in this Volume.

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. [SFFAS7, ¶157]

.118 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 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. [SFFAS7, ¶158]

.119 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. [SFFAS7, ¶159]

.120 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. [SFFAS7, ¶160]

Interest on Treasury Securities: Nonexchange Transactions—Intragovernmental Revenue

.121 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. [SFFAS7, ¶306]

.122 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. [SFFAS7, ¶307]

.123 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 Disability fund and the Military Retirement fund, consists of exchange revenue and other financing sources. 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. [SFFAS7, ¶308]

.124 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. [SFFAS7, ¶257]

Retirement of Treasury Securities Prior to Maturity: Trust Funds and Special Funds (except Trust Revolving Funds)

.125 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. [SFFAS7, ¶311]

.126 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. [SFFAS7, ¶312]

Interest on Treasury Securities Held by Revolving Funds

.127 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. [SFFAS7, ¶322]

.128 The source of balances for some revolving funds may not be predominantly exchange revenue. For such exceptions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule. [SFFAS7, ¶323]

.129 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. [SFFAS7, ¶324]

.130 The source of balances for some trust revolving funds may not be predominantly exchange revenue. For such exceptions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule. [SFFAS7, ¶325]

Retirement of Debt Securities Prior to Maturity: Revolving and Trust Revolving Funds

.131 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. [SFFAS7, ¶329]

.132 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. [SFFAS7, ¶330]

Investment in Treasury Securities—Non-Authoritative Guidance

Non-Authoritative Guidance – Illustration of the Interest Method for Investment Discount and Premium [SFFAS1, Appendix B]

.4000 This guidance 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

.4001 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 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.

.4002 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

.4003 Under the interest method of amortization,[4] 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.

Examples[5]

.4004 In the first example, which shows the amortization of a 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.

[4] 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, (See Subject Area Section L20 Leases in this Volume.) and paragraph 16 of APB Opinion No. 12, Omnibus Opinion.]

[5] These 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%	Effective Interest 8%	Discount Amortization	Unamortized Balance	Bonds 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	2,577	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.

Table 2: Premium Amortization

Date	Stated Interest 7%	Effective Interest 6%	Discount 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

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 such as the retirement of a debt by serial payments to a sinking fund. (Kohler's Dictionary).

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 FASB Concepts Statement No. 6 and Kohler's Dictionary.)

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.

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.

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. (JFMIP Standardization Project)

Earmarked Taxes – Taxes levied by the Government that are dedicated by law to finance a specific federal program.

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.

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.

Exchange Transaction – A transaction that arises when each party to the transaction sacrifices value and receives value in return.

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 r quotations.

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.

Interest Method – For purposes of SFFAS1, 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 I80.3000)

Liability – A probable and measurable future outflow of resources arising from past transactions or events.

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.

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.)

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.

Net Realizable Value(NRV) – The estimated amount that can be recovered from disposing of an item.

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)

Offsetting Receipts – Offsetting receipts are a subset of offsetting collections. (See *collections*.)

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.)

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)

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*)

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)

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).

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.

Land—L10

Source: SFFAS6

Related Reference(s): C40 Cleanup Costs; G20 General Property, Plant, and Equipment; S60 Stewardship Land; S70 Stewardship Reporting

Summary

The Federal Government has vast holdings of land and puts land to various uses. FASAB has defined land in its accounting standards, as the solid part of the surface of the earth. Land is to be reported in two of the three categories of plant, property, and equipment –

- General Plant, Property, and Equipment (PP&E), which includes land acquired for or in connection with other general PP&E)[1]
- Stewardship land (i.e., land not included in general PP&E)

SFFAS6 identifies and defines categories of PP&E and addresses recognition and measurement of, and disclosure requirements associated with general property, plant, and equipment including land. SFFAS8 established standards for reporting on the Federal government's stewardship of certain resources, including stewardship land. The present standards exclude natural resources on or beneath the surface; however, the FASAB has indicated it plans to undertake a project to address accounting for natural resources. The standards for stewardship land reporting are included in Subject Area section S60 Stewardship Land and S70 Stewardship Reporting in this volume.

Land

Definitions

.100 Land is defined as the solid part of the surface of the earth. [SFFAS6, ¶66]

.101 Excluded from the definition of land are materials beneath the surface (i.e., depletable resources such as mineral deposits and

[1] Certain portions of this section repeat SFFAS6 paragraphs that are included in Section G20 to simplify use in this Volume.

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. [SFFAS6, ¶67]

.102 General property, plant, and equipment are 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 services, or to support the mission of the entity, or
- It is used in business-type activities,[2] or
- It is used by entities in activities whose costs can be compared[3] to those of other entities performing similar activities (e.g., Federal hospital services in comparison to other hospitals). [SFFAS6, ¶23]

.103 According to SFFAS6, if land is acquired for or in connection with an item of general PP&E, it shall be categorized as general property, plant, and equipment.[4] According to SFFAS6,¶17, general PP&E consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives[5] of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and

[2] 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 SFFAS7.

[3] 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.

[4] See Section G20.

[5] Useful life is the normal operating life in terms of utility to the owner. (adapted from Kohler's Dictionary for Accountants)

- they have been acquired or constructed with the intention of being used, or being available for use by the entity. [SFFAS6, ¶17]

.104 Property, plant, and equipment also includes:

- assets acquired through capital leases (See Section L20) 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. [6] [SFFAS6, ¶18]

Categories of Plant Property and Equipment

.105 The following paragraphs provide recognition and measurement principles, and disclosure requirements for each category of PP&E that are applicable to land. SFFAS6 establishes three PP&E categories

- general PP&E (including land acquired for or in connection with other general PP&E),
- heritage assets, and
- stewardship land (i.e., land not included in general PP&E). [SFFAS6, ¶21 as amended by SFFAS23, ¶9]

[6] "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.

.106 According to SFFAS6, in determining which category PP&E should be placed in, it will be necessary to identify the “base unit”[7] 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).[8] [SFFAS6, ¶22]

General Property, Plant, and Equipment

.107 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. [SFFAS6, ¶24]

.108 Land and land rights acquired for or in connection with other general PP&E[9] 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. [SFFAS6, ¶25]

[7] “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.

[8] 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 less detail considered does not necessarily mean that (1) accounting systems or (2) property records must follow the same level of detail.

[9] “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.

Recognition and Measurement

.109 SFFAS6 requires that all general PP&E shall be recorded at cost. According to SFFAS6, ¶26, cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. Costs of acquiring land may, for example,[10] include:

- amounts paid to sellers;
- engineering, architectural, and other outside services, including surveys;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- legal and recording fees and damage claims; and
- material amounts of interest costs paid.[11] [SFFAS6, ¶26]

.110 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[12] unless the net present value exceeds the fair value of the asset). [SFFAS6, ¶29]

.111 The cost of general PP&E acquired through donation, devise,[13] or judicial process excluding forfeiture (See paragraph.112) shall be estimated fair value at the time acquired by the government. [SFFAS6, ¶30]

.112 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. [SFFAS6, ¶31]

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[10] These examples are an abbreviated listing of the examples related to general PP&E in SFFAS6. This listing is not meant to be all inclusive. G20.108 includes the complete listing of examples that were included in SFFAS6,¶26

[11] SFFAS6 states that "Interest costs" as used herein 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.

[12] See Statement of Recommended Accounting Standards No. 5, Accounting for Liabilities of the Federal Government.

[13] A will or clause of a will disposing of property.

.113 The cost of general PP&E acquired through exchange[14] shall be the fair value of the PP&E surrendered at the time of exchange.[15] 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 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. [SFFAS6, ¶32]

.114 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* (SFFAS3).[16] Amounts recorded for forfeited assets based on SFFAS3 shall be recognized as the cost of general PP&E when placed into official use. [SFFAS6, ¶33]

[14] 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 .110).

[15] 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 .111 and subsequently reduced to its fair value. A loss shall be recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value.

[16] SFFAS3 requires that forfeited real and personal property be valued at market value less an allowance for any liens or claims from a third party.

.115 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.[17] 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. [SFFAS6, ¶34]

[17] 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.

Leases—L20

Source: SFFAS5, SFFAS6

Related Reference(s): A10 Accounts Payable; A30 Advances and Prepayments; G60 General Property, Plant, and Equipment; L40 Liabilities

Summary

Leases may be either operating leases or capital leases. Operating leases of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Federal accounting standards establish four criteria for classifying a lease as a capital lease. If the lease meets one or more of these criteria, the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.

Rent due to a lessor under operating lease are recognized as accounts payable. Payments made in advance are recognized as prepaid expenses.

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. The liability for a capital lease is recognized when there is agreement between the federal government and the lessor. 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.

Leases

Classification

.100 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,[1] 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[2] 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[3] 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. [SFFAS6, ¶20; SFFAS5, ¶43]

.101 A lease that does not meet at least one of the above criteria should be classified as an operating lease. [SFFAS5 ¶43]

[1] 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.

[2] "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.

[3] "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)

.102 “Operating leases” of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E.[4] [SFFAS6, ¶20, Footnote 22]

Capital Lease Recognition and Measurement

.103 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. 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. [SFFAS5, ¶44]

.104 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. [SFFAS5, ¶45]

.105 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.[5] [SFFAS5, ¶46]

[4] Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases. [SFFAS6, ¶20, Footnote 22]

[5] 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.

.106 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 paragraph .103 above, unless the net present value exceeds the fair value of the asset). [SFFAS6, ¶29]

Operating Leases Recognition and Measurement

.107 Rents paid to a lessor at the beginning of a rental period are typical prepaid expenses. 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. [SFFAS1, ¶58 & 59]

.108 Rents due to other entities are accounts payable. [SFFAS1,¶74]

Glossary

Capital leases – Leases that transfer substantially all the benefits and risks of ownership to the lessee.

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)

Operating lease – An agreement conveying the right to use property for a limited time in exchange for periodic rental payments.

Liabilities—L40

Source: SFFAS5 as amended by SFFAS12; SFFAS1, Interpretation 2, TB2002-1; TR1

Related Reference(s): A10 Accounts Payable; C40 Cleanup Costs; E30 Entity and Non-entity Assets and Liabilities, F10 Federal Debt; G60 Governmental and Intragovernmental Assets and Liabilities; I40 Insurance and Guarantee Programs; I60 Interest Payable; L20 Leases; L 60 Loans and Loan Guarantees; O40 Other Current Liabilities; P20 Pensions, Other Retirement Benefits, and other Post-employment Benefits

Summary

FASAB has issued several statements that establish standards related to liabilities. SFFAS1 includes guidance for current liabilities including accounts payable, interest payable and other current liabilities.[1] SFFAS2 provides guidance on liabilities resulting from direct loans and loan guarantees.[2] In SFFAS5, FASAB established accounting standards to recognize and measure liabilities in general purpose federal financial reports, which are issued for both internal and external users.

SFFAS5 defines the recognition points for liabilities associated with different types of events and transactions,[3] as follows –

- 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).

[1] See Subject Area Sections A10 Accounts Payable, I50 Interest Payable and O40 Other Current Liabilities.

[2] Subject Area Section L60 Loans and Loan Guarantees.

[3] See L40.4004 for an illustration of the recognition points.

- 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, goods, or services[4] 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 .114 and .115 below 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

[4] 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.

the event and a nonexchange or exchange transaction has occurred. The liability for a nonexchange transaction should be recognized for any unpaid amounts due as of the reporting date and the liability for 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).

SFFAS12 amended SFFAS5's contingent liability criteria and applies to the evaluation, accounting recognition and disclosure of the future outcome of litigation.

Liabilities recognized according to SFFAS5 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 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.[5]

This section presents the SFFAS5 guidance on liabilities,[6] including the definition and general principles for recognition of a liability, and on contingent liabilities. SFFAS5 established accounting standards for several specific categories of liabilities. They are covered by separate sections in this Volume as follows: L20 Leases; F10 Federal Debt; I40 Insurance and

[5] Adapted from OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements."

[6] As amended by SFFAS12. See paragraphs .114 and .117.

Guarantee Programs; and P20 Pensions, Other Retirement Benefits, and Other Post-employment Benefits.

Liabilities

Definition and General Principle for Recognition of a Liability

.100 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[7] 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.[8] [SFFAS5, ¶19]

Events and Transactions

.101 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.[9] 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. [SFFAS5, ¶20]

.102 As the term is used in SFFAS5, a transaction involves the transfer of something of value . Transactions may be either exchange transactions or nonexchange transactions. The distinction between

[7] Recognition means reporting a dollar amount on the face of the basic financial statements.

[8] This document uses the 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.

[9] “Consequence” is defined as something of importance or significance.

exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting. [SFFAS5, ¶21]

.103 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.[10] [SFFAS5, ¶22]

.104 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. [SFFAS5, ¶23]

.105 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[11] 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). [SFFAS5, ¶24]

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[10] Executory contracts where goods and services have not been received are not generally recognized as liabilities in financial accounting, although they are generally recognized as obligations in governmental budgetary accounting.

[11] 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.

.106 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. [SFFAS5, ¶25]

.107 An event is defined as a happening of financial consequence to an entity. For federal 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. [SFFAS5, ¶26]

.108 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.[12] [SFFAS5, ¶27]

.109 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);[13]

[12] 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 .111.

[13] See C40 Cleanup Costs 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.[14] [SFFAS5, ¶28]

.110 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. [SFFAS5, ¶29]

.111 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. [SFFAS5, ¶30]

.112 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., 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. [SFFAS5, ¶31]

[14] 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 G20 General Property, Plant, and Equipment, paragraph .121, and Section C40 Cleanup Costs for discussions on the impairment or loss of federal property.

.113 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. [SFFAS5, ¶32]

Probable Future Outflow or Other Sacrifice of Resources

.114 "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 with the exception of pending or threatened litigation and unasserted claims.[15] 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

[15] 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.

both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources. [SFFAS5, ¶33 as amended by SFFAS12, ¶10]

Measurability

.115 "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). [SFFAS5, ¶34]

Contingencies

.116 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).[16] [SFFAS5, ¶35]

.117 SFFAS5 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, 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.

[16] 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.

- 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. [SFFAS5, ¶36 as amended by SFFAS12, ¶11]

.118 The following are some examples of loss contingencies:

- collectibility of receivables,
- pending or threatened litigation, and
- possible claims and assessments. [SFFAS5, ¶37]

Criteria for Recognition of a Contingent Liability

.119 A contingent liability should be recognized when all of these three conditions are met:[17]

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).[18]
- 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 likely 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

[17] 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, SFFAS2 "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." (See Section L60.) For a description of incurred but not reported (IBNR) claims, see Section I40 Insurance and Guarantees.

[18] 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.

settlement amount). [SFFAS5, ¶38 as amended by SFFAS12, ¶11]

.120 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. [SFFAS5, ¶39]

Criteria for Disclosure of a Contingent Liability

.121 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. [SFFAS5, ¶40]

.122 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. [SFFAS5, ¶41]

.123 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. [SFFAS5, ¶42]

Interpretation 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS4 and SFFAS5

Summary

The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source" amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss.

Accounting for Treasury Judgment Fund Transactions[19]

Accounting by the Federal Entity

.1000 SFFAS5, as amended by SFFAS12, states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss.[20] The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss. [I2, ¶3]

.1001 Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source"[21] amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity. [I2, ¶4]

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[19] An Interpretation of SFFAS4 and SFFAS5

[20] See paragraph .120 in this Subject Area for a complete discussion on "Estimating Contingent Liabilities."

[21] See Subject Area R40 Revenue, Gains & Losses, and Other Financing Sources, paragraph .142 for the complete discussion on "Financing Imputed for Cost Subsidies."

Accounting by the Treasury Judgment Fund

.1002 Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss. According to SFFAS4, the imputed financing source amount recognized by the Federal entity and the expense recognized by the Judgment Fund would be eliminated at the Federal Consolidated financial report level. [I2, ¶5]

Technical Guidance

Technical Bulletin 2002-1: Assigning to Component Entities Costs and Liabilities That Result from Legal Claims Against the Federal Government

Summary

This technical bulletin is intended to clarify the required reporting of costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government. This technical bulletin requires that all liabilities and costs related to legal claims (i.e., judgments and settlements) must be attributed to the component entities responsible for the programs or activities that contributed to the claims, or to their successor component entities.

Issue

.2000 What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (a) the actions of Federal component entities[22] contribute to a legal claim having been filed against the Federal government or (b) a Federal component entity disputes that its actions contributed to the legal

[22] 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 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) Use of “component entity” in this technical bulletin is only intended to distinguish between the U.S. Federal government’s consolidated financial statements and financial statements of its components.

claim having been filed against the Federal government? [TB2002-1, ¶8]

General Principles

.2001 All liabilities and costs must be attributed to the component entities responsible for the programs or activities that contributed to the claims or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity. [TB2002-1, ¶9]

Implementation

.2002 The following hierarchy of cost assignment principles should be applied when the actions of one or more Federal component entities contribute to a legal claim having been filed against the Federal government or when a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government and it is not clear where the liability and cost should be reported.

a. The component entities should apply the cost methodology principles provided in SFFAS4 in the following order of preference:

(1) Directly tracing costs wherever economically feasible;

(2) Assigning costs on a cause-and-effect basis; and

(3) Allocating costs on a reasonable and consistent basis.

The component entities should seek advice from the appropriate legal counsel (Office of the General Counsel, Department of Justice, etc.) about pertinent legal matters and other factors that could be relevant to assigning costs. The management of the component entities involved should work together to resolve the issues before moving on to step (b.) below.

b. If a reasonable cost assignment or allocation cannot be determined, as outlined in step (a.) above, the component entities should seek guidance from OMB's Office of Federal Financial Management (or its successor division) and recognize costs and liabilities as directed by OMB. In addition, all component entities involved should disclose the information concerning the nature of the costs and/or liability,[23] the problems of assigning the costs to the component entities involved, and the estimated total liability among all the component entities involved. [TB2002-1, ¶10]

[23] See specific disclosure requirements in L40.1000 and L40.121-.123.

Federal Financial Accounting and Auditing Technical Release No. 1: Audit Legal Representation Letter Guidance

Summary

Management of the Federal reporting entity is responsible for adopting policies and procedures to identify, evaluate and account for litigation, claims and assessments as a basis for the preparation of financial statements, including those handled by outside legal counsel. Management is responsible for reporting loss contingencies in accordance with the requirements of SFFAS5. This may require consultation by management and its legal department with DOJ, as well as other outside legal counsel.

The auditor should request that management send a letter of audit inquiry to legal counsel with whom management has consulted concerning litigation, claims and assessments. Management of the Federal reporting entity and its legal department are responsible for providing the auditor with a legal representation letter.

Issue

.3000 Who should be the source of audit legal representation letters in cases where Department of Justice attorneys are handling legal matters on behalf of other Federal reporting entities?

Background

.3001 This issue was raised by the Department of Justice (DOJ) in relation to Interpretation No. 2, Accounting for Treasury Judgment Fund Transactions,[24] issued by the Federal Accounting Standards Advisory Board (FASAB)however it is applicable to any situation

[24] L40.1000

where outside legal counsel is handling legal matters on behalf of a Federal reporting entity.

.3002 FASAB Interpretation No. 2 states that "the Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable." DOJ is concerned that the language in the Interpretation will lead agencies to conclude that DOJ is the sole source of audit legal representation letters in cases where DOJ attorneys are handling legal matters on behalf of other Federal reporting entities.

Recommended Implementation Guidance

.3003 Management of the Federal reporting entity is responsible for adopting policies and procedures to identify, evaluate and account for litigation, claims and assessments as a basis for the preparation of financial statements in accordance with the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These include litigation, claims and assessments handled by legal counsel outside of the Federal reporting entity's legal department.

.3004 Management of the Federal reporting entity is responsible for ensuring that loss contingencies, including those arising from litigation, claims and assessments, are presented in the financial statements in accordance with the requirements of Statement of Federal Financial Accounting Standards No.5, *Accounting for Liabilities of the Federal Government*. This may require consultation by management and its legal department with DOJ, as well as other outside legal counsel, to ensure the accuracy and completeness of the presentation of matters related to litigation, claims and assessments in the Federal reporting entity's financial statements. Such consultation may include requesting a list of pending litigation, claims and assessments from DOJ or other outside legal counsel.

.3005 A representation letter from legal counsel to the auditor, in response to a letter of audit inquiry from management to legal counsel, is the auditor's primary means of corroborating the information furnished by management concerning the accuracy and completeness of litigation, claims and assessments. The auditor should request that management send a letter of audit inquiry to legal counsel with

whom management has consulted concerning litigation, claims and assessments. A materiality limit for the legal representation letter is generally established in the letter of audit inquiry, based on an understanding between management and the auditor.

.3006 Management of the Federal reporting entity and its legal department are responsible for providing the auditor with a legal representation letter. The legal representation letter should cover all litigation, claims and assessments pertaining to the Federal reporting entity, including matters handled by DOJ or other outside legal counsel on behalf of the Federal reporting entity.

.3007 The legal representation letter provided to the auditor by the Federal reporting entity's legal department, or "inside counsel", may provide sufficient evidential matter for the auditor. In certain circumstances the auditor may also need supporting legal representation from outside counsel. Section AUI 337.26 of the AICPA Codification of Statements on Auditing Standards provides the following guidance for situations where inside counsel is handling litigation, claims and assessments either exclusive of or in conjunction with outside counsel:

> Audit inquiry letters should be sent to those lawyers, which may be either inside or outside lawyers, who have the primary responsibility for, and knowledge about, particular litigation, claims and assessments. If inside counsel is handling litigation, claims and assessments exclusively, their evaluation and response ordinarily would be considered adequate. Similarly, if both inside and outside lawyers have been involved in the matters, but inside counsel has assumed primary responsibility for the matters, inside counsel's evaluation may well be considered adequate. However, there may be circumstances where litigation, claims and assessments involving substantial overall participation by outside lawyers are of such significance to the financial statements that the auditor should consider obtaining the outside lawyers' response that they have not formulated a substantive conclusion that differs in any material respect from inside counsel's evaluation, even though inside counsel may have primary responsibility.

.3008 In those circumstances where the auditor determines that a legal representation letter is needed from DOJ, or other outside legal

counsel, to support the Federal reporting entity's legal representation letter, the Federal reporting entity's management, in conjunction with its legal department, would request such representation in a letter of audit inquiry. The Federal reporting entity would provide DOJ with its description and evaluation of the possible outcome of the case in question, and request that the DOJ lawyer respond directly to the auditor. If the Federal reporting entity is not sufficiently knowledgeable of the case to provide a description and evaluation, the DOJ lawyer would be requested to provide a description and evaluation directly to the auditor. Such requests to DOJ should be case specific and directed to the lead DOJ lawyer handling the case. To meet the reporting deadlines for audited financial statements, there should be early coordination between the auditor and the Federal reporting entity's management and legal department to determine whether supporting legal representations will be needed from DOJ.

.3009 The legal representation letter provided to the auditor by the legal department of the Federal reporting entity requires an assertion as to the completeness of the list of litigation, claims and assessments, including matters handled by DOJ or other outside legal counsel on behalf of the Federal reporting entity. The auditor's consideration of this completeness assertion is based primarily on the assessed effectiveness of the Federal reporting entity's internal control structure for identifying, evaluating and accounting for litigation, claims and assessments. The auditor also may need to request additional information from the Federal reporting entity, or DOJ or other outside legal counsel, to obtain evidence about the completeness assertion. Such requests to DOJ or other outside legal counsel should be made through management of the Federal reporting entity. Further, the auditor should consider whether the audit scope is limited by the inability to obtain sufficient competent evidential matter regarding the completeness assertion for litigation, claims and assessments.

Liabilities—Non-Authoritative Guidance

Non-Authoritative Guidance – Interpretation 2; Appendix B: Illustrative Journal Entries

.4000 Based on the above noted accounting standards and the generalized events described below, the conceptual journal entries[25] should be as follows:

Federal entity entries

.4001 The Federal entity's management, through the advisement of the Justice Department, has determined that the probability of the legal claim ending in a loss against the Federal entity is probable and the loss is estimable. The entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted as necessary based on any changes in the estimated loss.

Entry #1:

DR. Expense
CR. Liability—Legal claims

.4002 Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for payment of the claim, the liability should be removed and an other financing source recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would only reflect that amount paid by the Judgment Fund on behalf of the Federal entity.

[25] Actual journal entries are under the authority of the Standard General Ledger.

Entry #2:

DR. Liability—Legal claims
CR. Imputed Financing Source—Expenses Paid by Other Entities*

Treasury Judgment Fund entries

.4003 The claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment.

Entry #3:

DR. Expenses Paid for Other Entities*

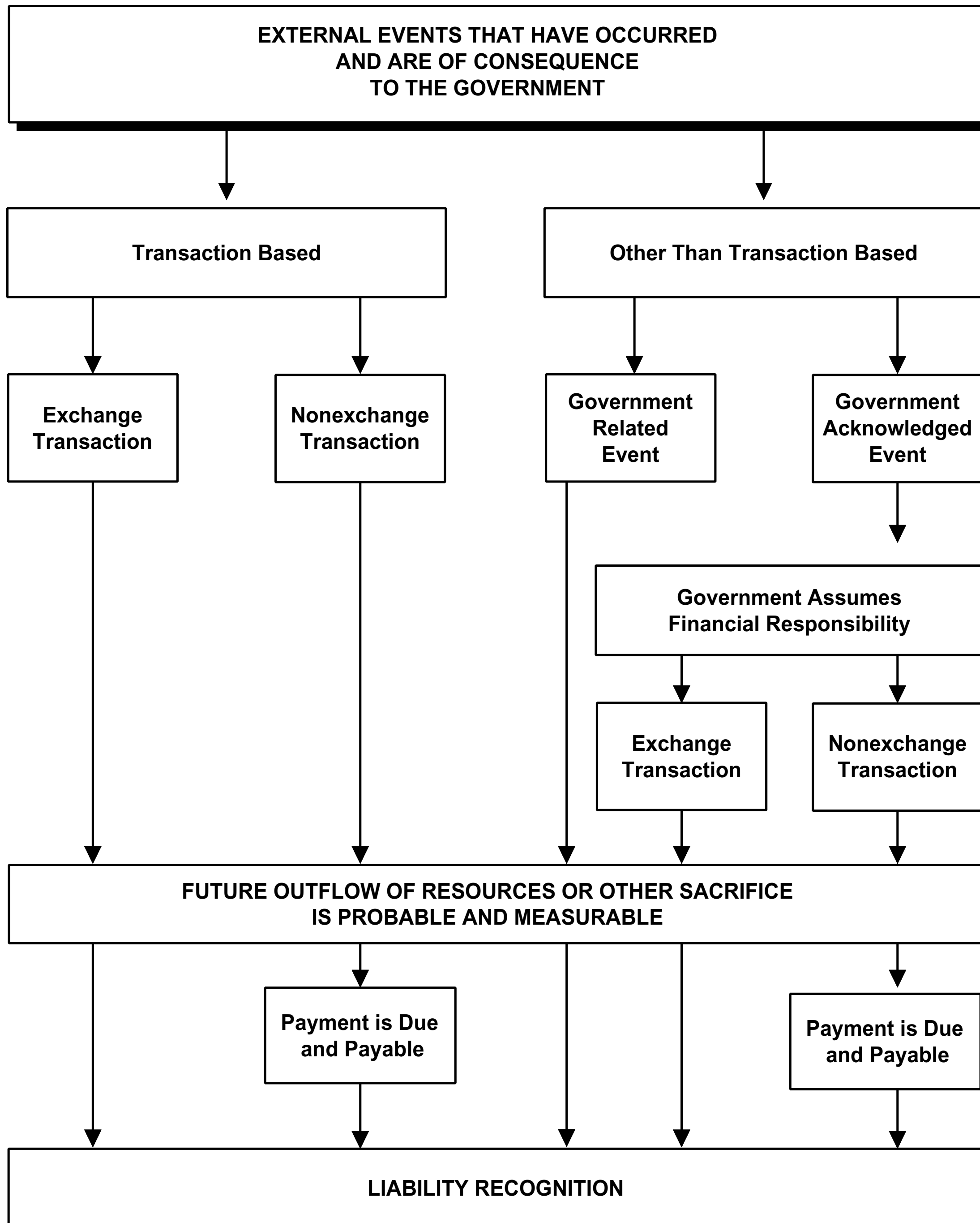
CR. Cash or Fund Balance with Treasury

* According to the Cost Accounting Standard, the imputed financing source and expenses paid for other entities amounts would be eliminated at the consolidation level. (See Subject Area Section M20 Managerial Cost Accounting.)

Non-authoritative Guidance – SFFAS5, Figure 1

.4004 The following diagram illustrates the SFFAS5 liability recognition criteria.

Figure 1: Liability Recognition Summary



Glossary

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 collections) and net (with reductions of offsetting collections). (OMB *Circular A-11*; and GAO, *A Glossary of Terms Used in the Federal Budget Process*, Exposure Draft, January 1993.)

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.

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.

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.

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.

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.

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. (SFFAS1, *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.

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.

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*)

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.

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).

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*)

Loans and Loan Guarantees—L60

Source: SFFAS2 as amended by SFFAS18 & SFFAS19; SFFAS3; TR3-Revised; TR6

Related Reference(s): L 40 Liabilities

Summary

SFFAS2, *Accounting for Direct Loans and Loan Guarantees*, provides accounting standards for federal direct loans and loan guarantees. SFFAS3 *Accounting for Inventory and Related Property* establishes the standards for foreclosed property.

SFFAS2's 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. 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 re-estimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the re-estimates 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 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.

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

SFFAS3 requires that foreclosed property must be classified as Post-1991 property or Pre-1992 property to remain consistent with the provisions of the Credit Reform Act of 1990. Post-1991 property is associated with direct loans obligated or loan guarantees committed after September 30, 1991 and is valued at its net present value. Pre-1992 property is associated with direct loans obligated or loan guarantees committed before October 1, 1991 and is valued at the lower of cost or net realizable value.

Loans and Loan Guarantees

Applicability Explanation

.100 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. [SFFAS2, ¶21]

Accounting Standards

Post-1991 Direct Loans

.101 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. [SFFAS2, ¶22]

Post-1991 Loan Guarantees

.102 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. [SFFAS2, ¶23]

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

.103 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 similar maturity to the cash flows, applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate). [SFFAS2, ¶24 as amended by SFFAS19, ¶6]

.104 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. [SFFAS2, ¶25]

.105 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. [SFFAS2, ¶26]

.106 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. [SFFAS19, ¶8]

.107 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 .106. [SFFAS19, ¶8]

.108 The present value of fees and other collections is recognized as a deduction from subsidy costs. [SFFAS2, ¶28]

.109 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. [SFFAS2, ¶29]

Subsidy Amortization and Re-estimation

.110 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. The amortized amount is recognized as an increase or decrease in interest income. [SFFAS2, ¶30 as amended by SFFAS19, ¶7]

.111 Interest is accrued and compounded on the liability of 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. The accrued interest is recognized as interest expense. [SFFAS2, ¶31 as amended by SFFAS19, ¶7]

Subsidy Re-estimates

.112 Credit programs should re-estimate 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 re-estimates: (a) interest rate re-estimates, and (b) technical/default re-estimates [1]. Entities should measure and disclose each program's re-estimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the re-estimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

(A) An interest rate re-estimate is a re-estimate 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 re-estimate 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 re-estimate for those cohorts should be made as of the date of the financial statements.

(B) A technical/default re-estimate is a re-estimate 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 re-estimates explained in (a) above. In making technical/default re-estimates, 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 re-estimate should be made each year as of the date of the financial statements. [SFFAS2, ¶32 as amended by SFFAS18, ¶9]

Reconciliation

.113 In a note to the financial statements, reporting entities should display a reconciliation between the beginning and ending balances

[1] The term "technical/default re-estimate" used in this statement is identical in meaning to the term "technical re-estimate" used in OMB Circular A-11, as revised in July 1999.

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 .104 through .109 for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy re-estimates as defined in paragraph .112, 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. [SFFAS18, ¶10]

Subsidy Disclosure and Discussion

.114 The disclosure and discussion requirements are prescribed in paragraphs (A) through (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 preceding reporting year, (b) the subsidy expense by components as defined in paragraphs .104 through .109, recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy re-estimates by components as defined in paragraph .112 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 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. [SFFAS18, ¶11]

Criteria for Default Cost Estimates

.115 The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent re-estimates. Default costs are estimated and re-estimated for each program on the basis of separate cohorts and risk categories. The re-estimates 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. [SFFAS2, ¶33]

.116 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 re-estimate defaults are also considered. [SFFAS2, ¶34]

.117 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. [SFFAS2, ¶35]

.118 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. [SFFAS2, ¶36]

Revenue and Expenses

.119 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. [SFFAS2, ¶37]

.120 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. [SFFAS2, ¶38]

Pre-1992 Direct Loans and Loan Guarantees

.121 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 re-estimated 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. [SFFAS2, ¶39]

.122 Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required. [SFFAS2, ¶40]

Modification of Direct Loans and Loan Guarantees

.123 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. [SFFAS2, ¶41]

.124 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 re-estimates, or workouts as defined below, or are permitted under the terms of existing contracts. [SFFAS2, ¶42]

.125 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. [SFFAS2, ¶43]

.126 The term modification does not include subsidy cost re-estimates, 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 re-estimates. [SFFAS2, ¶44]

Modification of Direct Loans

.127 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[2] of the loans over their post-modification value.[3] The amount of the modification cost is recognized as a modification expense when the loans are modified. [SFFAS2, ¶45; (footnotes amended by SFFAS19, ¶6)]

.128 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, after adjusting for the interest rate re-estimate). [SFFAS2, ¶46 as amended by SFFAS19, ¶7]

.129 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. [SFFAS2, ¶47]

[2] 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 cash flows of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[3] 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 cash flows of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

.130 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[4] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source [SFFAS2, ¶48]

[4] 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.)

Modification of Loan Guarantees

.131 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[5] of the loan guarantees over their pre-modification liability.[6] The modification cost is recognized as modification expense when the loan guarantees are modified. [SFFAS2, ¶49; (Footnotes amended by SFFAS19, ¶6)]

.132 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, after adjusting for the interest rate re-estimate). [SFFAS2, ¶50 as amended by SFFAS19, ¶7]

.133 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. [SFFAS2, ¶51]

[5] 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 cash flows of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).

[6] 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 cash flows of the guaranteed loans under pre-modification terms (simply stated, the pre- modification terms at the current rate.)

.134 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[7] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source). [SFFAS2, ¶52]

Sale of Loans

.135 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. [SFFAS2, ¶53]

.136 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. [SFFAS2, ¶54]

.137 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.[8] For sales of post-1991 direct loans, the modification adjustment transfer[9] paid or

[7] 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.)

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

[9] See footnote No. 4 for an explanation of modification adjustment transfer.

received to offset the gain or loss is recognized as a financing source (or a reduction in financing source). [SFFAS2, ¶55]

Modification Disclosure

.138 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. [SFFAS2, ¶56]

Foreclosure of Post-1991 Direct Loans and Guaranteed Loans

.139 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 adjusted for the interest rate re-estimate. [SFFAS2, ¶57 as amended by SFFAS19, ¶7]

.140 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. [SFFAS2, ¶58]

.141 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 adjusted for the interest rate re-estimate. [SFFAS2, ¶59 as amended by SFFAS19, ¶7]

.142 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. [SFFAS2, ¶60]

Write-off of Direct Loans

.143 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 re-estimates. Therefore, the write-off would have no effect on expenses. [SFFAS2, ¶61]

Foreclosed Property

Definition

.144 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. [SFFAS3, ¶79]

.145 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.[10] [SFFAS3, ¶80]

Valuation of Foreclosed Property

.146 Post-1991 foreclosed property is valued at the net present value of the projected future cash flows associated with the property. Pre-

[10] Section 506 of the Federal Credit Reform Act exempts specific agencies, such as the Federal Deposit Insurance Corporation and the Tennessee Valley Authority.

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. [SFFAS3, ¶81]

Net Present Value

.147 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. [SFFAS3, ¶82]

.148 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. [SFFAS3, ¶83]

.149 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 re-estimate of “subsidy expense.”[11] [SFFAS3, ¶84]

[11] Paragraphs .110-.112 above.

Net Realizable Value

.150 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; 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. [SFFAS3, ¶85]

.151 If the expected net realizable value is less than the cost,[12] 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. [SFFAS3, ¶86]

Assets Subject to Claims of Other Parties

.152 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"

[12] Cost is the carrying amount of the loan at the time of foreclosure or, for a loan guarantee, the amount of the claim paid.

and the re-estimate 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. [SFFAS3, ¶87]

Receipts and Disbursements during the Holding Period for Post-1991 Foreclosed Property

.153 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. [SFFAS3, ¶88]

Sale of Foreclosed Property

.154 Upon sale, any difference between the net carrying amount of foreclosed 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 re-estimate 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. [SFFAS3, ¶89]

Assets Converted from Held-for-Sale Assets to Operating Assets

.155 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. [SFFAS3, ¶90]

Foreclosed Property Disclosure Requirements

.156 Disclosure is made in notes to the financial statements of the following information:

- 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. [SFFAS3, ¶91]

Guidance for the Classification of Transactions Related to Loans and Loan Guarantees [SFFAS7, Appendix B]

.157 SFFAS7's Table of Transactions provides the following guidance related to direct loans and loan guarantees.

Transactions with the public – Exchange transactions with the public: Gains and losses:

.158 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.[13] [SFFAS7, ¶300]

.159 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. [14] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[15] [SFFAS7, ¶302]

[13] See paragraphs .144-.156 of this Subject Area Section.

[14] This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is made and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

[15] See paragraphs .135-.137 of this Subject Area Section.

Transactions Not Recognized as Revenue, Gains, or Other Financing Sources

.160 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.[16] [SFFAS7, ¶362]

.161 Downward subsidy re-estimates for post-1991 direct loans and loan guarantees.—A downward subsidy re-estimate 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 re-estimate is recognized as an expense; and a downward subsidy re-estimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source. [SFFAS7, ¶363]

.162 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. [17] [SFFAS7, ¶364]

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[16] The accounting for negative subsidy costs is symmetrical to the accounting for positive subsidy costs.

[17] The fee component of the subsidy cost is required to be disclosed separately.

.163 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.[18] [SFFAS7, ¶365]

.164 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.[19] [SFFAS7, ¶366]

.165 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.[20] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[21] 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.

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[18] If the actual repayment is different from the previous estimate, the present value of the difference between cash inflows and outflows over the term of the loan – calculated as of the date of disbursement – is re-estimated and is recognized as a subsidy expense or a reduction in subsidy expense.

[19] If the loan is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

[20] This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is disbursed and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

[21] See paragraphs .135-.137 and .4085-.4104 of this Subject Area Section

Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source. [SFFAS7, ¶368]

.166 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 re-estimate 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.[22] [SFFAS7, ¶369]

[22] See paragraphs .139-.142, .144-.156 and .4154-.4163, of this Subject Area Section.

Technical Guidance

Technical Release No. 3 - Revised: Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act[23] (Amendments to Technical Release 3: Preparing and Auditing direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act)

Summary

The purpose of this technical release is to amend the guidance for auditors to audit credit subsidy estimates provided in Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (TR3), July 1999. The original technical release (July 1999) contained both audit and accounting guidance. The most significant changes made in this amended TR 3 are 1) the removal of the preparation guidance from this amended TR to only include the audit guidance and 2) procedural changes updating the document to reflect new guidance and changes in terminology in the area of credit reform (e.g., SFFAS 18 & 19; and OMB Circular A-11). Concurrent

[23] The issuance of Technical Releases TR3-Revised and TR6 in January 2004 amended and revised technical guidance originally issued as TR3: Preparing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act, July 1999. TR3-Revised and TR6 were effective immediately upon their issuance and superseded TR3 as originally issued.

with the issuance of this amended technical release on auditing guidance, Technical Release 6 is being issued and will contain only the guidance for preparing estimates.[24] [TR3-Revised, ¶1]

Readers of this technical release should first refer to the hierarchy of accounting standards in Statement on Auditing Standards (SAS) 91, Federal Generally Accepted Accounting Principles Hierarchy (or see AU411). [TR3-Revised, ¶2]

This technical release includes sections on:

- Planning the Credit Subsidy Audit
- Testing Internal Control
- Substantive Testing of Subsidy Estimates

[TR3-Revised, ¶3]

It also presents four appendices on:

- Acceptable Sources of Documentation for Subsidy Estimates and Reestimates
- Technical Glossary Illustration[25]
- Summary of Reestimate Requirements
- Summary of Reporting Requirements

[TR3-Revised, ¶4]

This technical release does not address loan asset sales and does not provide complete guidance for administrative expenses and pre-1992 direct loans and loan guarantees. Guidance on these areas can be found in SFFAS Nos. 2, 18, & 19 and OMB Circular No. A -11 and OMB Bulletin No. 01-09.

[24] See L60,¶.3048

[25] The terms and definitions in the TR3-Revised Glossary are presented in the L60 Glossary.

Additional guidance on loan asset sales will be addressed separately in the future. [TR3-Revised, ¶5]

This technical release is designed to provide guidance on the audit of credit subsidy estimates. There are three parts of subsidy: initial subsidy, modifications of subsidy and reestimates of subsidy. This technical release discusses audit methods, both internal control and substantive procedures, that may be used to audit credit subsidy estimates, modifications and reestimates. As complex and varied as credit subsidies are within Government, auditor judgment is essential to implementing this guidance. This technical release also provides guidance on acceptable sources of documentation for subsidy estimates and reestimates. [TR3-Revised, ¶6]

Accounting and Budgeting Guidance

.3000 Federal agencies are required to account for direct loans and loan guarantees in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, and SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees*. [TR3-Revised, ¶7]

.3001 OMB Circulars A-11 *Preparation, Submission, and Execution of the Budget* and A-129 *Policies For Federal Credit Programs and Non-Tax Receivables* provide guidance to agencies on definitions, procedures and rules for calculating subsidy estimates and reestimates for the President's Budget and modification cost estimates, obligation of budget authority for the credit program's cost, and credit and receivables policy. [TR3-Revised, ¶8]

.3002 The Credit Subsidy Calculator (CSC) is a computer program provided to the agencies to calculate the cost of direct loans and loan guarantees using the agencies' cash flow estimates. The OMB Circular A-11 requires that all agencies with credit programs must use the CSC to discount the credit subsidy estimate and reestimate cash flows that they are responsible for generating. [TR3-Revised, ¶9]

Audit Tests for Direct Loan and Loan Guarantee Subsidy Estimates

.3003 The overall purpose of auditing the subsidy estimation and re-estimation process is to provide reasonable assurance that the reported credit program receivables and related foreclosed property and related allowance for subsidy, liabilities for loan guarantees, and subsidy expense, are reasonably stated in the financial statements and provide reliable and useful information for decision makers. Since the audit should be conducted in three phases--planning, internal control, and substantive testing--this technical release is organized in the same way. Due to the complexity of credit subsidy estimates, thorough planning is key to an effective and efficient audit. The auditor must also assess the agency's internal control and the risk of errors and irregularities that may cause a material misstatement in the financial statements. Based on this assessment, the auditor can determine the nature, timing, and extent of substantive testing to determine whether the credit subsidy estimate is reasonable in the context of the financial statements taken as a whole. [TR3-Revised, ¶12]

Planning the Credit Subsidy Audit

.3004 The audit of credit subsidy estimates should be considered in conjunction with other audit areas, e.g., claims, insurance in force, foreclosed property, premium receipts, and loan sales. In this way, the auditor will be able to leverage off the other audit areas to maximize audit efficiency and effectiveness. When planning the audit of credit subsidy estimates, the auditor must consider the budget preparation process, which generally occurs during the same time as the planning phase, and the impact audit adjustments may have on the budget submission. When planning the nature, timing, and extent of the audit of credit subsidy estimates, the auditor is encouraged to perform the review and testing of the cash flow models, as described throughout this section, early in the audit process. By performing these audit procedures early in the agency's audit, any necessary adjustments to the cash flow model can also be made in time to be included in the budget cash flow model. In this way, the audit of the credit subsidy estimates will fulfill the intent of paragraph 17 in SFFAS No. 2 which states that "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." Auditors are encouraged to use their judgment when determining the nature, timing, and extent of tests

that will be performed. Not all of the tests contained in this Technical Release will be applicable to all credit programs. [TR3-Revised, ¶13]

.3005 During the planning phase, the auditor should focus on four primary objectives: (1) understanding the agency's credit subsidy estimate process, (2) identifying key estimate assumptions, (3) identifying material and high risk credit programs, and (4) assessing inherent risk and the effects of information technology on inherent risk. [TR3-Revised, ¶14]

Understanding the Credit Subsidy Estimate Process

.3006 Without a thorough understanding of the agency's credit subsidy estimate process, the auditor is unable to efficiently and effectively audit the loans receivable and the related allowance, the liability for loan guarantees, and the subsidy expense, in accordance with applicable auditing standards. To gain an understanding of the credit subsidy process, the auditor should

a. Review the documented subsidy estimation procedures to gain an understanding of the process, including the types of underlying data used to develop cash flow assumptions, key formulas used in cash flow worksheets, and the person responsible for each phase of the process.

b. Identify significant external and internal factors that may affect the credit subsidy process. External factors may include economic conditions, current political climate, and relevant legislation. Internal factors may include the size of the agency's budget and accounting staff, qualifications of key personnel, turnover of key personnel, and systems capabilities.

c. Develop a high-level understanding of the agency's use of information technology, how information technology affects the subsidy estimate process, and which systems should be included with the general and application control review.[26]

d. Determine, with the assistance of a systems audit specialist as necessary, whether systems-related controls are likely to be effective.[27] If controls are not likely to be effective, the auditor should determine the impact on control risk, appropriately adjust substantive testing, and focus on testing the effectiveness of manual controls during the internal control phase of the audit.

e. The auditor may gather planning information through different methods such as observing agency operations, interviewing agency staff, reviewing procedures manuals, and conducting walk throughs. In addition, the auditor may gather information from relevant reports, including prior year financial statements, Federal Managers' Financial Integrity Act (FMFIA) reports and supporting documentation, Inspector General and internal audit reports, and Congressional hearings and reports.

[TR3-Revised, ¶15]

.3007 The auditor may gather planning information through different methods such as observing agency operations, interviewing agency staff, reviewing procedures manuals, and conducting walk-throughs. In addition, the auditor may gather information from relevant reports, including prior year financial statements, Federal Managers' Financial Integrity Act (FMFIA) reports and supporting documentation, Inspector General and internal audit reports, and congressional hearings and reports. [TR3-Revised, ¶16]

Identifying Key Assumptions

.3008 One way for the auditor to maximize audit efficiency is to focus on the key assumptions, i.e., those assumptions that have the greatest impact on the credit subsidy rate and hence, the credit subsidy amount. To identify key assumptions, the auditor should evaluate and retest selected areas of management's credit subsidy sensitivity analysis. For example, in performing this analysis, agency management may have varied the subsidy estimate assumptions by a fixed amount, such as 10 percent in either direction, and was thus

[26] The auditor should actively coordinate general and application control reviews of financial management systems to ensure that they focus on controls over key cash flow reports such as defaults or prepayments as well as the controls over the cash flow spreadsheets. Further, the auditor should consider evaluating controls over the agency's use of the OMB Credit Subsidy Calculator. For a detailed discussion of the audit procedures related to the OMB Credit Subsidy Calculator, refer to the Report of Independent Accountants and Independent Verification and Validation (Y2K) Documents Pertaining to the Credit Subsidy Calculator, available on OMB's Federal Credit Support Page prepared by the Budget Analysis Branch: http://www.omb.gov/credit. These audit procedures have been included in this technical release in summary form.

[27] Although the actual testing of technical system-related controls should generally be performed by a systems audit specialist, the financial statement audit team should participate in identifying and testing general controls, user controls, and application controls to tentatively conclude on the effectiveness of systems-related controls.

able to identify the degree to which the subsidy rate was sensitive to different assumptions. These assumptions often require greater audit effort because minor variations may have material effects on the subsidy amount. The auditor should review this sensitivity analysis carefully and retest selected portions as necessary to gain comfort with management's work before relying on it. In resetting the agency's sensitivity analysis, the auditor should consider recalculating the impact that changes in key assumptions have on a credit program's subsidy amounts. [TR3-Revised, ¶17]

.3009 When identifying key assumptions, additional consideration should also be given to those assumptions that fluctuate significantly. These assumptions may be more difficult to predict, and their normal fluctuation may materially affect the credit subsidy amount even though the credit subsidy amount may not change significantly during the sensitivity analysis. For example, prepayments may be difficult to predict since historically they fluctuated ten percent or more over the past five years. Thus, even though the auditor did not identify prepayments as a key assumption during the review of the agency's sensitivity analysis, prepayments should be considered a key assumption because their normal fluctuation may materially affect the credit subsidy amount. [TR3-Revised, ¶18]

.3010 If management has not performed sensitivity analysis of the credit subsidy assumptions, the auditor may consider performing a sensitivity analysis or other analysis to identify the key cash flow assumptions. This analysis will allow the auditor to focus on key areas and will increase the auditor's efficiency in the substantive testing phase of the audit. [TR3-Revised, ¶19]

Identifying Material and High Risk Credit Programs for Internal Control and Substantive Testing

.3011 In order for the auditor to maximize efficiency and effectiveness when selecting programs for internal control testing and substantive testing, the auditor should focus efforts on material programs. Generally, material programs have higher inherent risk than immaterial programs. Materiality is defined in Financial Accounting Standards Board Statement of Financial Concepts No. 2, *Qualitative Characteristics of Accounting Information*, 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." Thus, items of little importance are less likely to affect the financial

statement users' judgment. Materiality has both qualitative and quantitative factors, since certain types of relatively immaterial misstatements from a quantitative standpoint could be significant for other reasons. For example, some programs that are immaterial in amount could be sensitive because of Congressional interest. [TR3-Revised, ¶20]

.3012 According to Statement on Auditing Standard 47, AU Section 312, *Audit Risk and Materiality in Conducting an Audit*, "audit risk and materiality, among other matters, need to be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures." The following list includes some of the factors that the auditor should consider in determining which direct loan or loan guarantee programs are material and/or high risk and therefore should be selected for testing.

- The amount of subsidy expense for a given program,
- The dollar value of the program's direct loans on the balance sheet,
- The dollar value of the program's loan guarantees and their related liability for default,
- The dollar amount of subsidy expense, magnitude of transactions, and variance of past reestimates,
- Past audit experience for the program,
- The auditor's preliminary assessment of risk,
- Recent significant changes in economic conditions,
- The complexity of the program (the number, size, and technical difficulty of the loans),
- The age of the program (new programs may have more risk than older established programs, other things being equal),
- The degree to which sub-recipients, contractors, and private lenders make decisions about implementing the program, and
- Congressional and other public policy interest in a given program.

[TR3-Revised, ¶21]

.3013 This list is designed to assist the auditor in identifying material and/or high-risk programs. The above list is not designed to replace professional judgment. For example, a credit program could have a relatively small subsidy expense because the agency nets gross

subsidy expense components with offsetting fees, in accordance with SFFAS No. 2 and the Credit Reform Act. However, the auditor should not focus solely on the net subsidy expense. Rather, the auditor should consider the gross amounts of the subsidy expense and fees, the total loans receivable, and/or the total liability for loan guarantee account when determining whether the program is material. [TR3-Revised, ¶22]

.3014 Past audit experience should be considered since it may indicate that the program should be retested again this year when, for example, significant internal control weaknesses were discovered in the prior year's audit. Conversely, past audit experience may allow the auditor to reduce the level of current year testing for the program. Factors that should be considered in determining the appropriate level of detailed substantive testing for material programs include:

- The number of years since the last time the program was included in internal control and substantive testing,
- The results of the preliminary assessment of risk,
- Changes in economic events that affect the current cash flow assumptions,
- The level of employee turnover, and
- Changes in program characteristics, terms of credit, or implementation.

[TR3-Revised, ¶23]

.3015 Finally, when inherent risk is low and the agency's control environment is strong, the auditor may consider testing credit programs on a rotating basis. In determining whether rotational testing is appropriate, the auditor should consider (1) the results of prior audit experience, (2) the length of time since the program was tested, (3) the materiality of the program, and (4) the auditor's assessment of inherent and control risk. [TR3-Revised, ¶24]

.3016 Upon completion of the internal control testing, the auditor may wish to revise the assessment of which programs are material and/or high risk. For example, the auditor's preliminary risk assessment may not be supported by the results of the internal control testing. When the results of the internal control testing lead the auditor to conclude that the internal control is not operating effectively, the

auditor may revise the risk assessment for programs originally expected to have low risk. As a result, the auditor should include these programs in the detailed substantive testing. On the other hand, the auditor may decide to reduce the extent of detailed substantive testing for a material program based on the results of internal control testing. [TR3-Revised, ¶25]

Assessing Inherent Risk and the Effects of Information Technology

.3017 Based on the auditor's understanding of the credit subsidy estimation process, the auditor identifies specific inherent risks[28] and control environment weaknesses. To identify inherent risk factors, the auditor generally focuses on (1) the nature of the agency's program, (2) prior history of audit adjustments, and (3) the nature of material transactions. The nature of an agency's program may increase inherent risk. For example, some loan guarantee programs may be more susceptible to errors because of loans issued and serviced by third parties. Significant audit adjustments in previous audits often identify problem areas that may continue to result in financial statement misstatements. Accounts involving subjective management judgments, such as credit subsidy estimates and the liability for loan guarantees, are usually higher risk than those involving objective determinations. [TR3-Revised, ¶26]

.3018 Information Technology can also introduce inherent risk factors. The auditor should assess systems-related factors and determine the overall impact of information technology on inherent risk. For example, unusual or non-routine transactions generally increase inherent risk. Programs or systems developed to estimate credit subsidy amounts, e.g., the agency's cash flow spreadsheets, may not be subjected to the same procedures and controls as EDP programs and systems developed to process routine transactions. The degree of existence and completeness of the audit trail may also increase inherent risk. The audit trail demonstrates how a specific transaction was initiated and processed. Some EDP financial management systems are designed so that the audit trail exists only for a limited period, only in electronic format, or only in summary form. Uniform processing of transactions may also increase

[28] Inherent risk is the susceptibility of a financial statement assertion to a material misstatement, assuming that there are no related internal controls. Financial statement assertions are representations by management that are embodied in financial statement components. See *Codification of Statements on Auditing Standards*, AU Section 326.

inherent risk because a programming error will consistently misstate transactions. For example, if an agency misstates a cash flow assumption, such as defaults, recoveries, or the interest rate, in a cash flow spreadsheet that has been electronically linked to other cash flow spreadsheets, the error will affect all of the linked cohorts or programs. As a result, the auditor must be aware that some errors may be systemic rather than isolated incidents and the auditor should be careful to distinguish between the two. [TR3-Revised, ¶27]

Testing Internal control

.3019 As noted above, the auditor should select material programs for internal control and detailed substantive testing. In this way, the auditor will more effectively and efficiently focus audit efforts on the programs that are most significant to the users of the financial statements. In some instances, more than one program will utilize the same system of internal control. Thus, the auditor would need only test the system once to gain assurance on all related programs. This section provides guidance for the auditor to use in evaluating the agency's internal control for material and/or high-risk credit programs so that the auditor can determine the nature, timing, and extent of substantive tests to perform on credit reform related accounts such as subsidy expense, allowance for subsidy, and liabilities for loan guarantees. The auditor needs to evaluate the agency's internal control before updating the preliminary assessment of the control risk.[29] [TR3-Revised, ¶28]

.3020 Due to the complexity of credit reform, it is necessary for the auditor to obtain a good understanding of the internal control components to design effective substantive tests. If, after evaluating the agency's internal control, the auditor assesses control risk at a high level, the auditor will need to obtain most, if not all, of the audit assurance from substantive tests. Thus, the auditor will need to expand the level of detailed substantive testing. However, if the auditor determines that control risk is low based on the evaluation of the agency's internal control, the auditor has more assurance concerning the accuracy of the information generated within that

[29] Control risk is the risk that a material misstatement could occur in a financial statement assertion and will not be prevented, detected, and corrected on a timely basis by the entity's internal control structure.

structure. Thus, the auditor may be able to reduce the level of detailed substantive testing. [TR3-Revised, ¶29]

.3021 Internal control is a process--affected by an agency's management[30] and other personnel--to provide reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, control activities, information and communication, risk assessment, and monitoring. The auditor should consider the following when obtaining an understanding of the agency's internal control. [TR3-Revised, ¶30]

Assessing the Control Environment

.3022 The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing the discipline and structure. When assessing the control environment, the auditor should consider management's philosophy and operating style (done elsewhere in the audit) and generally perform the following steps for the material programs' systems of internal control.

a. Determine whether the same estimation process was used for other programs by comparing the documented procedures between programs. If the same process was used between programs, the results of the internal control testing for this program may help the auditor gain comfort with other programs.

b. Determine how management assures itself that established procedures and internal control have been consistently implemented among the various divisions/branches responsible for preparing subsidy expense estimates.

[30] In this technical release, the term "agency management" is used in the same context as it is used in OMB Circular A-123 and may include any individual Federal manager responsible for ensuring that credit reform is implemented efficiently and effectively to achieve intended program results. Agency management could include, but is not limited to, the Chief Financial Officer, Director of Budget, and Controller.

c. Determine how management assures itself that the historical data used as the basis for the subsidy amounts accurately supports the cash flow assumptions.

d. Determine whether the agency has the appropriate supporting documentation for key assumptions as outlined in Appendix A of this technical release.

e. Determine how management assures itself that assumptions or data requirements which are based on conditions affecting multiple programs and cohorts are uniformly applied. For example, identify and test the controls in place that management relies on to ensure that:

   - Similar assumptions are made concerning economic conditions for a particular business sector where both direct and guaranteed credit programs are delivered,
   - Historical data for subsidy expense components are consistently collected and interpreted among similar programs, and
   - Options chosen for the OMB Credit Subsidy Calculator properly reflect the specific characteristics of the applicable credit program.

f. Review management's comparison of projected cash flows to actual cash flows from the accounting department. Determine whether management (1) appropriately identified material variances and the cause of these variances, (2) performed trend analysis of the credit subsidy components, (3) adjusted future cash flow estimates of those cohorts to reflect these variances, (4) determined whether there was a flaw in the cash flow spreadsheet that caused the variance and, if so, determined the impact this flaw had on all cohorts, and (5) reestimated subsequent years' subsidy amounts, as appropriate.

g. Determine whether the agency is appropriately using the latest version of the OMB Credit Subsidy Calculator by recalculating the subsidy rate with the agency's estimated cash flows.[31]

[31] A copy of the model is available from OMB's Budget Analysis Branch.

h. If applicable, determine whether waivers were obtained from OMB for years in which subsidy reestimates were not performed in accordance with OMB guidance.

i. Determine how management assures itself that the agency used the proper scale for the cash flow spreadsheets. Some program subsidy rates, particularly those for programs disbursing over several years, may be influenced significantly by the scale for cash flow values. Therefore, management should determine whether an appropriate scale has been used so that rounding to three decimal places has no significant effect on the cash flow spreadsheet values and the subsidy rate.

j. Determine how management assures itself that the agency has appropriately prepared cash flows using a cohort basis or disbursement year basis. For example, when a program disburses over more than one year, the auditor should determine whether the agency used a disbursement year basis. If the agency used a cohort basis, the auditor should determine why the agency did not use a disbursement year basis and whether the use of cohort level cash flows has had a material effect on the subsidy calculation. If the effect is material, the auditor should recommend that the agency prepare cash flows on a disbursement year basis to eliminate the problem.

k. Determine whether agencies have controls over access to the OMB Credit Subsidy Calculator, e.g., confirmation of passwords, and determine whether these controls adequately protect the model from unauthorized use and corruption.

[TR3-Revised, ¶31]

Control Activities

.3023 Control activities are the policies and procedures designed to ensure that management directives are carried out. Control activities have various objectives and are applied at various organizational and functional levels. Control activities can include physical controls, segregation of duties, performance reviews, and information processing. When assessing management's assignment of responsibility and delegation of authority for ensuring the efficient and effective implementation of credit reform, the auditor should consider doing the following.

a. Assess management's control methods for monitoring and following up on the agency's ability to prepare reliable subsidy estimates by reviewing, on a test basis for material programs, management's comparison of projected net cash flows with actual cash flows to determine whether over time projected cash flows are becoming more representative of actual cash flows and whether reestimates are the result of controllable factors (technical cash flow assumptions) or uncontrollable factors (discount rate assumptions).

b. Verify that the cash flow assumptions that the agency used in developing its cash flow estimates were reviewed and approved by the appropriate agency management.

c. Determine how management assures itself of the reliability and logic flow in formulas and mathematical functions within agency initial cash flow worksheets.

d. Assess the internal control used by management to ensure that changes made to cash flow spreadsheet formulas are appropriate. For example, if changes made to one cash flow spreadsheet need to be carried forward to other spreadsheets, determine whether this is done automatically or if each spreadsheet must be updated individually. Assess the risk of errors being introduced during this process.

e. Determine whether management has a systematic process in place to identify significant changes in economic or other assumptions that will affect subsidy rates of existing cohorts. Determine whether management has a systematic process in place to calculate the differences between actual and estimated cash flows and the possible effect of these differences on the future cash flows of existing cohorts. Determine whether this process assesses the materiality of these changes on the cash flow estimates and the subsidy expense and appropriately concludes whether reestimates are required under OMB guidance. In evaluating potential changes in cash flow assumptions, the process should assess the impact that various factors may have on the program (which also may affect subsidy rates), such as:

    - Legislative program changes,

- Administrative program changes,
- Environmental changes,
- Operational changes, e.g., a reduction in employees because of budgetary constraints that would impact the servicing of loans,
- War, and
- International economic factors.

f. Determine how management assesses the impact of changes in laws or regulations on the reliability of estimates. For example, a legislative program change may include provisions about maturity or type of borrowers that are outside the scope of past agency experience or may include program changes that shift the composition of new lending toward more or less risky borrowers. Stratification of the portfolio by risk category[32] may enable management to assess the effect of the changes on the estimates. If the agency's databases do not permit such stratification, the uncertainty associated with the estimates may increase.

g. Determine whether management has a systematic process in place to estimate the effect of the factors considered in paragraph (e) above on the cash flows of new cohorts.

[TR3-Revised, ¶32]

.3024 Once specific controls related to the above activities have been identified, additional tests should be designed to ensure that the agency's controls are operating as designed. The auditor should consider using dual purpose testing to combine the internal control testing with substantive testing as appropriate. Dual purpose testing is discussed in more detail in the section on substantive testing of subsidy estimates in this technical release. [TR3-Revised, ¶33]

Information and Communication

.3025 The quality of system-generated information affects management's ability to prepare reliable financial reports. Communication involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. The auditor should obtain an understanding of (1) the

[32] All cohort level guidance in this technical release also applies to risk categories when they are used.

classes of transactions in the agency's operations that are significant to credit reform accounting in accordance with Treasury case studies, (2) how those transactions are initiated, (3) the accounting records, supporting information, and specific accounts in the financial statements involved in the processing and reporting of the transactions, (4) the accounting process involved from the initiation of a transaction to its inclusion in the financial statements, and (5) the financial reporting process used to prepare the agency's financial statements, including significant accounting estimates and disclosures. When assessing controls over information and communication, the auditor should consider doing the following:

a. Identify and test the controls in place designed to ensure that appropriate personnel are made aware of any concerns that result from reviewing key cash flow assumptions and comparing estimated to actual cash flows as well as the actions taken to resolve the concerns and update the subsidy estimate as appropriate.

b. Determine whether internal control are in place to ensure that the data supporting the cash flow identifiers[33] used in the spreadsheets are appropriate and consistent with the description of the identifier contained in the applicable user's guide of the OMB Credit Subsidy Calculator. Effective internal control are needed to ensure that disclosures concerning the amount of subsidy expense related to interest differential (direct loans), interest supplement (loan guarantees), defaults (net of recoveries), fees, and other are reasonable. For example, the auditor should identify and test controls designed to ensure that the amount estimated for recoveries is based on reliable, complete information from the agency's past experience. For example, the auditor should also identify and test controls designed to ensure that, when compiling the information upon which the estimate is made, transactions have been properly classified as a recovery rather than a reduction in the amount of

[33] Cash flow identifiers are listed in the document, “How to organize cash flow estimates in a spreadsheet file,” which is available on the Federal Credit Support Page (http://www.omb.gov/credit). The document includes various elements the agency must consider when estimating net cash flows, such as disbursements, principal payments, interest payments, fees and other income, defaults, etc.

another cash identifier such as "defaults" or "losses other than default."

c. Determine whether controls are in place to ensure that all applicable credit program cash flows are addressed in the subsidy estimation process. For example, cash flows should be estimated for all transaction types that affect Standard General Ledger Account nos. 1399, Allowance for Subsidy, and 2180, Loan Guarantee Liability. Conversely, transactions in unrelated accounts should be excluded from the subsidy calculation. To test these controls, the auditor should consider reviewing the cash flow worksheet input and the program description to determine whether all applicable cash flow types have been included. In addition, the auditor should review the transaction types included in the Allowance for Subsidy and the Liabilities for Loan Guarantees accounts on a test basis to determine whether these transactions are appropriate.

[TR3-Revised, ¶34]

Risk Assessment

.3026 The risk assessment process is an internal process used by the agency to (1) identify and analyze the relevant risks to achieving its objectives and (2) develop a plan to mitigate the identified risk. The auditor should obtain sufficient knowledge of the agency's risk assessment process to understand how management identifies, evaluates, and mitigates risks relevant to developing reliable credit subsidy estimates. In evaluating the risk assessment process, the auditor should determine if management developed a strategic plan with goals and objectives for ultimately improving the reliability of estimates. The auditor should determine whether this plan addresses (1) clearly defining the data requirements, (2) developing an effective information store and modeling methods as described in issue paper 96-CR-7 *Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store*, available from the AAPC web page (http://fasab.gov/aapc/cdreform/othercrddoc.htm), (3) improving the methods of estimating cash flows, and (4) step-by-step resource allocations and target completion dates to meet the goals and objectives of the strategic plan. Also the auditor should assess management's progress at meeting the plan's goals and the targeted completion dates. [TR3-Revised, ¶35]

Monitoring

.3027 Management should monitor controls to determine whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring is a process that assesses the quality of internal control performance over time. OMB Circular A-123, Management Accountability and Control, is issued under the authority of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 and provides guidance to federal managers on improving the accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on management controls. During federal financial statement audits, the auditor is required to assess the agency's compliance with the FMFIA. The auditor should obtain sufficient knowledge of the major types of activities the entity uses to monitor internal control over financial reporting, including how those activities are used to initiate corrective actions. When assessing control risk, the auditor should be cognizant of any material weaknesses reported in the agency's FMFIA report that relate to the efficient and effective implementation of credit reform. [TR3-Revised, ¶36]

Substantive Testing of Subsidy Estimates

.3028 Agencies are required by SFFAS No. 2 to account for subsidies at the cohort level in their accounting systems. This information is then aggregated for inclusion in the financial statements. As previously noted, footnote information related to credit programs is typically reported at the fund or program level and the total subsidy expense for the year is divided among three categories: the current year's direct loans or loan guarantees, modifications, and reestimates. The subsidy expense for the current year's direct loans or loan guarantees is segregated into four categories consisting of interest differential or supplement, defaults, fees, and other. The auditor needs to gain assurance about these cost categories at the aggregated fund/program level; however, it is difficult for the auditor to apply adequate procedures for summary amounts which represent numerous cohorts. It would be difficult to explain variations in aggregated amounts without addressing the more detailed cohort level. Determination of what level to disaggregate subsidy information for the purposes of an audit will vary for each agency and will be contingent on current practice and available information. [TR3-Revised, ¶37]

General Approach to Substantive Testing

.3029 The following four steps provide a general approach for performing substantive testing. Detailed guidance on implementing these four

general steps follows. The nature, timing, and extent of substantive tests will be significantly influenced by the auditor's assessment of the internal control environment. **This section is written under the premise that the agency has established effective internal control.** The next section includes a discussion of the impact of ineffective controls on the nature, timing, and extent of substantive testing as well as the impact on the audit opinion.

a. Select a representative sample of cohorts for detailed testing, for those material programs selected for internal control testing.[34]

b. Test sampled cohort estimates to determine whether the credit reform process is working as defined and whether the account balance is reasonably stated.

c. erform analytical review procedures to gain assurance that the estimates are reasonable for lines of business, funds, programs, or cohorts not selected for detail testing.

d. Conclude on audit differences identified during the test work and determine the financial statement impact.

[TR3-Revised, ¶38]

Impact of Ineffective Internal control on Substantive Testing

.3030 The auditor's assessment and conclusions regarding the effectiveness of the agency's internal control structure, including computer security and the effectiveness of edits and other system controls, will significantly impact the level of substantive testing. If the agency's internal control structure is not effective (i.e., does not adequately reduce the risk that a material misstatement related to credit reform in the financial statements would be detected and corrected), the auditor will need to design substantive tests to gain assurance on the account balance and propose audit adjustments as necessary. [TR3-Revised, ¶39]

.3031 For example, if there is no system in place to trigger reestimates, the auditor will need to review management's comparison of actual cash

[34] Professional standards stated in AU Section 350.24 that "sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected."

flows for material programs to projected cash flows to search for and identify material variances. In addition, the auditor will need to determine whether the agency identified other factors that may materially affect future cash flows, e.g., economic downturn, program changes, or drought, and may require a reestimate. If the budgeted to actual cash flow comparison was not done by the agency, the auditor should consider performing this analysis based on resource availability. Based on the auditor's analysis of the identified variances and other changes that may affect future cash flows, the auditor should determine whether a reestimate is necessary and urge the agency to calculate the reestimate. Once the reestimate is made, the auditor is then able to assess the impact of the reestimate on the financial statements. [TR3-Revised, ¶40]

.3032 If in the auditor's opinion (1) the internal control weaknesses are so significant that the subsidy expense is likely to be materially misstated, (2) resource constraints make it unreasonable for the auditor to conduct the level of substantive testing necessary to determine the possible audit adjustments, or (3) resource constraints at the agency make it unreasonable to calculate all the necessary material reestimates and include them in the financial statements, the auditor would likely be required to modify the audit opinion. For example, the monitoring process to determine whether reestimates are necessary is a key internal control. Without effective monitoring, the agency may not have reasonable assurance that material reestimates will be made timely and the auditor would need to expand the level of substantive testing. When an agency does not (1) reestimate credit subsidies for the most recently completed fiscal year and include the reestimate in the current year's financial statements or (2) provide assurance that there is no material financial statement impact (as specified in TR 6 paragraphs 47 – 58), the auditor should consider modifying the audit opinion. [TR3-Revised, ¶41]

.3033 When assessing the financial statement impact of subsequent events related to credit subsidies, the auditor should follow the guidance in AU Section 342.13 for events occurring after the reestimate date but before the end of fieldwork. In addition, auditors should consider AU Sections 508.19 and .29 - .32 when assessing the effect of uncertainties on the agency's financial statements and the auditor's opinion. [TR3-Revised, ¶42]

Selecting the Sample of Cohorts

.3034 The procedures for selecting a sample of cohorts depend upon the type of information to be gleaned from the sample and the desired precision of sample estimates. The sampled cohort is tested to determine whether the credit reform process is working as defined and more specifically, whether the related balance sheet and statement of net cost line items are reasonably stated. In order to gain audit efficiencies, the auditor should consider utilizing dual purpose testing[35] for a representative sample of cohorts selected from material credit programs. In this way, the auditor will be able to gain assurance from the same sample that both the internal control structure is effective and that the account balance is reasonably stated in relation to the financial statements taken as a whole. When more than one program utilizes the same system of internal control, the auditor should only test the system once to gain assurance on all related programs and their cohorts. To utilize representative sampling, the auditor must select sample items in such a way that each item in the population has an opportunity to be selected and the estimators are appropriate for the selection methods. In this way, the sample and the resulting estimate or projection are expected to be representative of the population from which the sample was selected. In addition, sufficient sample sizes are necessary in order for the auditor to arrive at meaningful conclusions. [TR3-Revised, ¶43]

.3035 The auditor may wish to stratify the population of cohorts into homogeneous groups prior to selecting the sample to improve sampling efficiency. For example, the auditor may stratify the cohort population into the following three significant groups: (1) material cohorts of such a magnitude that the auditor will test them all, (2) material cohorts that the auditor will sample for testing, and (3) immaterial cohorts that will be subjected to analytical review procedures. For some agencies, the small number of cohorts may prohibit using this sampling approach. In these instances, the auditor should focus on selecting a representative sample in a nonstatistical manner, i.e., using auditor's judgment to select material cohorts for testing to obtain sufficient coverage of the balance being audited or doing a 100 percent sample. [TR3-Revised, ¶44]

[35] Dual purpose testing often improves audit efficiency by performing multiple audit procedures on a single sample, e.g., internal control attribute and substantive testing.

.3036 Alternatively, when the agency's control environment is strong and inherent risk is low, the auditor may test cohorts on a rotating basis. In determining whether rotational testing is appropriate, the auditor should consider (1) the results of prior audit experience, (2) the length of time since the cohort was tested, (3) the materiality of the cohort in terms of the relative effect of the cohort on total program expenditures or the size of the program in absolute dollars, and (4) the auditor's assessment of inherent and control risk. The auditor may wish to score these factors in determining the cohort's relative risk. Based on the cohort's score, the auditor may establish a rotation matrix for substantive testing. For example, all cohorts above a predetermined score would be considered high risk and selected for substantive testing while other cohorts below this score could be tested on a rotating basis. [TR3-Revised, ¶45]

Testing Sampled Cohorts

.3037 Professional standards call for the auditor to "analyze historical data used in developing the assumptions to assess whether the data are comparable and consistent with data of the period under audit, and consider whether such data are sufficiently reliable for the purpose."[36] In the planning phase, the auditor identified the key assumptions as those whose variation had the greatest impact on the subsidy rate or which varied significantly. Based on this work, and the results of the internal control analyses, the auditor should be able to focus on the key assumptions. However, these key assumptions may be tested in conjunction with the audit of other financial statement line items. For example, the default rate assumption for guaranteed loans can be tested as part of the audit of claim payments, recovery rate assumptions can be tested during the audit of foreclosed property, fees can be audited in conjunction with insurance premium or other cash receipts, and prepayments can be audited during the audit of insurance in force. In these cases, the auditor must carefully plan the audit samples for these areas in order to include information that will be applicable to the credit subsidy audit and gather sufficient evidence for the auditor to determine the reasonableness of the credit subsidy. For example, when auditing credit subsidy default, prepayment, and recovery assumptions, it is important to determine for which cohort the claim payment was made. [TR3-Revised, ¶46]

[36] Codification of Statements on Auditing Standards, AU Section 342, Auditing Accounting Estimates.

.3038 The following are examples of the types of tests the auditor can perform on a representative sample of cohorts selected for dual purpose testing:

a. Collect projected cash flow worksheets used for budget execution and the most recent reestimates for each cohort selected for testing to determine whether the program assumptions are utilized at the cohort level. Trace and compare key cash flow assumptions to the agency's supporting data, including reports on defaults, prepayments, recoveries, etc.

b. Verify the reliability of the data used in developing the assumptions and ensure that key assumptions are sufficiently reliable by

- Comparing the reports to similar reports tested in related audit areas to assess consistency and
- Tracing summary reports to historical supporting documentation, on a test basis, to determine whether the reports are complete and accurate.

c. Determine whether management used reasonable and systematic methods to project key cash flow assumptions by reviewing, assessing, and recalculating, on a test basis, key portions of the cash flow worksheets.

d. Based on the results of system-related control tests, the auditor should consider obtaining an appropriate, unmodified version of the OMB Credit Subsidy Calculator, downloading the agency's cash flows into this version, and comparing the output to the agency's subsidy calculation. In performing these procedures, it is important for the auditor to use the same cash flows as those used to calculate the subsidy rate. Thus, the auditor should verify that the file name, range name, and the date and time the spreadsheet was last changed matches the information on the model output. If differences are identified through this comparison, the auditor should consider recalculating the subsidy rate using the agency's data and an appropriate copy of the model.[37] Differences between the auditor's recalculated rate and the agency's rate should be investigated and explained.

e. The auditor should review the OMB Credit Subsidy Calculator output to determine whether any warning messages are listed and, if so, to determine why the situation causing the warning message was not resolved and whether not eliminating the error could have any impact on the subsidy rate calculation. Also, if applicable, auditors should determine whether the suppression of any error messages was appropriate by checking the agency's cash flow spreadsheet to determine whether the "suppress warnings" command was used and assess the impact these suppressed error messages could have on the subsidy rate.

f. The auditor should determine whether the OMB Credit Subsidy Calculator options that were selected properly reflect specific characteristics of the applicable credit program. For example, the OMB Credit Subsidy Calculator options for the timing of principal and interest payments for direct loan programs and the timing of commitments and disbursements by the private lender of a loan guaranteed should agree with the program's credit terms.

g. Verify that reestimates were performed under the conditions specified in Technical Release 6. Determine whether reestimates were performed in addition to those required in Technical Release 6. For example, reestimates required for budgetary purposes may not be material to the financial statements.

h. Determine that these reestimates were completed, included in the financial statements, and submitted to OMB.

i. Determine whether the re-estimation process included adjustments to subsequent years' estimates of cash flows for this cohort.

j. Determine why reestimates were not calculated[38] and included in the financial statements, if applicable. When reestimates are not prepared for the most recently completed fiscal year, the agency must document the reason for forgoing the reestimate otherwise required in Circular A-11 and SFFAS No. 2 and provide the

[37] A copy of the model is available on OMB's Federal Credit Support Page (http://www.omb.gov/credit) or from OMB's Budget Analysis Branch.

necessary supporting documentation to OMB and the auditor. The documentation should address the requirements prescribed in Technical Release 6.

k. Trace interest rates to approved OMB rates to ensure that interest expense and income are calculated in accordance with OMB Circular A-11.

l. Determine if the reestimates recorded in the accounting records were submitted to OMB.

m. Determine whether modifications occurred as defined in SFFAS No. 2 and OMB Circulars A-11 and whether the modification cost was estimated.

n. Verify whether the cash flows and discount rates used to calculate the pre-modification and post-modification values of the direct loans (or values of the loan guarantee liability) were determined appropriately.

o. Verify whether the modification cost was submitted to OMB, recorded in the accounting

[TR3-Revised, ¶47]

Analytical Review Procedures

.3039 Analytical review procedures can be performed on lines of business, funds, programs, or cohorts not selected for detailed testing. Generally, these procedures consist of comparing recorded balances of subsidy expense, fund balance with Treasury, debt owed to Treasury, credit program receivables and related foreclosed property, and the liabilities for loan guarantees, with the auditor's expectations. The basic premise of analytical review procedures is that plausible relationships among data may be expected to continue unless conditions are known that would change the relationship.

[38] OMB has established a four-step process, outlined in Circular A-11, for agencies to calculate technical reestimates for the budget less often than every fiscal year—subject to OMB approval. However, this guidance does not allow agencies to omit material technical reestimates from the current year financial statements or to postpone including material technical reestimates in the financial statements until a subsequent year. Conversely, the OMB process may require agencies to make technical reestimates for the budget that are not material to the financial statements.

Based on the results of the analytical review procedures outlined below, some programs may be selected for detail substantive testing. In applying analytical review procedures, the auditor should consider the following procedures.

a. Based on the information gathered during the internal control phase of the audit, including the auditor's understanding of the estimation process and economic events affecting the period under review, develop an expectation or estimate of what the recorded amount should be. For example, the auditor could compute an estimate of the subsidy expense by using averages as an overall test of reasonableness, i.e., average loans outstanding, average interest rate, average default rate, and average fees. Compare the results of the auditor's estimate to the actual recorded balance to identify significant differences that require investigation. When making estimates of an account balance, the auditor should assess the reliability of the data used and the impact faulty data could have on the auditor's expectation of the subsidy amount.

b. Compare the subsidy amounts for lines of business, funds, programs, or cohorts not selected for sampling for three or more years to identify trends and significant fluctuations in the subsidy rates.

c. Obtain explanations for these fluctuations from management to determine whether the fluctuations are reasonable. Scan[39] cash flow worksheets/reports to search for unusual items and investigate significant fluctuations.

d. Corroborate management's explanations as necessary. Corroboration generally consists of reviewing related supporting documentation or obtaining explanations from accounting or budget personnel or from the appropriate program department. These explanations should be quantified and address the direction and magnitude of the event causing the fluctuation.

[39] Although scanning is not usually considered an analytical procedure on its own, this technique could be used to investigate unusual fluctuations in subsidy amounts or corroborate management's explanation of variances between projected cash flows and actual cash flows.

e. If the explanation and/or corroborating evidence do not adequately explain the fluctuation, the auditor should consider

- Increasing the precision in the auditor's expectations,
- Increasing the extent of detailed testing for the cohorts discussed above and not relying on the analytical procedures, or
- Treating the difference as a misstatement.

f. Review and recalculate selected portions of the agency's trend analysis of the credit subsidy expense components to determine whether the agency identified and explained unusual or significant fluctuations in interest, defaults, fees, and other. If the agency has not done the credit subsidy component trend analysis, the auditor should consider performing this analysis. Once unusual or significant fluctuations have been identified, the auditor should obtain and corroborate management's explanation.

[TR3-Revised, ¶48]

Compliance with Laws and Regulations

.3040 By using the audit approach described in this technical release, the auditor will test compliance with the Federal Credit Reform Act of 1990, as amended. Thus, no separate audit procedures are necessary to test compliance with this act. [TR3-Revised, ¶49]

Concluding on the Reasonableness of Estimates

.3041 Statement on Auditing Standard No. 57 Auditing Accounting Estimates, AU 342, states that the auditor evaluates the reasonableness of accounting estimates in relationship to the financial statements taken as a whole. It goes on to state:

> "Since no one accounting estimate can be considered accurate with certainty, the auditor recognizes that a difference between an estimated amount best supported by the audit evidence and the estimated amount included in the financial statements may be reasonable, and such difference would not be considered to be a likely misstatement. However, if the auditor believes the estimated amount included in the financial statements is unreasonable, he should treat the difference between that estimate and the closest reasonable estimate as a likely misstatement and aggregate it with other likely misstatements. The auditor should also consider whether the difference between

estimates best supported by the audit evidence and the estimates included in the financial statement, which are individually reasonable, indicate a possible bias on the part of the entity's management. For example, if each accounting estimate included in the financial statements was individually reasonable, but the effect of the difference between each estimate best supported by the audit evidence was to increase income, the auditor should reconsider the estimates taken as a whole."

[TR3-Revised, ¶50]

.3042 Uncertainties, among other qualitative aspects of information in financial reports, are discussed in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, Objectives of Federal Financial Reporting. According to SFFAC No. 1, "Reliability [of financial information] 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." Thus, an amount reported in the financial statements may be "fairly stated," but still imprecise. In addition, SFFAC No. 1 states that "Financial reporting may need to include narrative explanations about underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all." In other words, imprecision of accounting estimates can be overcome, to some extent, by appropriate financial statement disclosures. In determining whether (1) the credit program receivables and related foreclosed property and the liabilities for loan guarantees line items on the balance sheet, (2) the subsidy expense included in the statement of net costs, and (3) related footnote disclosures regarding credit reform are reasonably stated, the auditor must evaluate and carefully consider all of the audit evidence gathered, including the results of the internal control testing, system reviews, detailed substantive testing, analytical review procedures, as well as the above authoritative guidance. [TR3-Revised, ¶51]

TR3-Revised. Appendix A: Acceptable Sources of Documentation for Subsidy Estimates and Reestimates

.3043 Documentation must be provided to support the assumptions used by the agency in the subsidy calculations. This documentation will not only facilitate the agency's review of the assumptions, a key internal control, it will also facilitate the auditor's review. Documentation should be complete and stand on its own, i.e., an independent person could perform the same steps and replicate the same results with little or no outside explanation or assistance. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purposes of reconstructing the estimate. [TR3-Revised, ¶52]

.3044 Management should ensure that the following documentation is available for initial subsidy estimates, reestimates, and modifications of existing credit programs:

1. Procedures for calculating the subsidy estimate,
2. Review and approval process of the subsidy estimate, including the sign-off procedure within the agency,
3. Calculation of the recorded subsidy estimates, including the underlying assumptions and cash flow model,
4. Historical supporting documents used in the underlying assumptions,
5. Documentation of relevant supporting actual cash and economic experience (including the date and source of reports, and how recently the data were updated), which may include:
    - Cash reports on historical performance,
    - Historical data and trends, citing sources of information and relevant time frame,
    - Sensitivity analysis or other analysis that identifies the most critical factors,
    - Reports from the accounting or management systems showing trends
    - Actuarial studies,
6. Experience of other agencies with similar programs,

- Emergencies (acts of God) or legislated changes (acts of Congress), such as changes in the program terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population, and
- Economic and/or industry data and subsequent analyses, including industry studies, journal articles, trade papers, and third party studies.[40]
- Documentation of relevant program design factors, which may include:
- Program definition including fees, grace period, term to maturity, borrower interest rates, legal definitions, and enabling or enacted legislation,
- Legislation or regulations changing the terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population,
- Program eligibility requirements,
- Lender agreements detailing the terms of the guarantee, and
- Borrower contracts outlining the terms and conditions of the loan or guarantee.

[TR3-Revised, ¶53]

.3045 Management should ensure that the following documentation is available for new programs or changes to existing programs that may not have historical supporting documentation for cash flow assumptions and spreadsheets. In the absence of valid and relevant historical experience as the support for cash flow assumptions, the agency should document the basis for cash flow assumptions. Typical support will include:

- Relevant experiences from other agencies, including documentation of why another agency's experience is relevant, as well as similarities and differences (particularly possible

[40] For example, past data may document the historical relationship between interest rates, whereas an independent study may demonstrate how trends in past data are expected to change in the future.

biases) between the other agency's experience and the changes to existing programs or new programs,

- Extrapolation from subsets of prior program activity, e.g., while prior loans were not targeted for single heads of households, it may be possible to identify prior loans that were made to single heads of households and the experience of such loans in prior records.
- Assumptions used by underwriters for the purposes of determining eligibility, loan approval, or credit scoring.
- Private sector proxies for risk, such as bond ratings to assess default risk, may be used when there is no relevant Federal Government experience. For example, an agency may consider using bond ratings for a state agency that finances similar loan programs, such as education, farm, or housing, with bonds.
- Extrapolations from private sector lending experience including documentation explaining why this experience is applicable to the agency's credit program and possible biases for which an adjustment is needed, e.g., different borrower characteristics.
- Expert opinion may also be used as an interim measure to support cash flow assumptions. In these cases, the agency must document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis of the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:
    - Memos from conversations with outside experts,
    - Reports and studies on similar industry conditions,
    - Minutes from internal meetings describing the basis for any assumptions or changes in assumptions, and
    - Previous studies conducted by the expert, including industry studies, journal articles, and third party studies

[TR3-Revised, ¶54]

TR3-Revised. Appendix B: Technical Glossary Illustration

.3046 **Service or line of business** is defined as an aggregation of funds into a common grouping: for example, grouping funds into single family or multifamily designations. The following example is provided to illustrate the relationship the above terms have to each other and show how they may be aggregated for financial statement purposes. Agencies should consult applicable OMB guidance to determine what level of aggregation is most appropriate and acceptable.

<u>Business line or service</u>: Farm Service Agency

<u>Fund</u>:

A.CCC Export Guarantees
B.Agricultural Credit Insurance Fund

Program:

B1.Farm Ownership Loans
B2.Farm Operating Loans, subsidized
B3.Farm Operating Loans, unsubsidized

<u>Cohort</u>:

B3a. FY 1992 Farm Operating Loans, unsubsidized
B3b. FY 1993 Farm Operating Loans, unsubsidized
B3c. FY 1994 Farm Operating Loans, unsubsidized
B3d. FY 1995 Farm Operating Loans, unsubsidized
B3e. FY 1996 Farm Operating Loans, unsubsidized

<u>Risk category</u>:

B3e1. FY 1996 Farm Operating Loans, unsubsidized, Southwest Region
B3e2. FY 1996 Farm Operating Loans, unsubsidized, Northeast Region

[41] Terms and definitions from the TR3-Revised “technical glossary” are included in the L60 Glossary.

Case:

B3ai Fiscal year 1992 unsubsidized loan to farmer A
B3aiiFiscal year 1992 unsubsidized loan to farmer B

TR3-Revised. Appendix C: Summary of Reestimate Requirements

.3047 The table below summarizes the reestimate requirements for the budget and financial statement presentations.

	Budget	Financial Statement
Interest Rate Reestimate	Frequency: At least one time when the cohort is 90 percent disbursed - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	Frequency: Whenever the change in the interest rate materially affects the financial statements or, if no material change occurs prior to the cohort being 90 percent disbursed, at least one time when the cohort is 90 percent disbursed.
	Timing: At the end of the fiscal year.	Timing: Typically as of the end of the fiscal year.
Technical Reestimate	Frequency: Annually unless a different plan is approved by OMB - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	Frequency: Any year when material. Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.
	Timing: At the end of the fiscal year unless otherwise approved by OMB.	Timing: Typically as of the end of the fiscal year. Also, agencies must disclose if the reestimate was calculated at a time other than the end of the fiscal year.

Technical Guidance

Technical Release No. 6: Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act (Amendments to Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act)

Summary

The purpose of this technical release is to amend the implementation guidance for agencies to prepare and report credit subsidy estimates provided in Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (TR3), July 1999. The most significant changes made between the original TR3 and this amended TR are as follows:

a. Removal of the audit guidance from this amended TR to only include the preparation guidance.[42]

[42] Audit Guidance related to auditing direct loan and loan guarantee subsidies under the Federal Credit Reform Act can be found in TR3-Revised; Subject Area L60,¶3000-3047 in this volume.

b. Clarification of OMB's role in the credit subsidy estimation and re-estimation process. OMB has statutory authority over subsidy estimates in the Budget but has delegated the authority to calculate those estimates to the agencies. This document outlines guidance and tools provided by OMB for entities to use during their calculations of the credit subsidy estimates. The guidance also states that OMB provides economic assumptions to be used in the estimation and re-estimation of subsidies.

c. Credit subsidy reestimates may now include 6 months of actual data and 6 months of projected estimates. This would be a change from the current requirement of 9 months of actual data and 3 months of projected estimates.

The original Technical Release 3 (July 1999) contained audit guidance, as well as accounting guidance. Concurrent with the issuance of this technical release[43] on accounting guidance, Technical Release 3 was amended to contain only the audit guidance. [TR6, ¶1]

Readers of this technical release should first refer to the hierarchy of accounting standards in Statement on Auditing Standards (SAS) 91, *Federal Generally Accepted Accounting Principles Hierarchy* (or see AU411). This technical release supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This Technical Release is intended to facilitate consistency between the budgetary and financial statement presentation of subsidy estimates; however, fair presentation of subsidy estimates in the financial statements may be different from that in the President's Budget. [TR6, ¶2]

Federal agencies are required to account for direct loans and loan guarantees in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, and SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees*. In developing the financial accounting standards in SFFAS No. 2, the Board recognized "the value of having financial accounting support the budget" and recommended that "accounting standards for

[43] TR3 and TR6 were issued January 2004 and were effective immediately upon their issuance.

credit be consistent with budgeting under credit reform." Further, the Board stated 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."[44] This technical release provides guidance on acceptable accounting practice in light of current budgetary requirements. [TR6, ¶3]

Technical Release 6 includes sections on:

- OMB's role in the Subsidy estimation and re-estimation process and
- Preparing Direct Loan and Loan Guarantee Subsidy Estimates

[TR6, ¶4]

It also presents a Summary of Selected Reporting Requirements[45] in Appendix B. (See paragraph .3096 of this Subject Area Section.) [TR6, ¶5]

TR6 does not address loan asset sales and does not provide complete guidance for administrative expenses and pre-1992 direct loans and loan guarantees. Guidance on these areas can be found in SFFAS Nos. 2, 18, & 19 (which are offered in this volume as Subject Area L60, ¶100 - ¶160), OMB Circular No. A -11 and OMB Bulletin No. 01-09. Additional guidance on loan asset sales will be addressed separately in the future. [TR6, ¶6]

Since the Credit Reform Act of 1990 was passed, agencies have struggled with the numerous challenges in implementing the various provisions of the act--especially formulating credit subsidy estimates. This technical release is designed to provide guidance on the preparation of credit subsidy estimates. There are three parts of subsidy: initial subsidy, modifications of subsidy and reestimates of subsidy. A goal of this technical release is to provide implementation guidance that will ensure greater financial statement consistency with the accounting standards set forth in Statement

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[44] SFFAS No. 2, paragraph 17. Also see SFFAS No. 2 paragraph 66.

[45] The terms defined in TR6's Technical Glossary are included in the L60 Glossary.

of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, *SFFAS No. 18*, *Amendments to Accounting for Direct Loans and Loan Guarantees*, and SFFAS No. 19, *Technical Amendments to Accounting for Direct Loans and Loan Guarantees*.[46] [TR6, ¶7]

This technical release begins with a discussion of the OMB's role in the credit subsidy estimation and re-estimation process. It continues by addressing procedures for preparing estimates and reestimates--including acceptable interim alternatives in the absence of the ideal data store and estimation methods. This technical release also provides guidance on acceptable sources of documentation for subsidy estimates and reestimates. [TR6, ¶8]

OMB Role

.3048 Under the Federal Credit Reform Act of 1990, as amended, OMB is responsible for subsidy estimates published in the President's Budget. OMB has delegated the authority to the agencies to calculate estimates but retains the responsibility and final approval of subsidy estimates, reestimates, and modification cost estimates. For agencies that have credit programs, OMB provides guidance and specific tools for credit budgeting. [TR6, ¶11]

.3049 OMB Circulars A-11 *Preparation, Submission, and Execution of the Budget* and A-129 *Policies For Federal Credit Programs and Non-Tax Receivables* provide guidance to agencies on definitions, procedures and rules for calculating subsidy estimates and reestimates for the President's Budget and modification cost estimates, obligation of budget authority for the credit program's cost, and credit and receivables policy. [TR6, ¶12]

.3050 The Credit Subsidy Calculator (CSC) is a computer program provided to the agencies to calculate the cost of direct loans and loan guarantees using the agencies' cash flow estimates. The OMB Circular A-11 requires that all agencies with credit programs must

[46] Authoritative guidance for the recognition of many transactions under credit reform is also included in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, Appendix B. See Subject Areas L60, ¶.160-.103, .165 and .166 or T30, ¶.113-.116, .118 and .119 of this Volume.

use the CSC to discount the credit subsidy estimate and reestimate cash flows that they are responsible for generating. [TR6, ¶13]

.3051 OMB provides spreadsheets and instructions to calculate reestimates and interest paid and received for financing accounts.[47] [TR6, ¶14]

.3052 Each year, in preparing the President's Budget, OMB provides agencies with a set of economic assumptions that must be used when determining budget estimates. Some of these assumptions, such as gross domestic product (GDP), are used for both credit programs and others. For credit programs specifically, the economic assumptions include the discount rates, which are derived from the Treasury yield curve, used to calculate subsidy estimates. The discount rates are built into the most recent version of the CSC. Prior year actual discount rates and credit related assumptions are available from OMB ten business days prior to the close of the fiscal year. [TR6, ¶15]

Preparing Direct Loan and Loan Guarantee Estimates

.3053 Preparing reliable and timely direct loan and loan guarantee subsidy estimates must be a joint effort between the budget, CFO and program offices at each agency. These offices should work together to ensure that the procedures and internal control[48] outlined in this section are implemented and operating as designed. However, some agencies may not be able to effectively implement all of these procedures, since they have not yet developed the ideal data stores or methods of estimation necessary. Therefore, until the required information on all cash disbursements and collections related to direct or guaranteed loans can be collected at the case level and summarized, by cohort and program, the acceptable alternatives identified in this technical release will need to be utilized to provide

[47] The CSC and spreadsheets for calculating reestimates and financing account interest are available on the Federal Credit Support Page (http://www.omb.gov/credit).

[48] Internal control is an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, risk assessment, control activities, information and communication and monitoring.

the necessary information for developing subsidy estimates. [TR6, ¶16]

.3054 Agencies must accumulate sufficient relevant and reliable data on which to base cash flow projections. It is important to note that agencies should prepare all estimates and reestimates based upon the best available data at the time the estimates are made. Agencies should prepare and report reestimates of the credit subsidies, in accordance with SFFAS No. 2, 18, and 19, [Subject Area L60 of this Volume] to reflect the most recent data available as discussed in the reestimate section of this technical release. The OMB Circular A-11 also provides guidance on reestimating credit subsidies. Guidance on the types of supporting documentation that is acceptable is found in paragraphs .3071 - .3073 of this technical release. [TR6, ¶17]

.3055 In certain limited instances, informed opinion may be used to support cash flow projections in the absence of historical data. Informed opinion refers to the judgment of agency staff or others who make subsidy estimates based on their programmatic knowledge and/or experience without using a fully satisfactory information store and, in some cases, without using an econometric or other statistical model. Informed opinion may be used only as a last resort when relevant historical data and/or modeling capabilities are not available. This could occur when a new program has been established or when the Congress has changed an existing program in ways that cannot be represented by historical data. Informed opinion should therefore be used as an interim method only, and the agency should develop an action plan to establish an information store, appropriate models, and supporting documentation. [TR6, ¶18]

.3056 Certain conditions must be met before informed opinion will be considered an appropriate source of information. First, the expert's qualifications, such as professional or academic certification or length and kind of experience, must be assessed. Then, the basis of the stated opinion must be articulated and documented in detail. For example, a statistician may be best qualified to determine the appropriate kind of model for estimated cash flows using limited or imperfect data. Most importantly, the expert must document why that particular projection is appropriate for that particular program. [TR6, ¶19]

.3057 Documentation must be provided to support the assumptions used by the agency in the subsidy calculations. This documentation will not only facilitate the agency's review of the assumptions, a key internal control, it will also facilitate the auditor's review. Documentation should be complete and stand on its own, i.e., a knowledgeable independent person could perform the same steps and replicate the same results with little or no outside explanation or assistance. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purposes of reconstructing the estimate. [TR6, ¶20]

.3058 Management should ensure that the following documentation is available for initial subsidy estimates, reestimates, and modifications of existing credit programs.

1. Procedures for calculating the subsidy estimate,

2. Review and approval process of the subsidy estimate, including the sign-off procedure within the agency,

3. Calculation of the recorded subsidy estimates, including the underlying assumptions and cash flow model,

4. Historical supporting documents used in the underlying assumptions,

5. Documentation of relevant supporting actual cash and economic experience (including the date and source of reports, and how recently the data were updated), which may include:

- Cash reports on historical performance,
- Historical data and trends, citing sources of information and relevant time frame,
- Sensitivity analysis or other analysis that identifies the most critical factors,
- Reports from the accounting or management systems showing trends
- Actuarial studies,
- Experience of other agencies with similar programs,
- Emergencies (acts of God) or legislated changes (acts of Congress), such as changes in the program terms, maximum

allowable loan amount, total program size, or characteristics of the credit program's borrower population, and
- Economic and/or industry data and subsequent analyses, including industry studies, journal articles, trade papers, and third party studies. [49]

6. Documentation of relevant program design factors, which may include:

- Program definition including fees, grace period, term to maturity, borrower interest rates, legal definitions, and enabling or enacted legislation,
- Legislation or regulations changing the terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population,
- Program eligibility requirements,
- Lender agreements detailing the terms of the guarantee, and
- Borrower contracts outlining the terms and conditions of the loan or guarantee.

[TR6, ¶21]

.3059 Management should ensure that the following documentation is available for new programs or changes to existing programs that may not have historical supporting documentation for cash flow assumptions and spreadsheets. In the absence of valid and relevant historical experience as the support for cash flow assumptions, the agency should document the basis for cash flow assumptions. Typical support will include:

- Relevant experiences from other agencies, including documentation of why another agency's experience is relevant, as well as similarities and differences (particularly possible biases) between the other agency's experience and the changes to existing programs or new programs,
- Extrapolation from subsets of prior program activity, e.g., while prior loans were not targeted for single heads of households, it

[49] For example, past data may document the historical relationship between interest rates, whereas an independent study may demonstrate how trends in past data are expected to change in the future.

may be possible to identify prior loans that were made to single heads of households and the experience of such loans in prior records.

- Assumptions used by underwriters for the purposes of determining eligibility, loan approval, or credit scoring.
- Private sector proxies for risk, such as bond ratings to assess default risk, may be used when there is no relevant Federal Government experience. For example, an agency may consider using bond ratings for a state agency that finances similar loan programs, such as education, farm, or housing, with bonds.
- Extrapolations from private sector lending experience including documentation explaining why this experience is applicable to the agency's credit program and possible biases for which an adjustment is needed, e.g., different borrower characteristics.
- Expert opinion may also be used as an interim measure to support cash flow assumptions. In these cases, the agency must document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis of the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:
    - Memos from conversations with outside experts,
    - Reports and studies on similar industry conditions,
    - Minutes from internal meetings describing the basis for any assumptions or changes in assumptions, and
    - Previous studies conducted by the expert, including industry studies, journal articles, and third party studies.

[TR6, ¶22]

Overall CFO/Budget Procedures and Internal Control

.3060 Document the procedures and flow of information used in developing the agency's subsidy estimates at a high level, e.g., flow chart with supporting narrative. These documents should be used to establish consistent procedures for developing the subsidy estimates across funds/programs/cohorts. These documents should also include a discussion of who is responsible for each step of the estimate as well as the review and approval process followed. Documented procedures are necessary to communicate information on the subsidy estimation and re-estimation process to employees as

well as other interested parties, such as auditors and OMB examiners. Also, when employee turnover is experienced, these documented procedures will provide vital information for new employees on how to complete reliable, well supported estimates of the costs of credit programs. [TR6, ¶23]

.3061 Document the agency's cash flow model(s) used, the rationale for selecting the specific methodologies, and the degree of calibration[50] within the model(s). Also, document the sources of information, the logic flow, and the mechanics of the model(s) including the formulas and other mathematical functions. In addition, document the controls over the model(s) used by the agency in preparing cash flow worksheets. Further, document that the cash flow model(s) reflect the terms of the loan contracts and, in a loan guarantee program, the loan guarantee contracts. Additional details regarding internal control are discussed in the specific fund/program procedures and controls section of the technical release. [TR6, ¶24]

.3062 For agencies that have not yet implemented the ideal data store or implemented the estimation methods described in the *Model Credit Program Methods and Documentation for Estimating Subsidy Rates and The Model Information Store* (issue paper 96-CR-7), available from the AAPC web page (http://fasab.gov/aapc/cdreform/othercrddoc.htm), document management's strategic plans towards improving the agency's information store and estimation methods. This strategic plan should include who is responsible for various aspects of the plan and milestone dates for significant plan segments. Finally, it should document the progress at achieving the plan goals. [TR6, ¶25]

.3063 Ensure that general data and assumptions applicable to more than one cohort are used consistently for current year estimates and reestimates. For example, the overall economic conditions should be consistent for all cohorts within a program for a given fiscal year or management should document the reasons for the deviations,

[50] Calibration is the degree of precision within the model, i.e., the model's ability to accurately predict the cash flows of a given credit program. The degree of calibration within the model can be documented by charts or graphs showing projected cash flows versus the actual cash flows by year and cohort. This document would analyze the variance between projected cash flows and actual cash flows over time.

e.g., different economic assumptions could appropriately vary for specific geographic regions. [TR6, ¶26]

.3064 Ensure that estimates and all key assumptions used in preparing the budget and financial statements have been coordinated with both the program and accounting offices. [TR6, ¶27]

.3065 Management should assess the impact of changes in laws or regulations on the reliability of estimates and should ensure that the cash flow model reflects these changes. For example, a legislative program change may include provisions about maturity or type of borrowers that are outside the scope of past agency experience or may include program changes that shift the composition of new lending toward more or less risky borrowers. [TR6, ¶28]

.3066 The budget and accounting offices should work together to ensure that cash flow models are updated to reflect the actual cash flows and terms of the loan program recorded in the accounting records. Where material differences exist between the initial budgetary estimate and the actual cash flows, the differences should be investigated and reestimates and/or adjustments to the model should be made as required.[51] Actual obligations, disbursements, recoveries, and receipts should be recorded on a case-by-case basis. The detail of these transactions should be reflected in the accounting records. However, when this level of detailed information is not available, it may be necessary for the agency to record transactions on another basis. For example, agencies may only receive information in summary from entities that actually make the loans that the Government guarantees. As a result, the agency may need to estimate cash flows based on a detailed analysis of the loan portfolio as a whole and allocate program level cash receipts and disbursements to individual cohorts on an appropriate basis. The basis for this allocation should be clearly documented. Transactions may also be recorded based on estimates derived from representative samples of loans, and/or related transactions, e.g.,

[51] Reestimates may not be required in all cases where material differences exist between the initial budgetary estimate and the actual cash flows. For example, if offsetting differences exist in cash flows, such as positive difference in default recoveries and a negative difference in fees, a reestimate may not be necessary.

sampling of loan receipts to allocate cash receipts to cohorts. [TR6, ¶29]

.3067 Interest expense and income should be calculated in accordance with guidance from OMB. Discount rates used should be based on the authorized rates from OMB. [TR6, ¶30]

.3068 The agency should have an audit trail from individual transactions to the subsidiary ledgers to the general ledger. This will ensure that cash transactions can be identified by type so that they may be identified by subsidy expense component. SFFAS No. 18 states: "Reporting entities… should disclose for each program …the subsidy expense by components as defined in paragraphs 25 through 29 [SFFAS No. 2], recognized for the direct or guaranteed loans disbursed in those years [current reporting year and the preceding reporting year]…" [TR6, ¶31]

.3069 When a direct loan or loan guarantee is modified as defined by SFFAS No. 2 (additional guidance provided in the OMB Circular A-11), the nature of the modification, the estimated effect on cash flows, and key assumptions should be documented in the same way as the original subsidy estimate. Modifications do not include routine administrative workouts of troubled individual loans or actions that are permitted within the existing contract terms.[52] [TR6, ¶32]

.3070 Ensure that the financial statements consolidate the activity of the program accounts, the financing accounts, and, if needed, the negative subsidy receipt accounts. Negative subsidy receipt accounts are established for programs that have negative subsidies or downward subsidy reestimates (except certain programs classified in the budget as mandatory). [TR6, ¶33]

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[52] Neither the Federal Credit Reform Act as enacted in 1990 nor its amendments in the Balanced Budget Act of 1997 explicitly states that modifications do not include routine administrative workouts. However, the definition of modification in the 1990 Act was interpreted as excluding routine administrative workouts, and the definition in the 1997 amendments is interpreted in the same way. This interpretation is consistent with paragraph 44 of SFFAS No. 2. Further, the Joint Explanatory Statement of the Committee of Conference on H.R. 2015, the Balanced Budget Act of 1997, states that "workouts are not assumed to be included in the definition of modifications. The conference agreement does not change the treatment of workouts as implemented under the Federal Credit Reform Act of 1990."

.3071 Cash flow spreadsheets should be prepared on a cohort or disbursement year basis, as appropriate. Cash flow spreadsheets prepared on a cohort basis include one line for each cash flow type (for example, principal payments, fees, or defaults). Cash flow spreadsheets prepared on a disbursement year basis include one line per disbursement year for each cash flow type (for example, principal payments associated with first year disbursements, principal payments associated with second year disbursements, etc.). The documentation for the Credit Subsidy Calculator provides details on how to indicate that a particular cash flow line is associated with a particular disbursement. When loan disbursements occur over multiple years, cash flow spreadsheets prepared on a disbursement year basis will produce a more precise subsidy calculation. However, when agencies are unable to provide this level of detail, combinations of multiple disbursement years may be used as an approximation. [TR6, ¶34]

.3072 Establish security over access to the OMB Credit Subsidy Calculator to adequately protect it from unauthorized use and corruption. For example, agency management should establish procedures to ensure that the desktop workstations where the OMB Credit Subsidy Calculator resides are password protected. In addition, the data used as input or generated as output should also be safeguarded and reviewed for errors. [TR6, ¶35]

Specific Fund/Program Procedures and Controls

.3073 Procedures in place should ensure that cash flow estimates for budgetary and financial statement reporting purposes are based on actual cash flows in previous years to the extent it is appropriate. Agencies should compare budgeted to actual cash flows to ensure that the cash flow models reflect the actual cash flows from the accounting records. Where material differences exist between the initial budgetary estimate and the actual cash flows, the differences should be investigated and reestimates and/or adjustments should be made as required.[53] Changes in key factors and assumptions used as a baseline (e.g., disbursement rates, default rates, recovery rates,

[53] Reestimates may not be required in all cases where material differences exist between the initial budgetary estimate and the actual cash flows. For example, if offsetting differences exist in cash flows such as a positive difference in default recoveries and a negative difference in fees, a reestimate may not be necessary.

time periods, etc.) must be explained, supported, and documented. For example, recoveries have averaged a given percentage for the past four years and this recovery rate had been consistently used in preparing cash flow worksheets. However, during the past year, events have occurred which have increased the recovery rate and these events are expected to continue in the future. As a result, the agency may decide to use a recovery rate above the historical average. [TR6, ¶36]

.3074 Sensitivity analysis (or other testing of the agency cash flow models used in developing the subsidy estimates) should be performed to identify which cash flow assumptions have the greatest impact on the credit subsidy rate. To perform sensitivity analysis, management must first identify the root of each cash flow assumption[54] to ensure that all subsequently related formulas and assumptions are adjusted appropriately. Generally, each root assumption should be individually adjusted by a fixed proportion (e.g., plus and minus 10 percent), and the revised cash flows run through the OMB Credit Subsidy Calculator to determine the assumption's effect on the subsidy rate. Timing assumptions for defaults, recoveries, prepayments, etc. should also be adjusted by a fixed amount (e.g., plus and minus one year). The recovery assumption should be adjusted along with the timing of recovery assumption to ensure that a realistic relationship between these two assumptions continues to exist, i.e., to test the sensitivity of recoveries, the default timing assumption must also be adjusted to ensure that the recovery occurs after the default. Those assumptions that caused the largest change in the subsidy rate are determined to be the key cash flow assumptions. [TR6, ¶37]

.3075 Key assumptions, identified by the sensitivity analyses that are utilized in the process of developing estimates, should be documented including the rationale, justification, and source of supporting documentation. [TR6, ¶38]

.3076 The accounting office should maintain detailed subsidiary accounting records by program, cohort, risk category (if applicable) and case (individual direct loan or loan guarantee). [TR6, ¶39]

[54] The root of the cash flow assumption is the starting point for the assumption, i.e., there are no preceding formulas or related inputs that would affect the assumption.

.3077 The cash flow estimation process, including all underlying assumptions, should be reviewed and approved at the appropriate level including revisions and updates to the original model. Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance. [TR6, ¶40]

.3078 The agency should do trend analysis of the credit subsidy expense components, i.e., interest, defaults, fees, and other. When unusual fluctuations are identified, they should be investigated and explained. [TR6, ¶41]

.3079 The agency must document the options used in the OMB Credit Subsidy Calculator and the reasons those options were selected.[55] [TR6, ¶42]

.3080 The agency should determine whether the proper dollar scale (e.g., whole dollars, hundreds, thousands, etc.) for the cash flow spreadsheets was used. Some program subsidy rates, particularly those for programs disbursing over several years, may be influenced slightly with the scale of the program. Therefore, management should determine whether rounding to three decimal places has no significant effect on the cash flow spreadsheet values and the subsidy rate. [TR6, ¶43]

.3081 The agency should determine whether the OMB Credit Subsidy Calculator options selected properly reflect specific characteristics of the applicable credit program. For example, the OMB Credit Subsidy Calculator option for the timing of principal and interest payments for direct loan program and the timing of commitments and disbursements by the private lender of a loan guaranteed should agree with the program's credit terms. [TR6, ¶44]

.3082 The agency should review the OMB Credit Subsidy Calculator output to determine whether any warning messages are listed and determine why the situation causing the warning message was not

[55] OMB contracted with an independent public accounting firm to review the OMB Credit Subsidy Calculator's compliance with the Credit Reform Act. Results of the audit may be obtained from the applicable OMB program examiner or OMB's Budget Analysis Branch.

resolved and whether not eliminating the error could have any impact on the subsidy rate calculation. Also, if applicable, the agency should determine whether the suppression of any error messages was appropriate by checking the agency's cash flow spreadsheet to determine whether the "suppress warnings" command was used and assess the impact these suppressed error messages could have on the cash flows. [TR6, ¶45]

.3083 The agency should review trends in the direct loan subsidy allowance account balance and/or the liability for loan guarantees account balance as compared to the outstanding balances of loans and/or guarantees. Any unusual fluctuations identified should be investigated and explained. When unusual fluctuations occur, an analysis by cohort may be helpful to identify the causes. [TR6, ¶46]

Reestimates

.3084 OMB Circular A-11 has established criteria for when agencies should calculate credit subsidy reestimates for the budget. It states that "interest rate reestimates of the subsidy cost of a cohort of direct loans or loan guarantees must be made when a cohort has substantially disbursed (i.e., when at least 90 percent of the direct loans or guaranteed loans have been disbursed.) The computation should be made after the close of the fiscal year in which this criterion is met, unless a later time within the same fiscal year is approved by the OMB representative with primary budget responsibility for the credit account"; and that "technical reestimates of the subsidy cost of a cohort of direct loans or loan guarantees must be made after the close of each fiscal year as long as the loans are outstanding, unless a different plan is approved by the OMB representative with primary budget responsibility for the credit account. The different plan might be with regard to the time when reestimates are made within the year or the frequency of reestimates." If the plan allows technical reestimates to be made less frequently than every year, it should require technical reestimates to be made for any year when any one of four conditions is met.[56] The period for which reestimates are to be calculated includes the first

[56] These four conditions are: (1) based on periodic schedules established in coordination with OMB, (2) when a major change in actual versus projected activity is detected, (3) when a material difference is detected through monitoring "triggers" developed in coordination with OMB, and (4) when a cohort is being closed out.

year that loans were disbursed. Reestimates are calculated as of the end of the fiscal year regardless of when the actual computation is performed. [TR6, ¶47]

.3085 SFFAS No. 2 states that "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 re-estimation takes into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies and recoveries.[57] 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) as of the end of the fiscal year to which it applies. Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required."[58] SFFAS No. 7, paragraphs 362-363, state that "[a] negative subsidy…" or "…downward subsidy reestimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source."[59] In addition, SFFAS No. 18 requires that the interest rate and technical reestimates be disclosed separately for each program.[60] [TR6, ¶48]

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[57] OMB has an alternative method of computing reestimates, the "balances approach," which compares (a) the net present value of the best current estimate of the remaining cash flows with (b) the net balance owed to Treasury (for direct loan programs) or the net balance on deposit with Treasury (for loan guarantee programs). In estimating the net present value of the remaining cash flows, agencies would still need to estimate future cash flows based on actual experience with cash flows to date and forecasts of other factors. They would therefore still need to maintain historical cash flow data, at the subsidy component level, to analyze the sources of error in the estimates of cash flows for past periods.

[58] See paragraph .112 of this Subject Area Section (SFFAS2,¶32 as amended by SFFAS18,¶9.)

[59] See paragraphs .160-.161 of this Subject Area Section or Subject Area Section T30.113-.114.

[60] See paragraph .112 of this Subject Area Section (SFFAS2,¶32 as amended by SFFAS18,¶9.)

.3086 The table below summarizes the reestimate requirements for the budget and financial statement presentations.

	Budget	Financial Statement
Interest Rate Reestimate	Frequency: At least one time when the cohort is 90 percent disbursed - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	Frequency: Whenever the change in the interest rate materially affects the financial statements or, if no material change occurs prior to the cohort being 90 percent disbursed, at least one time when the cohort is 90 percent disbursed.
	Timing: At the end of the fiscal year.	Timing: Typically as of the end of the fiscal year.
Technical Reestimate	Frequency: Annually unless a different plan is approved by OMB - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	Frequency: Any year when material. Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.
	Timing: At the end of the fiscal year unless otherwise approved by OMB.	Timing: Typically as of the end of the fiscal year. Also, agencies must disclose if the reestimate was calculated at a time other than the end of the fiscal year.

[TR6, ¶49]

.3087 An interest rate reestimate of the subsidy cost of a cohort of direct loans or loan guarantees is made for the difference between (a) the interest rate assumed in the President's budget for the fiscal year in which the subsidy is obligated, and (b) the actual annual interest rates prevailing during the years of disbursement. OMB Circular A-11 instructs that an interest rate reestimate should be made when the cohort is 90 percent disbursed.[61] However, when an interest rate change has occurred that would materially affect the financial statements, agencies should calculate the interest rate reestimate and include the reestimate in the current year's financial statements. [TR6, ¶50]

.3088 A technical reestimate of the subsidy cost of a cohort of direct loans or loan guarantees is made for all changes in assumptions other than

discount rates. If OMB has approved a plan that permits an agency to make technical reestimates less often than annually, the agency should monitor the indicators specified in that plan to determine whether a reestimate is needed for other reasons: in particular, because it is needed to comply with other parts of that plan and/or because the reestimate has a material financial statement impact. [TR6, ¶51]

.3089 An agency that does not plan to perform technical reestimates annually must establish a systematic process to determine each year whether a reestimate is necessary and, if material to the financial statements as a whole, the reestimate must be reflected in the current year's financial statements. *If an acceptable monitoring process is not in place, reestimates must be made annually for the financial statements.* An acceptable process would generally include the following:

(a) *A comparison between actual experience to date and the assumptions that had been previously used for the period to date.* – An acceptable process would regularly (but not less than annually) compare the actual cash flows, by subsidy component, reported by the accounting office at the program level to those used in the previous budget estimates.

(b) *Differences between the current best estimate of future cash flows and the assumptions that had been previously used.* – An acceptable process would also include procedures that identify and systematically monitor significant economic and other assumptions underlying cash flows in order to determine whether changes have occurred in the expected future cash flows that make a reestimate necessary. The significant assumptions would be expected to differ from program to

[61] If the interest rate assumption is a key assumption, agencies should consider using sensitivity analysis, as discussed in the section entitled *Specific Fund/Program Procedures and Controls*, to determine whether the change in interest would have a material affect on the financial statements. To do this, agencies would need to repeatedly adjust the interest rate by predetermined increments, e.g., plus or minus 100 basis points, and re-run the revised cash flows through the OMB Credit Subsidy Calculator to determine the impact on the subsidy rate. Agencies should then multiply the revised subsidy rate by the assumed disbursement amount, to calculate financial statement impact. As a result, agencies will be able to document the amount of interest rate change that would be necessary, under an assumed disbursement amount, to materially affect the financial statements.

program according to each program's own attributes. Economic changes could include, for example, recessions, changes in interest rates, and changes in the market value of collateral or international economic factors (such as trade disruptions). Other changes could include, for example, legislative or administrative program changes (of the kind that do not meet the OMB Circular A-11 definition of a modification), operational changes (such as reduction in staff because of budgetary constraints that would affect loan servicing), environmental changes, or war. The impact of these changes on the estimates of future cash flows (and, if necessary, the cash flow models) must be assessed and documented.

(c) *Special emphasis for programs that have peak periods* - Where applicable, an acceptable monitoring process should provide extra emphasis during periods when cohorts are experiencing significant increases or decreases in defaults, prepayments, recoveries, or other cash flows. For example, suppose for one particular program historical experience has demonstrated that a cohort usually experiences increased defaults starting in year three which peak in years 6 through 8. Historical experience has further demonstrated that defaults decline steadily beginning in year nine, until a stabilized rate is reached in years 13 through 30. During years 3 through 13, the agency's monitoring efforts should compare actual cash flows for defaults reported by the accounting department to estimated default cash flows as a way of validating the default cash flow assumption and determining whether a reestimate or adjustment to the overall rate or timing is necessary. However, once the monitoring system has demonstrated that the cohort has stabilized and no significant unusual events have occurred, it is less likely that annual reestimates would be necessary.

[TR6, ¶52]

.3090 In years for which reestimates are made, they should normally be made as of September 30 of the reporting period using a data base that is complete through the same date. If OMB has approved a plan to make reestimates at another time during the year, this will be acceptable for financial statement purposes if the following conditions are met:

(a) The technical reestimate of the subsidy cost is made for a 12-month period ending not earlier than March 31, using actual transaction data through March 31 of the reporting year. Agencies may also use actual transaction data beyond the March 31 date through to the end of the reporting period. The reestimated subsidy cost is compared with the previous estimate of the subsidy cost for the year ended September 30.[62] The difference is the amount of the reestimate. Alternatively, for the last two quarters of the fiscal year (or for a portion of this period), agencies may estimate those quarters' cash flows on a reasonable basis e.g., the last two quarters' cash flows from the previous fiscal year, or if the cash flows are relatively uniform, two quarters of the originally estimated cash flows, or the average cash flows of the previous two quarters. For cohorts with an interest rate reestimate, the interest rate reestimate and a revised technical reestimate[63] would be calculated after September 30 using actual interest rates.

(b) In order to use this approach, agencies must ensure that the monitoring process described previously includes monitoring major events occurring during the third and fourth quarters that could have a significant impact on the subsidy reestimate. If such an event is identified, an adjustment to the reestimate of the affected cohorts may be necessary.

(c) Agencies may be unable to calculate, and reflect in the financial statements, a reestimate for major events occurring during the third and fourth quarters because, at this point, the effects of the major event may not yet be determinable. In this case, agencies must disclose such events in the footnotes as a potential material uncertainty. The disclosure will further acknowledge that this/these event(s) will be taken into consideration in making the reestimate for the following year or once the impact of the events is determinable.

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[62] See footnote 33 for a discussion of the "balances approach" for calculating reestimates.

[63] A revised technical reestimate in this context is limited to the change in the reestimate due to revised discount rates and not to any difference in cash flows.

(d) This policy, when adopted by an agency, with OMB's approval, will be disclosed in the footnotes to the agency's financial statements.

[TR6, ¶53]

.3091 If OMB has approved a plan to make reestimates at another time during the year that does not meet the conditions detailed in paragraph 47 above, its financial statement impact should be evaluated. The conditions listed in paragraph 47 are just one acceptable scenario that details the steps that agencies should perform to ensure that the financial statements are materially correct. Agencies may develop alternative procedures to ensure financial statements are fairly presented without performing a full reestimate as of the date of the financial statements. The agency and OMB examiner may wish to collaborate in developing the alternative procedures that will best address each individual agency's workload, the needs of the budget, financial statements, and all applicable standards. [TR6, ¶54]

.3092 If the most recent estimated cash flows of a cohort are different from the actual experience, these differences and the reasons for these differences may affect the future estimated cash flows of that cohort. The effects on the future cash flows of that cohort need to be assessed and included in the reestimate, and the reasons for the estimated effects need to be documented. [TR6, ¶55]

.3093 Reestimates for any of the reasons in this section should be completed, submitted to OMB, and included in the current year's financial statements, on a timely basis.[64] If OMB has approved a plan that permits an agency to make technical reestimates less often than annually, written documentation of the plan and OMB's approval should be obtained. If a technical reestimate is not made in a particular year, documentation should explain why that is consistent with the approved plan and provide assurance (in the ways specified above) that the lack of a technical reestimate would not have a material financial statement impact.[65] [TR6, ¶56]

[64]Fair presentation of subsidy estimates in the financial statements may differ from estimates in the budget.

.3094 Reestimates submitted by the budget office to OMB should be recorded in the accounting records. The agency should have an audit trail from individual transactions to the subsidiary ledgers to the general ledger. This will ensure that cash transactions can be identified by type so that they may be identified by subsidy expense component. SFFAS No. 18 states: "Reporting entities… should disclose for each program …the subsidy reestimates by components as defined in paragraph 32 [SFFAS No. 2] for those years [current reporting year and the preceding reporting year]." [TR6, ¶57]

.3095 If the cause of the reestimate affects the cash flows of future cohorts, the assumptions used to produce cash flow estimates and/or the method of estimating cash flows should be revised appropriately for the budget estimates of future cohorts. [TR6, ¶58]

[65] OMB has established a four-step process, outlined in OMB Circular A-11, that allows for calculating budgetary technical reestimates for the budget at times other than the beginning of each fiscal year following the year in which the initial disbursement was made, as long as the loans are outstanding (subject to OMB approval). However, this does not allow agencies to omit material reestimates from the current year financial statements or to postpone including material technical reestimates in the financial statements until a subsequent year. Conversely, the OMB process may require agencies to make technical reestimates for the budget that are not material to the financial statements.

TR6, Appendix B:

.3096 Summary of Selected Reporting Requirements[66]

Principal Statements	Credit Reform Information Presented
Balance Sheet	Credit program receivables and related foreclosed property, net of related subsidy allowance Liabilities for loan guarantees
Statement of Net Cost	Subsidy expense will be included as part of the gross program costs (present value of fees will be included as an offset in calculating subsidy expense rather than recording actual collection of fees as revenue) Interest revenue and interest expense
Statement of Changes in Net Position	Appropriations received (subsidy) and appropriations used
Statement of Budgetary Resources	Appropriations received (subsidy), borrowing authority, offsetting collections (examples: Collection of fees, principal, interest, subsidy from program account) and obligations (subsidy to financing account, direct loans, interest supplements, default claims) and offsetting receipts (example: negative subsidy or downward reestimate received by general fund receipt account)
Statement of Financing	Reconcile net obligations to net cost using components from the Statements of Budgetary Resources, Changes in Net Position and Net Cost. Examples of reconciling items include upward/downward reestimates of subsidy expense, offsetting collections pertaining to fees and obligations

[66] Refer to FASAB Standards for a complete listing of accounting and reporting requirements. The requirements in the Standards may be supplemented by guidance provided in OMB Bulletin 01-09 and OMB Circular A-11.

Note Disclosures	Credit Reform Information Presented
Direct Loans (and Defaulted Guaranteed Loans) by Program or Fund *Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09. SFFAS No. 18 requires the reconciliation of the subsidy cost allowance for direct loans and not defaulted guaranteed loans.	By program or fund: • Loans receivable gross, • Interest receivable, • Foreclosed property, • Allowance for subsidy cost (present value), and • Net value of assets related to direct loan programs (and loan guarantee programs) Total amount of loans disbursed for current and prior years Reconciliation between the beginning and ending balance of the subsidy cost allowance at the reporting entity level
Guaranteed Loans by Program or Fund *Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09.	By program or fund: • Present value of post-1991 liabilities for loan guarantees • Face value of guaranteed loans outstanding, • Amount of outstanding principal guaranteed Reconciliation between the beginning and ending balance of the loan guarantee liability at the reporting entity level
Both Direct Loans (and Defaulted Guaranteed Loans) and Guaranteed Loans by Program or Fund *Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09. Both Direct Loans (and Defaulted Guaranteed Loans) and Guaranteed Loans by Program or Fund - continued	By program or fund: • Total subsidy expense, and its components • Total subsidy expense for modifications • Total subsidy expense for reestimates, and their components, for current and prior year (interest and technical) • Subsidy rates for the total subsidy cost, and its components, for the current year • Total administrative expense • Description of the characteristics of loan programs • Discussion of events and changes in economic conditions, other risk factors, legislation, credit policies and subsidy estimation methodologies and assumptions that have a significant and measurable effect on subsidy rates, subsidy expense and subsidy reestimates • Nature of the modification of direct loans or loan guarantees, discount rate used to calculate the modification expense, and basis for recognizing a gain or loss relating to the modification. • Restrictions on the use/disposal of foreclosed property, number of properties held and average holding period by type or category, number of properties for which foreclosure proceedings are in process and changes from prior year's accounting methods

Loans and Loan Guarantees—Non-Authoritative Guidance

Loan and Loan Guarantee Accounting: Technical Explanations and Illustrations [SFFAS2, Appendix B]

Summary

This guidance[67] 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.

The guidance has 4 parts:

- Part I: Post-1991 Direct Loans
- Part II: Pre-1992 Direct Loans
- 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 re-estimation and the amortization of the subsidy cost allowance;

[67] This guidance has not been revised to consider amendments to SFFAS2 by SFFAS18 and SFFAS19.

- the re-estimation of loan guarantee liabilities and the accumulation of interest on the liabilities;
- the recognition of revenue 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.

Part 1: Post -1991 Direct Loans

.4000 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.

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).[68] 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).

[68] 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)

Dollars in thousands

Year	Payment (a)	Interest (b)	Principal (c)	Year-End Loan Balance (d)
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.

A. Reporting Post-1991 Direct Loans and Their Subsidy Costs

.4001 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.[69]

[69] In this non-authoritative guidance, 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 in L60.100 et seq. for their exact wording.

.4002 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. [70] Table 2 below displays the cash flow projections and present value calculations.

Table 2: Projected Cash Flows Discounted to the end of FY1994

Dollars in thousands

Year	Fee Collections	P & I Payments*	Default Losses	Net Cash Inflows
1994				$500
1995		$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.

.4003 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.

.4004 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

[70] SFFAS2 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 non-authoritative guidance.

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).

.4005 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.

.4006 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 interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

.4007 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.

.4008 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.

.4009 The present value of fee collections is $500, which is recognized as a deduction from subsidy costs.

.4010 There are no other subsidy costs[71] in this example.

.4011 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**

.4012 The loan disbursements are financed by three sources: subsidy payments, borrowing from Treasury, and fee 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.

.4013 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.

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

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

Dollars in thousands

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 Re-estimation and Amortization

(1) Subsidy Re-estimation

.4015 The accounting standard for post-1991 direct loans requires that the subsidy cost allowance for direct loans be re-estimated 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 re-estimation 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 resulting from the re-estimates is recognized as a subsidy expense (or a reduction in subsidy expense).

.4016 The standard further states that reporting the subsidy cost allowance of direct loans and re-estimates by component is not required.

.4017 In SFFAS2's "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 re-estimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and re-estimates.

.4018 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 re-estimate 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 re-estimate is zero. (This illustration assumes that the interest rates at the time of loan obligation and disbursement are the same, so no re-estimate is needed for the difference in interest rates.)

.4019 The second re-estimation is performed early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It re-estimates 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 re-estimated cash flows discounted to the end of fiscal year 1994.

Table 4: Subsidy Cost Re-estimation: Projected Cash Flows

Discounted to the end of FY 1994 (Dollars in thousands)

Year	P & I Payments	Default Losses	Net Cash Flows
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

.4020 The present value of the re-estimated 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 re-estimate, is recognized as subsidy expense re-estimates.

.4021 A subsidy payment of $2,802, equal to the subsidy expense resulting from the re-estimate, 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.

.4022 Furthermore, the direct loan program also receives a payment under permanent indefinite authority to cover the interest accrued on the re-estimate 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 re-estimates, and the money is used to pay the interest on the $2,802 borrowed from Treasury but repaid with the re-estimate subsidy.

.4023 Table 5 displays the asset and liability balances as of the end of fiscal year 1994, adjusted for the re-estimate that was calculated early in fiscal year 1996.

Table 5: Assets and Liabilities as of the End of FY 1994: Amounts Adjusted for Re-estimate Calculated in Early FY 1996

Dollars in thousands

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

(2) Subsidy Amortization

.4024 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.

.4025 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.

.4026 In the example, the book value of the direct loans, as re-estimated, 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 $5,041. The amortized amount is recognized as a reduction in interest income. (Interest income for fiscal year 1995 is calculated in section C: Revenue and Expenses.)[72]

.4027 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.

.4028 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.

.4029 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 re-estimate. 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 re-estimate is $168, but it is covered by the interest on the re-estimate. 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.

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

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.

Table 6: Assets and Liabilities After Amortization at the End of FY 1995

Dollars in thousands			
Assets		**Liabilities**	
Loans receivable	$ 8,154	Debt to Treasury	$3,113
Less: Allowance for subsidy costs	(5,041)		
Loans receivable - net	$ 3,113		

C. Revenue and Expenses

.4031 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.

.4032 In this example, interest income for fiscal year 1995 is $471, which consists of the following items:

Nominal interest	$400
Amortized interest	(97)
Interest re-estimates	168
Total interest income	**$471**

.4033 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 re-estimated subsidy payments	168
Total interest expense	**$471**

.4034 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 subsidy costs of direct loans.

D. Modification of Post-1991 Direct Loans

.4035 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.

.4036 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.

.4037 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.

.4038 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.

.4039 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.

.4040 The accounting is implemented in the steps described below.

(1)Calculate the Pre-Modification Value

.4041 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.

.4042 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. [73]

.4043 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 re-estimated 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

Dollars in thousands, calculated at the current discount rate

Year	P & I Payments	Default Losses	Net Cash Flows
1996	$ 2,246	$ (1,348)	$ 898
1997	2,246	(1,348)	898
1998	2,246	(1,348)	898
1000	2,246	(1,348)	898
PV at 4.5%	$ 8,058	$ (4,835)	$ 3,223

(2) Calculate the Post-Modification Value

.4044 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).

[73] The definition of the current discount rate is provided in the Glossary at the end of this Subject Area Section.

.4045 The modification forgives 70 percent of the outstanding principal amounts, and requires the remaining 30 percent, or $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

Dollars in thousands

Year-end	Payment	Interest	Principal	Year-end Loan Balance
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

.4046 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

Dollars in thousands, calculated at the current discount rate

Year	P & I Payments	Default	Net Cash Flows
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

.4047 The cost of modification is the excess of the pre-modification value over the post-modification value. 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

.4048 SFFAS2 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).

.4049 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

Dollars in thousands, calculated at the original discount rate

Year	P & I Payments	Default	Net Cash Flows
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

.4050 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.

.4051 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 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

Dollars in thousands

	Gross Amount	Book Allowance	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

.4052 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.)]

.4053 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.

.4054 The credit program receives a subsidy appropriation 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.

.4055 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.

.4056 Table 12 displays the asset and liability balances after the modification in October 1995.

Table 12: Assets and Liabilities After Modification in October 1995

Dollars in thousands

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

.4057 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.

.4058 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: [74]

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

[74] The disclosure will not be illustrated for other modifications explained in this guidance.

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

.4059 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 re-estimates. Therefore, the write-off would have no effect on expenses.

.4060 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 re-estimation, the amortization of the allowance for subsidy costs, and the recording of collections and payments. This takes the following steps:

(1) The Re-estimation of the Subsidy Cost Allowance

.4061 In early fiscal year 1997, before the write-off, the credit program makes a year-end re-estimation for the subsidy cost allowance. This re-estimation is for the balances calculated as of the end of fiscal year 1995 adjusted for the modification in October 1995 (Table 12). The result of the re-estimation 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 re-estimated 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 re-estimated 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 Re-estimation: Projected Cash Flows Discounted to the End of FY 1995

Dollars in thousands, calculated at the original discount rate

Year	P & I Payments	Default	Net Cash Flows
1996	$ 549	$ (110)	$ 439
1997	549	(165)	384
1998	549	(165)	384
1999	549	(165)	384
2000	549	(165)	384
PV at 6%	$2,312	$(643)	$1,670

.4062 Based on the re-estimate, the direct loans' book value is reduced by $179, from $1,849 to the re-estimated 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 re-estimates.

.4063 A subsidy payment of $179 equal to the subsidy cost increase resulting from the re-estimate 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 recognized as interest income re-estimates, 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 re-estimate.

.4064 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 re-estimate 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 Re-estimates Calculated in Early FY 1997

Dollars in thousands

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

.4065 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 re-estimated, 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

.4066 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 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.

.4067 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 re-estimate, 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 re-estimate. 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.

.4068 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

Dollars in thousands

Assets		Liabilities	
Loans receivable	$ 2,446	Debt to Treasury	$1,331
Interest receivable	20		
Less: Allowance for subsidy costs	(776)		
Loans receivable - net	$ 1,331		

4) Write-Off of Uncollectible Direct Loans

.4069 It is confirmed that non-performing loans with an 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.

.4070 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

Dollars in thousands

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

.4071 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.

.4072 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 re-estimated 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.

Table 17: Projected Cash Flows After Loan Write-off: Discounted to the End of FY 1996

Dollars in thousands, calculated at the original discount rate

Year	P & I Payments	Default	Net Cash Flows
1997	$.439	$(55)	384
1998	439	(55)	384
1999	439	(55)	384
2000	439	(55)	384
PV at 6%	$1,521	$(190)	$1,331

.4073 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

.4074 The accounting standard on sale of loans states that the sale of post-1991 and pre-1992 direct loans is a direct modification. [75]

.4075 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.

1) Recognize the Cost of Amortization

.4076 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.

.4077 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.

.4078 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

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

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

Dollars in thousands, calculated at the current discount rate

Year	P & I Payments	Default	Net Cash Flows
1997	$ 439	$ (55)	$ 384
1998	439	(55)	384
1999	439	(55)	384
2000	439	(55)	384
PV at 6%	$1,557	$(195)	$1,362

.4079 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.)

(2) Recognize Book Value Gain or Loss

.4080 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.[76] 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)

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

.4081 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

.4082 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.

.4083 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 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.

.4084 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.)

.4085 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**

.4086 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

.4087 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 collected. The allowance of the uncollectible amounts should be re-estimated 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.

.4088 The standard further states that restatement of pre-1992 direct loans on a present value basis is permitted but not required.

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

A. Provision for Uncollectible Amounts

.4089 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.[77] Thus, the book value of the loans is $3,000, as shown below:

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

B. Modification of Pre-1992 Direct Loans

.4090 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.

.4091 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.

.4092 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.

.4093 Accounting for the cost of modification takes the following steps:

(1) Calculate the Pre-modification Value

[77] 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.

.4094 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.

.4095 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

Dollars in thousands, calculated at the current discount rate

Year	P & I Payments	Default	Net Cash Flows
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

(2) Calculate the Post-Modification Value

.4096 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.

.4097 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

Dollars in thousands

Year	Payment	Interest	Principal	Year-end Loan Balance
1994	$ 477			$ 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

.4098 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.

Table 21: Pre-Modification Value

Dollars in thousands, calculated at the current discount rate

Year	P & I Payments	Default	Net Cash Flows
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

.4099 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.

.4100 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

.4101 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 reflect amounts that would not be collected due to the modification. Indirect modifications of pre-1992 direct loans are not illustrated.]

.4102 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.

.4103 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.

.4104 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.

.4105 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:

.4106 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. 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.

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

Part III: Post-1991 Loan Guarantees

A. Reporting the liability of Post-1991 Loan Guarantees and their Subsidy Costs

.4107 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.

.4108 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.

.4109 Table 22 below shows the estimated cash flows and the present values of the cash flows.

Table 22: Projected Cash Flows Discounted to the time of Disbursement

Dollars in thousands

Year	Fee Receipts	Interest Supplements	Net Default Payments	Recoveries	Cash Flows
1994	$ (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

.4110 The present value of the estimated net cash outflows of the loan guarantees is $1,201. This amount is recognized as a liability.

.4111 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.)

.4112 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).

.4113 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.

.4114 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 subsidy expense of those new loan guarantees be recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

.4115 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.

.4116 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.

.4117 The present value of fee collections, which is $500, is recognized as a deduction from subsidy costs.

.4118 There are no other subsidy costs in this example.

.4119 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**

.4120 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.

.4121 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 Receipt of Fees

Dollars in thousands

Year	Interest Supplements	Net Default Payments	Recoveries	Net Cash Flows
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	$ 2,690	$ (1,410)	$ 1,701

.4122 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

Dollars in thousands

Assets		Liabilities	
Fund Balance with Treasury	$ 1,701	Loan Guarantee Liability	$1,701

B. Liability Re-estimation and Interest Compounding

(1) The Re-estimation of the Liability of Loan Guarantees

.4123 The accounting standard for post-1991 loan guarantees requires that the liability for loan guarantees be re-estimated 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 re-estimation 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 re-estimates is recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the liability of loan guarantees and re-estimates by component is not required.

.4124 In SFFAS2, Appendix A, the Basis of the Board's Conclusions, it is pointed out that the primary factor that causes changes in the subsidies would be default re-estimates. The accounting standard provides a number of risk factors and other default cost criteria to be considered in making the default cost estimates and re-estimates.

.4125 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 re-estimate 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 re-estimate is zero. (This illustration assumes that the interest rates at the time of commitment and disbursement are the same, so no re-estimate is needed for the difference in interest rates.)

.4126 The second re-estimation of the subsidy cost is made early in fiscal year 1996, in preparing financial statements for fiscal year 1995. It re-estimates 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 24: Subsidy Cost Re-estimation: Projected Cash Flows, Discounted to the End of FY 1994

Dollars in thousands

Year	Interest Supplements	Net Default Payments	Recoveries	Net Cash Flows
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

.4127 The re-estimated liability is $2,406, compared to the existing liability of $1,701, an increase of $705. The increase of $705 is added to the loan guarantee liability and is recognized as a subsidy expense re-estimates.

.4128 The credit program receives a subsidy payment under permanent indefinite authority equal to $705 to cover the cost increase resulting from the re-estimate. In addition, a payment of $42 is also received under permanent indefinite authority to cover the interest accrued on the $705 re-estimate 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

.4129 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.

.4130 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 re-estimated, 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.

.4131 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 re-estimated subsidy cost and the accrued interest are also added to the fund balance.

.4132 The interest supplement of $100 is paid for fiscal year 1995. Both the fund balance and the liability are reduced by $100.

.4133 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 re-estimates	705
Interest on subsidy payment re-estimates	42
Interest supplement paid	(100)
Fund balance at the end of FY 1995	$2,450

.4134 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 re-estimated	$2,406
Increase due to passage of time	144
Interest supplement paid	(100)
Fund balance at the end of FY 1995	$2,450

.4135 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

Dollars in thousands

Assets		**Liabilities**	
Fund Balance with Treasury	$ 2,450	Loan Guarantee Liability	$1,701

C. Revenue and Expenses

.4136 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.

.4137 In the example, interest accrued on the liability of loan guarantees is $144, which equals the re-estimated liability of $2,406 times 6

percent. The amount is recognized as interest expense, and the same amount is added to the liability, as explained above.

.4138 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 re-estimates.

.4139 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

.4140 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.

.4141 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.

.4142 The accounting is implemented in the steps described below.

(1) Calculate the Pre-modification Liability

.4143 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.

.4144 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. [78]

.4145 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 re-estimated 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

Dollars in thousands, calculated at the current discount rate

Year	Interest Supplements	Net Default Payments	Recoveries	Net Cash Flows
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

.4146 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.

.4147 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. This estimate is not affected by

[78] The definition of the current discount rate is provided in the L60 Glossary.

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

Dollars in thousands, calculated at the current discount rate)

Year	Interest Supplements	Net Default Payments	Recoveries	Net Cash Flows
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

.4148 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

.4149 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 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 Liability

Dollars in thousands, calculated at the current discount rate)

Year	Interest Supplements	Net Default Payments	Recoveries	Net Cash Flows
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	$ 3,401

.4151 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

.4152 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[79] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

[79] 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 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.)

.4153 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.

.4154 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.

.4155 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

Dollars in thousands

Assets		Liabilities	
Fund Balance with Treasury	$ 3,401	Loan Guarantee Liability	$3,401

E. Default and Foreclosure

.4156 Assume that for fiscal year 1996 and thereafter, annual re-estimations do not result in any changes in cash flow estimates.[80] 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.

[80] This assumption is made only to avoid repetitious illustrations.]

Table 31: Fund Balance

Dollars in thousands

Year	Interest Accrued	Interest Supplement Paid	Fund Balance
1995			$ 3,401
1996	204	(100)	3,505
1997	210	(100)	3,615
1998	217	(100)	3,732
1999	$ 224	(100)	$ 3,856

.4157 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.

.4158 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.

.4159 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,[81] 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.

[81] 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.

.4160 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.

.4161 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.

.4162 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.

.4163 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.

.4164 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.[82] Thus, the fund balance is increased by $943 to $4,800, allowing the default payment to be made.

.4165 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

[82] 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.

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 After Interest Accumulations at the End of FY 1999

Dollars in thousands

Assets		Liabilities	
Foreclosed Property	$ 943	Debt to Treasury	$943

F. Disposition of the Foreclosed Property

.4166 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.

.4167 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.

.4168 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.

.4169 A re-estimation should be performed for the net cash flow of the property after the end of fiscal year 2000. If the re-estimation resulted in a reduction of the present value of the property, the amount of the reduction would be recognized as subsidy expense re-estimates. As illustrated in preceding sections on re-estimates, a

payment from permanent indefinite authority would be available to cover the subsidy re-estimate expense. In this case, because the property was sold at the estimated time for the estimated amount, there is no re-estimate subsidy expense.

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

Part IV: Pre-1992 Loan Guarantees

.4170 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 re-estimated 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.

.4171 The standard states that restatement of pre-1992 loan guarantees on a present value basis is permitted but not required.

A. Recognition of Liabilities

.4172 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. [83]

.4173 Disclosure is made in a footnote to the financial statements for fiscal year 1994 that guaranteed loans have an outstanding principal of

[83] 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.

$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.)

.4174 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.[84]

B. Modification of Pre-1992 Loan Guarantees

.4175 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.

.4176 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.

.4177 Accounting for the cost of modification takes the following steps:

(1) Calculate the Pre-modification Liability

.4178 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.

[84] 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.

.4179 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

Dollars in thousands

Year	Default Payments	Net Recoveries	Net Cash Outflow
1995			
1996			
1997	$ 1,500		$ 1,500
1998		$ (500)	(500)
PV at 4%	$ 1,333	$ (427)	$ 906

(2) Calculate the Post-modification Liability

.4180 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.

.4181 The modification expands the guarantee from 60 percent 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

Dollars in thousands

Year	Default Payments	Net Recoveries	Net Cash Outflow
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

.4182 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

.4183 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 amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees.[85]

.4184 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

[85] 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.

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

.4185 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.

.4186 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.

.4187 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.

.4188 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.

Non-Authoritative Guidance – SFFAS18, Appendix B: Illustrative Reporting Formats

.4189 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.

Table 3: A: Schedule for Reconciling Subsidy Cost Allowance Balances

Dollars in thousands

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 re-estimates		
Add or subtract subsidy re-estimates by component		
(a) Interest rate re-estimate		
(b) Technical/default re-estimate		
Total of the above re-estimate components		
Ending balance of the subsidy cost allowance		

Table 4: B: Schedule for Reconciling Loan Guarantee Liability Balances

Dollars in thousands		
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 re-estimates		
Add or subtract subsidy re-estimates by component		
(a) Interest rate re-estimate		
(b) Technical/default re-estimate		
Total of the above re-estimate components		
Ending balance of the loan guarantee liability		

Glossary

Allowance for Subsidy – See Direct Loan Subsidy Allowance Account definition.

Assumptions – basic beliefs about the future operating and functional characteristics of the loan or group of loans or loan guarantees. Types of assumptions include:

> Cash flow assumptions – all known and/or forecasted information about the characteristics and performance of a loan or group of loans or loan guarantees. Examples include estimates of loan maturity, borrower interest rate, default/delinquency rate, timing of defaults, overall impact of changes in economic factors, etc.
>
> Model assumptions – determinations of how cash flow assumptions are applied through the life of the cohort. For example, determining whether the entire assumed amount of defaults should be applied in 1 year or whether a constant or variable proportion of the assumption value should be allocated to each year. The allocation of cash flows over time is the selected model form and is just as influential as the cash flow assumptions.

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.

Case level - each individual loan or guarantee within a cohort.

Cash flow stream – the agency's projection of the dollar amount for the scheduled cash flows and deviations from scheduled cash flow items for each year over the life of the cohort.

Cash flows – Estimates of payments to or from the Government over the life of a loan or group of loans or loan guarantees. For direct loans, these may include: loan disbursements, repayments of principal, payments of interest, and any other payments such as prepayments, fees, penalties, and other recoveries. For loan guarantees, these may include: payments by the Government to cover defaults and delinquencies, interest subsidies, payments to the Government, such as origination and other fees, penalties and recoveries, and any other payments.

Cohort – 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 by that fiscal year. For direct loans and loan guarantees for which multi-year or no-year appropriations are provided, the cohort will be 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 Subsidy Allowance Account – the balance maintained in the general ledger that represents the difference between the current outstanding loans receivable balance and the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the direct loans. The subsidy allowance is subtracted from the loans receivable balance when calculating the net loans receivable balance. A similar account may also be used for defaulted guaranteed loans.

Econometrics – the application of statistical methods to the estimation of economic relationships.

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 – the non-budgetary account or accounts associated with each credit program account that holds 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. Each program account is associated with one or more financing accounts, depending on whether the account makes both direct

loans and loan guarantees (separate financing accounts are required for direct loans and loan guarantees).

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)

Fund – an aggregation of programs into a common grouping consistent with how the Congress provides appropriations - i.e., the program and financing accounts together and, if needed, the negative subsidy accounts.[86] (This term has other meanings in different contexts.)

Inputs – in the context of Federal credit, cash flow data elements used to develop spreadsheet calculations.

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).

Interest rate re-estimate – A re-estimate 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.

Internal control – an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal

[86] Financial statements consolidate the activity of the program and financing accounts and, if needed, the negative subsidy accounts. Thus, it may be difficult to establish adirect link between these accounts and the financial statement presentation.

control consists of the control environment, risk assessment, control activities, information and communication and monitoring.

Key assumptions – assumptions that have been established, through sensitivity analysis or other means, to be the elements that have a large impact on estimates, and thus are the most important factors in determining the cost of a loan or group of loans or loan guarantees.

Liability for Loan Guarantees Account – the balance maintained in the general ledger that represents the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the outstanding loan guarantees.

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.

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. .

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 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).

Negative Subsidy Receipt Account – the budget account for the receipt of amounts paid from the financing account when there is a negative subsidy cost for the original estimate or a downward reestimate. For mandatory programs, negative subsidies and downward reestimates may be credited directly to the program account as offsetting collections from non-Federal sources.

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.)

OMB Credit Subsidy Calculator – computer software developed by OMB for discounting cash flows in estimating credit subsidies. It uses agency cash flow inputs to compute the net present value at the point of disbursement and the subsidy rate associated with those cash flows.

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 – in the context of Federal credit, an aggregation of cohorts which are linked by common terms, conditions, regulations, and/or mission goals; often a sub-division of a fund or the budgetary financing account.

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)

Re-estimate –Revisions of the subsidy cost allowance for outstanding direct loans or the liability of outstanding loan guarantees, through re-estimating the subsidy costs of those direct loans and loan guarantees. See "interest rate re-estimate" and "technical/default re-estimate."

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 or other costs.

Service or line of business – an aggregation of funds into a common grouping: for example, grouping funds into single family or multifamily designations. (See also illustration at L60,¶.3046.)

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 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.

- 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.

Technical/default re-estimate – A re-estimate 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, 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)

Management's Discussion and Analysis—M10

Source: SFFAS15

Related Reference(s): SFFAC3, Management's Discussions and Analysis

Summary

In SFFAS15, the FASAB established standards for preparing Management's Discussion and Analysis (MD&A). The 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.

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.

SFFAS15 requires that MD&A 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.

[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.

The discussion and analysis of these subjects may be based on information in other discrete sections of the GPFFR or it may be based on reports separate from the GPFFR.

Management's Discussion and Analysis

.100 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] [SFFAS15, ¶1]

.101 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. [SFFAS15, ¶2]

[2] See section 558, "Required Supplementary Information," in Codification of Statements on Auditing Standards, American Institute of Certified Public Accountants (AICPA).

.102 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.[3] Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above. [SFFAS15, ¶3]

.103 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. [SFFAS15, ¶4]

.104 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. [SFFAS15, ¶5]

.105 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

[3] 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.

discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- lead to significant actions or proposals by top management of the 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. [SFFAS15, ¶6]

.106 Management of the reporting unit is responsible for the content MD&A. [SFFAS15, ¶7]

Managerial Cost Accounting—M20

Source: SFFAS4; SFFAS9[1]; I2; I6

Related Reference(s): P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits; R40 Revenues, Gains & Losses, and Other Financing Sources

Summary

The managerial cost accounting concepts and standards contained in SFFAS4 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.

The concepts of managerial cost accounting contained in SFFAS4 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 entities, and (5) using appropriate costing methodologies to accumulate and assign costs to outputs.

The cost accounting 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 SFFAS4:

[1] SFFAS 9 amended the SFFAS 4 standard's effective date, changing it to be effective for fiscal periods beginning after September 30, 1997 with earlier implementation encouraged.

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.

Managerial Cost Accounting Standards

Requirement for cost accounting. 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. 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 be performed to determine the costs of outputs.

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.

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 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. 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 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.

Managerial Cost Accounting

Requirement for Cost Accounting

.100 Each reporting entity[2] 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. [SFFAS4, Standard Text Box ¶]

.101 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. [SFFAS4, ¶67]

Need for Consistent Cost Accounting on a Regular Basis

.102 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

[2] The term “reporting entity” as used in this document conveys the same meaning as defined in FASAB Statement of Accounting Concepts No. 2, Entity and Display (May 1995).

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. [SFFAS4, ¶68]

.103 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 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. [SFFAS4, ¶69]

.104 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. [SFFAS4, ¶70]

Basic Cost Accounting Processes

.105 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 each responsibility segment.[3]
- 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.[4]
- 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.[5]
- 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 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.

[3] See cost accounting standard in this Subject Area section, beginning with paragraph .111, on responsibility segments.

[4] See cost accounting standards in this Subject Area section, beginning with paragraph .124, on full costs and, beginning with paragraph .144 on inter-entity costing.

[5] See cost accounting standard in this Subject Area section, beginning with paragraph .154, on costing methodologies.

- 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. [SFFAS4, ¶71]

Complexity of Cost Accounting Processes

.106 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;
- 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. [SFFAS4, ¶72]

.107 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. [SFFAS4, ¶73]

Cost Findings, Studies, and Analyses

.108 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. [SFFAS4, ¶74]

.109 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. [SFFAS4, ¶75]

.110 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 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. [SFFAS4, ¶76]

Responsibility Segments

.111 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. [SFFAS4, Standard Text Box ¶]

.112 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. [SFFAS4, ¶77]

Defining Responsibility Segments

.113 A responsibility segment is a component of a reporting entity[6] 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:

(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 entity.[7] [SFFAS4, ¶78]

.114 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. [SFFAS4, ¶79]

.115 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

[6] The term "reporting entity" referred to in this document conveys the same meaning as defined in FASAB Statement of Accounting Concepts No. 2 Entity and Display (May 1995).

[7] 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.

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. [SFFAS4, ¶80]

.116 However, for a given reporting entity, its management should establish one or more responsibility segments to perform managerial cost accounting functions. [SFFAS4, ¶81]

Purposes of Segmentation

.117 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. [SFFAS4, ¶82]

.118 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. [SFFAS4, ¶83]

.119 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.[8] Some entities may find costs accumulated by segments useful in support of financial reporting by components. [SFFAS4, ¶84]

.120 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. [SFFAS4, ¶85]

Structuring Responsibility Segments

.121 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. [SFFAS4, ¶86]

.122 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' compensation and pension benefits, and provides home loans and

[8] This point is discussed in FASAB Statement of Recommended Accounting Concepts No. 2, Entity and Display, pars. 75-76.

home loan guarantees to veterans. Each of these program areas could constitute a responsibility segment. [SFFAS4, ¶87]

.123 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. [SFFAS4, ¶88]

Full Cost

.124 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. [SFFAS4, Standard Text Box ¶]

.125 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 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. [SFFAS4, ¶89]

Direct Costs

.126 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"). [SFFAS4, ¶90]

Indirect Costs

.127 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 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. [SFFAS4, ¶91]

.128 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.[9] [SFFAS4, ¶92]

Certain Cost Elements

Costs of Employees' Benefits

.129 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 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. [SFFAS4, ¶93]

.130 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

[9] A similar explanation is provided in FASAB Statement of Accounting Concepts No. 2, Entity and Display, par. 95.

agencies, and direct appropriations. The management expenses of the trust funds are paid with the funds' receipts. [SFFAS4, ¶94]

.131 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.[10] 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. [SFFAS4, ¶95]

.132 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.[11] [SFFAS4, ¶96]

.133 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. [SFFAS4, ¶97]

Costs of Public Assistance and Social Insurance Programs

.134 Major costs of welfare, insurance, and grant programs are the costs of resources transferred from the federal government to individuals

[10] SFFAS5, Accounting for Liabilities of the Federal Government (November 7, 1994), pars. 61-96. See Subject Area section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits, paragraphs .106-.140 in this volume.

[11] SFFAS5, paragraphs. 94-96. See Subject Area section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits, paragraphs .138-.140 in this volume.

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 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. [SFFAS4, ¶98]

.135 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. [SFFAS4, ¶99]

.136 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. [SFFAS4, ¶100]

.137 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 type of cost is useful in measuring the efficiency of program operations. [SFFAS4, ¶101]

Costs related to Property, Plant and Equipment

.138 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. [SFFAS4, ¶102]

.139 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.[12] 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. [SFFAS4, ¶103]

Non-production costs

.140 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 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

[12] SFFAS6, Accounting for Property, Plant, and Equipment, requires that the costs of acquiring or constructing "heritage" property, plant, and equipment be recognized as expenses when the costs are incurred. See H20 Heritage Assets, paragraph 106 in this Volume.

costs and the production of outputs that may have benefited from those costs. [SFFAS4, ¶104]

Inter-Entity Costs

.141 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. [SFFAS4, Standard Text Box ¶]

.142 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. [SFFAS4, Standard Text Box ¶]

.143 As stated in the full cost 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 other users in evaluating overall program costs and performance and in making decisions about resource allocations and changes in programs. [SFFAS4, ¶105]

Inter-Entity Activities

.144 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. [SFFAS4, ¶106]

.145 Recently, consideration has been given to 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. [SFFAS4, ¶107]

Accounting and Implementation Guidance

.146 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. [SFFAS4, ¶108]

.147 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 financing source.[13] Inter-entity expenses/assets and financing sources would be eliminated for any consolidated financial statements covering both entities. [SFFAS4, ¶109]

.148 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. [SFFAS4, ¶110]

[13] See Statement of Federal Accounting Concepts No. 2, Entity and Display, par. 65, page 21. See also, SFFAS5, Accounting for Liabilities of the Federal Government, pars. 61-99, (Section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits in this Volume), 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 standard dealing with accounting for pensions and other retirement benefits.

Recognition Criteria

.149 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.[14] 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. [SFFAS4, ¶111]

.150 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 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:

[14] OMB Circular A-25 addresses user charges by federal entities.

- 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.

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. [SFFAS4, ¶112]

.151 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. [SFFAS4, ¶113]

Accounting Example

.152 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. [SFFAS4, ¶114]

.153 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 5: 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 6: 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

[SFFAS4, ¶115]

Costing Methodology

.154 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. [SFFAS4, Standards Text Box ¶]

.155 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. [SFFAS4, Standards Text Box ¶]

.156 This standard addresses two aspects of costing: cost accumulation and cost assignment. Each of them is explained and discussed below. [SFFAS4, ¶116]

Cost Accumulation

.157 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. [SFFAS4, ¶117]

.158 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 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. [SFFAS4, ¶118]

.159 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. [SFFAS4, ¶119]

Cost Assignment

.160 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. [SFFAS4, ¶120]

.161 The term "cost object" refers to an activity or item whose cost is to be measured.[15] In a broad sense, a cost object can be an

[15] Some literature, the CASB pronouncements for example, use the term "cost objective" for the same meaning.

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 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. [SFFAS4, ¶121]

.162 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. [SFFAS4, ¶122]

.163 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. [SFFAS4, ¶123]

.164 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 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. [SFFAS4, ¶124]

.165 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. [SFFAS4, ¶125]

Directly tracing costs to outputs

.166 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. [SFFAS4, ¶126]

.167 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. [SFFAS4, ¶127]

.168 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 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. [SFFAS4, ¶128]

Assigning costs on a cause-and-effect basis

.169 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.") [SFFAS4, ¶129]

.170 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 circumstances where there is direct and definitive relationship between the function or functions and the benefiting cost objectives."[16] [SFFAS4, ¶130]

.171 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. [SFFAS4, ¶131]

.172 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. [SFFAS4, ¶132]

Allocating costs

.173 Sometimes, it might not be economically feasible to directly trace or assign costs on a cause-and-effect basis. These may include general

[16] Cost Accounting Standards Board, Restatement of Objectives, Policies and Concepts, par. 2915.

management and support costs, depreciation, rent, maintenance, security, and utilities associated with facilities that are commonly used by various segments. [SFFAS4, ¶133]

.174 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 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. [SFFAS4, ¶134]

.175 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 7: The Allocation of the Personnel Department Costs

Segment	Employees	Percent	Allocated Amount
A	300	60	$300,000
B	200	40	$200,000
Total	**500**	**100**	**$500,000**

[SFFAS4, ¶135]

.176 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. [SFFAS4, ¶136]

.177 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. [SFFAS4, ¶137]

Assigning common costs

.178 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. [SFFAS4, ¶138]

.179 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. [SFFAS4, ¶139]

.180 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.[17] Common costs should be assigned to activities either on a cause-and-effect basis, if feasible, or through reasonable allocations. [SFFAS4, ¶140]

.181 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 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

[17] 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.

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. [SFFAS4, ¶141]

Cost-benefit considerations

.182 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. [SFFAS4, ¶142]

.183 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. [SFFAS4, ¶143]

Selecting a Costing Methodology

.184 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 entities and responsibility segments may find a preferred costing methodology for their operations. [SFFAS4, ¶144]

.185 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. [SFFAS4, ¶145]

.186 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. [SFFAS4, ¶146]

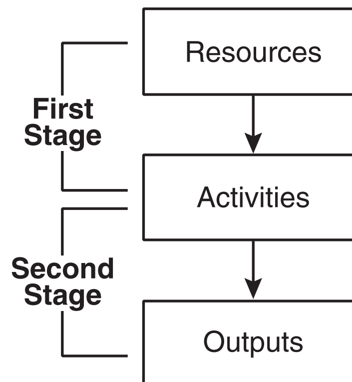
.187 Several costing methodologies have been successful in the private sector and in some government entities. Four are briefly described below for agency consideration. It should be noted in particular that activity-based costing has gained broad acceptance by manufacturing and service industries as 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. [SFFAS4, ¶147]

Activity-based costing (ABC)

.188 ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities 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.[18] [SFFAS4, ¶148]

[18] 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 9-13.

Figure 2: The Activity-Based Two Stage Costing Procedure



[SFFAS4, ¶148]

.189 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.[19] Management may combine related small activities into larger activities to avoid excessive costing efforts.

(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.

[19] Cooper, Kaplan, et al. page 20.

(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). [SFFAS4, ¶149]

.190 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. [SFFAS4, ¶150]

.191 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. [SFFAS4, ¶151]

.192 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. [SFFAS4, ¶152]

.193 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. [SFFAS4, ¶153]

Job order costing

.194 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. [SFFAS4, ¶154]

.195 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. [SFFAS4, ¶155]

.196 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. [SFFAS4, ¶156]

Process costing

.197 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. [SFFAS4, ¶157]

.198 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 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. [SFFAS4, ¶158]

.199 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. [SFFAS4, ¶159]

Standard costing

.200 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."[20] [SFFAS4, ¶160]

[20] Horngren, Charles T. and George Foster, Cost Accounting, A Managerial Emphasis, 7th ed. (Prentice Hall, Englewood Cliffs: New Jersey, 1991), page 222.

.201 Many organizations frequently review and update the standards to assure that they encourage improvements in efficiency and are within an attainable range. [SFFAS4, ¶161]

.202 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. [SFFAS4, ¶162]

Managerial Cost Accounting—Interpretations

Interpretation 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS4 and SFFAS5

Summary

The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source" amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss.

Accounting for Treasury Judgment Fund Transactions

Accounting by the Federal Entity

.1000 SFFAS No. 5, as amended by SFFAS12, states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss.[21, 22] The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss. [I2, ¶3]

.1001 Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source"[23] amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity. [I2, ¶4]

[21] An Interpretation of SFFAS4 and SFFAS5

[22] See paragraph .120 in this Subject Area for a complete discussion on "Estimating Contingent Liabilities."

[23] See Subject Area R40 Revenues, Gains & Losses, and Other Financing Sources, paragraph .142 for the complete discussion on "Financing Imputed for Cost Subsidies."

Accounting by the Treasury Judgment Fund

.1002 Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss. According to SFFAS 4, the imputed financing source amount recognized by the Federal entity and the expense recognized by the Judgment Fund would be eliminated at the Federal Consolidated financial report level. [I2, ¶5]

Interpretation 6: Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS4

Summary

Paragraph 110 of SFFAS No. 4, states "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…"

Some of those involved with preparing and auditing financial statements for part of a department or larger reporting entity have asked whether paragraph 110 of SFFAS No. 4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, limits the recognition of imputed intra-departmental costs, i.e. costs between reporting entities that are part of the same department or larger reporting entity (other than the U.S. government as a whole).

This interpretation clarifies that paragraph 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs. This interpretation further explains that reporting entities should account for imputed intra-departmental costs in accordance with the full cost

provisions of SFFAS No. 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.

Accounting for Imputed Intra-departmental Costs

.1100 Although paragraph 4.3 of OMB Bulletin 01-09, does limit the recognition of inter-entity costs to those costs that OMB has identified for recognition, this limitation applies solely to imputed inter-departmental costs. Paragraph 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs. [I6, ¶9]

.1101 **Imputed inter-departmental costs** are the unreimbursed (i.e. non-reimbursed and under-reimbursed) portion of the full costs of goods and services received by the entity from a providing entity that is not part of the same department or larger reporting entity other than the U.S. government as a whole. [I6, ¶10]

.1102 **Imputed intra-departmental costs** are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, components or responsibility segments within the department or larger reporting entity). [I6, ¶11]

.1103 Section 4004 of this Subject Area Section provides an illustration of inter-departmental and intra-departmental relationships. [I6, ¶12]

.1104 Reporting entities should account for and recognize imputed intra-departmental costs in accordance with the full cost provisions of SFFAS No. 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs. [I6, 13]

.1105 The recognition criteria in paragraphs 112-113 of SFFAS No. 4 (which provides general criteria to determine which costs should be recognized) apply to both imputed intra-departmental and inter-departmental costs. Accounting and reporting for imputed intra-departmental and inter-departmental costs that are recognized should be consistent and in accordance with paragraphs 108-109 and 114-115 of SFFAS No. 4, which provide specific accounting examples. [I6, 14]

.1106 Reporting entities should disclose on the face of the financials or in the notes to the financial statements, which are an integral part of the basic financial statements, both imputed intra-departmental and inter-departmental financing sources that are recognized. [I6, 15]

Managerial Cost Accounting—Technical Guidance

Technical Guidance – Technical Bulletin 2002-1: Assigning to Component Entities Costs and Liabilities That Result from Legal Claims Against the Federal Government

Summary

This technical bulletin is intended to clarify the required reporting of costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government. This technical bulletin requires that all liabilities and costs related to legal claims (i.e., judgments and settlements) must be attributed to the component entities responsible for the programs or activities that contributed to the claims, or to their successor component entities.

Issue

.2000 What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (a) the actions of Federal component entities[24] contribute to a legal claim having been filed against the Federal government or (b) a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government? [TB2002-1, ¶8]

General Principles

.2001 All liabilities and costs must be attributed to the component entities responsible for the programs or activities that contributed to the claims or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity. [TB2002-1, ¶9]

Implementation

.2002 The following hierarchy of cost assignment principles should be applied when the actions of one or more Federal component entities contribute to a legal claim having been filed against the Federal government or when a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government and it is not clear where the liability and cost should be reported.

a. The component entities should apply the cost methodology principles provided in SFFAS 4 in the following order of preference:

(1) Directly tracing costs wherever economically feasible;

[24] 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 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) Use of "component entity" in this technical bulletin is only intended to distinguish between the U.S. Federal government's consolidated financial statements and financial statements of its components.

(2) Assigning costs on a cause-and-effect basis; and

(3) Allocating costs on a reasonable and consistent basis.

The counsel (Office of the General Counsel, Department of Justice, etc.) about pertinent legal matters and other factors that could be relevant to assigning costs. The management of the component entities involved should work together to resolve the issues before moving on to component entities should seek advice from the appropriate legal step (b.) below.

b. If a reasonable cost assignment or allocation cannot be determined, as outlined in step (a.) above, the component entities should seek guidance from OMB's Office of Federal Financial Management (or its successor division) and recognize costs and liabilities as directed by OMB. In addition, all component entities involved should disclose the information concerning the nature of the costs and/or liability,[25] the problems of assigning the costs to the component entities involved, and the estimated total liability among all the component entities involved. [TB2002-1, ¶10]

[25] See specific disclosure requirements in L40.1000 and L40.121-.122.

Managerial Cost Accounting—Non-Authoritative Guidance

Illustrative Journal Entries [I2; Appendix B]

.4000 Based on the above noted accounting standards and the generalized events described below, the conceptual journal entries[26] should be as follows:

Federal entity entries

.4001 The Federal entity's management, through the advisement of the Justice Department, has determined that the probability of the legal claim ending in a loss against the Federal entity is probable and the loss is estimable. The entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted as necessary based on any changes in the estimated loss.

Entry #1:

DR. Expense
CR. Liability—Legal claims

.4002 Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for payment of the claim, the liability should be removed and an other financing source recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would only reflect that amount paid by the Judgment Fund on behalf of the Federal entity.

[26] Actual journal entries are under the authority of the Standard General Ledger.

Entry #2:

DR. Liability—Legal claims
CR. Imputed Financing Source—Expenses Paid by Other Entities*

Treasury Judgment Fund entries

.4003 The claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment.

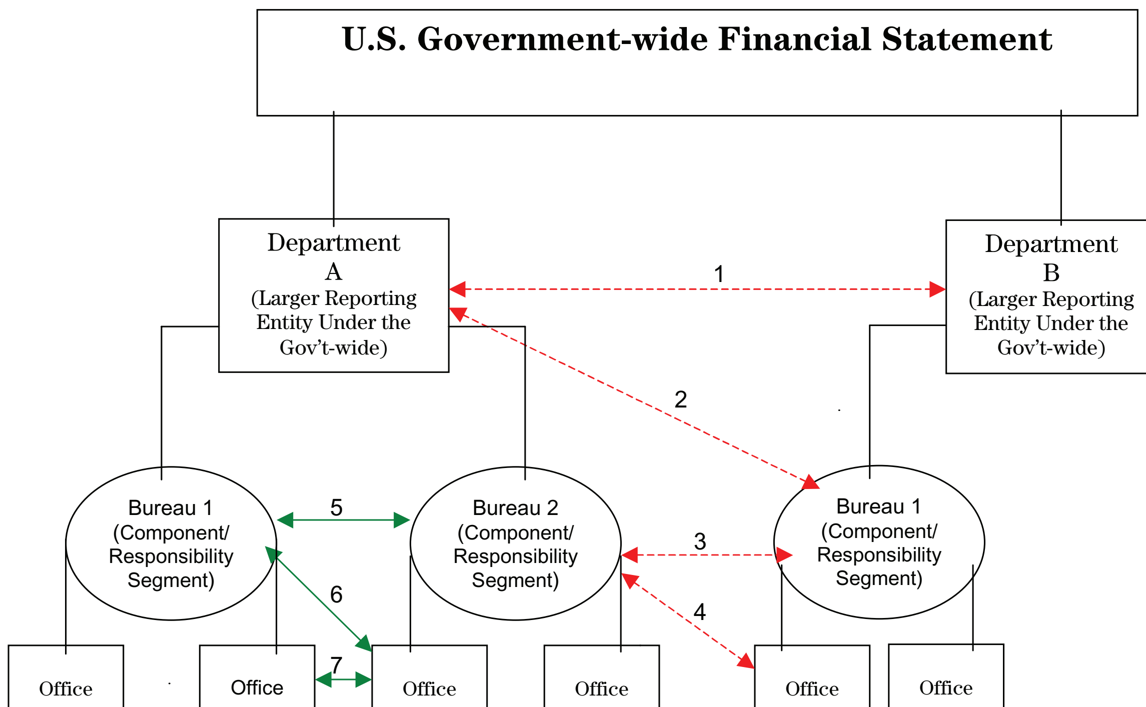
Entry #3:

DR. Expenses Paid for Other Entities*
CR. Cash or Fund Balance with Treasury

*According to the Cost Accounting Standard, the imputed financing source and expenses paid for other entities amounts would be eliminated at the consolidation level.

.4004 Illustration of Inter-entity Relationships [I6, Appendix B]

The following chart provides an illustration of the inter-departmental and intra-departmental relationships.



The lines labeled 1-7 represent goods and services provided between reporting entities.

Inter-departmental--The dashed lines (labeled 1-4) represent activities between reporting entities that are not part of the same department or larger reporting entity and are considered inter-departmental. The provision of goods or services result in inter-departmental costs and if the providing entity is not fully reimbursed, paragraph 110 of SFFAS No. 4 applies and when considered in conjunction with section 4.3 of OMB Bulletin 01-09, recognition of imputed inter-departmental costs is limited to those specifically identified by OMB.

Intra-departmental--The solid lines (labeled 5-7) represent activities between reporting entities that are part of the same department or larger reporting entity (such as bureaus, components or responsibility segments within a department) and are considered intra-departmental. The provision of goods or services result in intra-departmental costs and if the providing entity is not fully reimbursed, recognition of imputed intra-departmental costs is required to achieve full cost recognition, in accordance with SFFAS No. 4.

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 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.

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, 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, 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 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 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 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.

Non-Federal Physical Property—N60

Source: SFFAS8

Related Reference(s): S70 Stewardship Reporting

Summary

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.

Non-Federal Physical Property

Definition

.100 "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 for maintenance and operations are not considered investments. [SFFAS8, ¶83]

Measurement

.101 "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.[1] Amounts shall be reported in nominal dollars. [SFFAS8, ¶84]

[1] See Managerial Cost Accounting Standards for the Federal Government, SFFAS No. 4, (Subject Area Section M20 in this Volume) for a full discussion of Federal cost accounting principles and standards.

.102 Cash grants related to nonfederal physical property programs are recognized and reported as expenses in arriving at the net cost of operations. [SFFAS8, ¶85]

.103 Expenses incurred for program costs, contracts, or grants with split purposes[2] 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. [SFFAS8, ¶86]

Minimum Reporting

.104 Minimum reporting shall include the following:

- Annual investment[3] 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 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 government wide 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

[2] 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.

[3] As defined in SFFAS8, “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. See Subject Area Section M20 in this Volume.

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. [SFFAS8, ¶87]

Recommended Reporting

.105 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. [SFFAS8, ¶88]

Non-Recourse Loans & Purchase Agreements—N80

Source: SFFAS3

Related Reference(s): G40 Goods Held Under Price Support and Stabilization Programs

Summary

Commodity non-recourse loans are short-term loans with commodities pledged as collateral. The principal amount of the loan is recognized as an asset upon issuance. Losses on farm price supports are recognized at the reporting date if such losses are more likely than not and measurable.

Commodity purchase agreements are agreements to purchase commodities at a given price at the option of the seller. The estimated amount of the contingent loss is recognized as a contingent liability if the loss is more likely than not and measurable.

Non-Recourse Loans and Purchase Agreements

Non-Recourse Loans

.100 In conducting price support operations, the money is frequently disbursed in the form of "non-recourse 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. [SFFAS3, ¶93]

.101 Besides acquiring commodities through surrender of collateral for non-recourse 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. [SFFAS3, ¶94]

.102 Because non-recourse 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 SFFAS 3. Subject Area Section G40 Goods Held Under Price Support and Stabilization Programs includes the accounting guidance for commodities. [SFFAS3, ¶95]

Recognition

.103 Non-recourse 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. [SFFAS3, ¶96]

Purchase Agreements

.104 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. The amount of the loss shall be estimated and may be based on the contract price and the expected net realizable value of the commodities to be acquired. [SFFAS3, ¶97]

.105 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 possible that a loss may occur. [SFFAS3, ¶98]

Valuation – Non-Recourse Loans and Purchase Agreements

.106 All non-recourse loans shall be valued at the loan amount. Losses on non-recourse 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 re-estimated on each financial reporting date. [SFFAS3, ¶102]

.107 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.[1] [SFFAS3, ¶103]

Disclosure Requirements

.108 Disclosure requirements applicable to commodities, non-recourse loans and purchase agreements include:

- 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 non-recourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments. [SFFAS3, ¶109]

[1] Contract price is the amount the government would be committed to pay in exchange for the commodities.

Operating Materials and Supplies—O20

Source: SFFAS3

Related Reference(s): I50 Inventories: Inventory Held for Sale, Inventory Held in Reserve, Excess Obsolete and Unserviceable Inventory, Inventory Held for Repair; S80 Stockpile Materials

Summary

Operating materials and supplies are to be accounted for under the consumption method and valued at historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. In addition, categories for (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 must be reported.

An exception to the consumption method is provided when (1) the 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. In any of these events, the purchases method may be used.

Operating Materials and Supplies

Definition

.100 "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations.[1] 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. [SFFAS3, ¶36]

.101 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 .100, .109, and .111 respectively. [SFFAS3, ¶37]

Recognition

.102 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. [SFFAS3, ¶38]

[1] When developing SFFAS11 (now rescinded by SFFAS23), the FASAB considered whether there should be other standards that covered ammunition and munitions. The Board 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 .104 above 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. [SFFAS11, ¶41]

.103 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. [SFFAS3, ¶39]

.104 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. [SFFAS3, ¶40]

.105 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. [SFFAS3, ¶41]

Valuation Under the Consumption Method

.106 Operating materials and supplies shall be valued on the basis of historical cost. [SFFAS3, ¶42]

.107 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. [SFFAS3, ¶43]

.108 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). [SFFAS3, ¶44]

Other Categories of Operating Materials and Supplies

Operating Materials and Supplies Held in Reserve for Future Use

.109 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. [SFFAS3, ¶45]

.110 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. [SFFAS3, ¶46]

Excess, Obsolete, and Unserviceable Operating Materials and Supplies

.111 "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. [SFFAS3, ¶47]

.112 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). [SFFAS3, ¶48]

.113 Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies. [SFFAS3, ¶49]

Disclosure Requirements

.114 Disclosure Requirements for operating materials and supplies include;

- 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. [SFFAS3, ¶50]

Glossary

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.

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)

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.

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.

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. 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.

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.

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.

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)

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.

Other Current Liabilities—O40

Source: SFFAS1

Related Reference(s): A10 Accounts Receivable; A30 Advances and Prepayments; G60 Governmental and Intragovernmental Assets and Liabilities; L40 Liabilities

Summary

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 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.

Other Current Liabilities

.100 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 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. [SFFAS1, ¶83]

.101 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. [SFFAS1, ¶84]

.102 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. [SFFAS1, ¶85]

.103 The reporting entity should disclose the amount of current liabilities not covered by budgetary resources. [SFFAS1, ¶86]

Pensions, Other Retirement Benefits, and Other Post-Employment Benefits—P20

Source: SFFAS5, I3, & I4

Related Reference(s): L40 Liabilities

Summary

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 post-employment 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 post-employment 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.

Pensions, Other Retirement Benefits, and Other Post-Employment Benefits

.100 Employee benefits of federal civilian and military personnel and veterans[1] include pensions and postemployment and retirement benefits other than pensions. Pension plans[2] 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. [SFFAS5, ¶56]

[1] 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.

[2] 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.

.101 In addition to or in lieu of pension 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.[3] 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.[4] [SFFAS5, ¶57]

.102 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. [SFFAS5, ¶58]

.103 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 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. [SFFAS5, ¶59]

.104 SFFAS5's provisions related to pensions, other retirement benefits and other postemployment benefits are intended to specify the accounting objectives. With regard to pensions and ORB, if

[3] Special termination benefits (such as specially authorized separation incentive programs) are considered other postemployment benefits and should be recognized as such.

[4] 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.

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. [SFFAS5, ¶60]

Pensions

.105 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. [SFFAS5, ¶61]

.106 This Statement establishes standards of accounting for pension expense and related pension liability for federal government employers and administrative agencies. [SFFAS5, ¶62]

Accounting for the Pension Plan

.107 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.[5] A subsequent section covers federal employer entities. [SFFAS5, ¶63]

[5] 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.

Attribution Methods

.108 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."[6] 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. [SFFAS5, ¶64]

Assumptions

.109 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.[7] 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. [SFFAS5, ¶65]

.110 In addition to complying with the guidance in the preceding paragraph, the interest rate assumption should be based on an

[6] Adapted from Actuarial Standards of Practice No.4, Measuring Pension Obligations (Jan. 1990), p. 31.

[7] The Actuarial Standards Board is a board within the American Academy of Actuaries that sets professional standards of actuarial practice.

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. [SFFAS5, ¶66]

.111 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. [SFFAS5, ¶67]

Assets

.112 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 amortization, if appropriate. For investments in market-based and marketable securities, the market value of the investment should be disclosed.[8] [SFFAS5, ¶68]

Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses

.113 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

[8] SFFAS Number 1, Accounting for Selected Assets and Liabilities. See Subject Area I80 Investment in Treasury Securities of this Volume.

the pension liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions. [SFFAS5, ¶69]

.114 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. [SFFAS5, ¶70]

Accounting by the Administrative Entity

.115 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, promotion, and other factors. [SFFAS5, ¶71]

.116 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. [SFFAS5, ¶72]

.117 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.[9]

The employer entity's contribution represents intragovernmental revenue.[10]

An illustration of the accounting for the administrative entity (and the employer entity) is explained in the following section entitled "Accounting Illustration." [SFFAS5, ¶73]

Employer Entity Accounting

.118 The federal employer entity should recognize a pension expense in its financial report that equals the service cost[11] 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. [SFFAS5, ¶74]

.119 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. [SFFAS5, ¶75]

.120 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

[9] 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.

[10] Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

[11] "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."

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. [SFFAS5, ¶76]

Accounting Illustration

.121 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 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. [SFFAS5, ¶77]

.122 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

	Debit	Credit
Employer's Pension Expense	$100,000	
Appropriations Used		$60,000
Imputed Financing – Expenses Paid by Other Entities		$40,000

Table 1

Employer Entity's Other Financing Sources as They Should Appear on Its Statement of Changes in Net Position

FINANCING SOURCES:[12]

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.

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.

[12]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.

Entry #2—Administrative entity's entry to record revenue received from employer entity

	Debit	Credit
Fund Balance with Treasury	$120,000	
Retirement Program Revenue – Contribution Received from Employer Entity		$60,000
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

	Debit	Credit
Fund Balance with Treasury	$XXX,XXX	
Interest Revenue		$XXX,XXX

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

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.

Entry #4—Administrative entity's entry to record its pension expense

	Debit	Credit
Pension Expense	$XXX,XXX	
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 .116.

Table 4: Administrative Entity's Pension Liability

Beginning balance	$ XX,XXX,XXX
Add: additional pension expense 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.

[SFFAS5, ¶78]

Other Retirement Benefits (ORB)

.123 ORB include all retirement benefits other than pension plan benefits. 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.[13] [SFFAS5, ¶79]

.124 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. [SFFAS5, ¶80

[13] Accounting for life insurance is described in a separate section of SFFAS5. See I40 Insurance and Guaranty Programs in this Volume. 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.

.125 SFFAS5 establishes standards of accounting for ORB expense and related ORB liability for federal government employers and administrative agencies. [SFFAS5, ¶81]

Accounting for the ORB Plan

Attribution Method

.126 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.[14] 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. [SFFAS5, ¶82]

Assumptions

.127 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 discount projected benefits

[14] 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).

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. [SFFAS5, ¶83]

Accrual Period

.128 The accrual period should be based on expected retirement age rather than the age when the employee first becomes eligible. [SFFAS5, ¶84]

Assets

.129 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.[15] For investments in market-based and marketable securities, the market value of the investment should be disclosed. [SFFAS5, ¶85]

Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses

.130 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. [SFFAS5, ¶86]

.131 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. [SFFAS5, ¶87]

[15] SFFAS No. 1, Accounting for Selected Assets and Liabilities. See I80 Investment in treasury Securities in this Volume

.132 **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. [SFFAS5, ¶88]

.133 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.[16] An illustration of the accounting for the administrative entity (and employer entity) is provided in the following section entitled "Accounting Illustration". [SFFAS5, ¶89]

[16] Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

Employer Entity Accounting

.134 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[17] 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. [SFFAS5, ¶90]

.135 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. [SFFAS5, ¶91]

.136 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. [SFFAS5, ¶92]

Accounting Illustration

.137 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

[17] "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".

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.[18]
- 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.

Entry #5—Employer entity's entry to record ORB expense

	Debit	Credit
Employer's ORB Expense	$10,000	
Imputed Financing – Expenses Paid by Other Entities		$10,000

[18] 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.

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.

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

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.

Entry #6—Administrative entity's entry to record its ORB expense

	Debit	Credit
ORB Expense	$XX,XXX	
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 .131.

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

Note: The liability balance should be reported on the administrative entity's Balance Sheet.

[SFFAS5, ¶93]

Other Postemployment Benefits (OPEB)

.138 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. [SFFAS5, ¶94]

.139 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. [SFFAS5, ¶95

.140 Most OPEB liabilities should be short-term because the benefits will be paid in the near future. Some OPEB, however, could be longer term. 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.[19] Also, certain specially authorized separation incentive programs could provide for payments that extend over many future years. [SFFAS5, ¶96]

[19] Both the federal employee unemployment program and the federal workers' compensation program are financed by direct reimbursements from federal employers.

Pensions, Other Retirement Benefits, and Other Post-Employment Benefits—Interpretations

Interpretation 3: Measurement Date for Pension and Retirement Health Care Liabilities

Summary

Pension and retirement health care liabilities[20] in general purpose federal financial reports prepared pursuant to SFFAS 5 shall be measured as of the end of the fiscal year (or other reporting period if applicable). This measurement shall be performed following the end of the period reported, but does not have to be based on a full actuarial valuation as of the end of the reporting period. The measurement shall, however, reflect the best available estimates of the major factors that would be reflected in a full actuarial valuation. This measurement may be based on an actuarial valuation performed as of an earlier date during the fiscal year, including a beginning-of-year actuarial valuation, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise, cost of living adjustment, etc.

[20] This interpretation applies to pension and retirement health care liabilities recognized in accordance with SFFAS 5 in general purpose federal financial reports, such as financial statements prepared pursuant to the Chief Financial Officers Act of 1990, as amended. It does not apply to reports on pension plans pursuant to the requirements of PL 95-595.

Measurement Date for Pension and Retirement Health Care Liabilities

.1000 Pension and retirement health care liabilities in general purpose federal financial reports prepared pursuant to SFFAS 5 shall be measured as of the end of the fiscal year (or other reporting period if applicable). This measurement shall be performed following the end of the period reported, but does not have to be based on a full actuarial valuation as of the end of the reporting period. The measurement shall, however, reflect the best available estimates of 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 employees covered (enrollment) that cause a change in the liability. [I3, ¶3]

.1001 This measurement may be based on an actuarial valuation performed as of an earlier date during the fiscal year, including a beginning-of-year actuarial valuation, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise, cost of living adjustment, etc. This is sometimes referred to as a measurement based on a "projection" or "roll-forward" of the most recent available actuarial valuation. In evaluating the effect on the liability caused by changes in enrollment for plans that cover employees of more than one reporting entity (e.g., CSRS, FERS), materiality shall be assessed at the plan level. In evaluating the effect on the liability caused by changes in enrollment for plans that cover employees of only one reporting entity (e.g., Coast Guard, Department of State), materiality shall be assessed at the reporting entity level. [I3, ¶4]

Interpretation 4: Accounting for Pension Payments in Excess of Pension Expense

Summary

Changes in normal costs due to re-estimates of demographic and economic assumptions should be accounted for by the administrative entity as a change in accounting estimate. The effect of the change should be recognized in current and future years. When the employer entity's total payment for FERS and CSRS exceeds the related total pension expense as

defined in SFFAS No. 5, the entity should account for the excess payment as a transfer-out. The entity should include the transfer-out when determining results of operations on its statement of changes in net position. Any FERS-related payment that exceeds the FERS-related pension expense should be offset against any imputed financing resulting from a CSRS-related payment being less than CSRS-related pension expense in calculating the amount of the transfer out. Only when the total pension payment exceeds total pension expense would a transfer-out be recognized.

Accounting for Pension Payments in Excess of Pension Expense

Change in Estimate

.1100 Changes in normal costs due to re-estimates of demographic and economic assumptions should be accounted for by the administrative entity as a change in accounting estimate. The effect of the change should be recognized in current and future years. [I4, ¶9]

Payments in Excess of Pension Expense

.1101 When the employer entity's total payment for FERS and CSRS exceeds the related total pension expense as defined in SFFAS No. 5, the entity should account for the excess payment as a transfer-out. The entity should include the transfer-out when determining results of operations on its statement of changes in net position. [I4, ¶10]

.1102 Any FERS-related payment that exceeds the FERS-related pension expense should be offset against any imputed financing resulting from a CSRS-related payment being less than CSRS-related pension expense in calculating the amount of the transfer out. Only when the total pension payment exceeds total pension expense would a transfer-out be recognized. [I4, ¶11]

.1103 Example #1:

i. if an employer entity calculates total pension expense as $635,000 reflecting a FERS-related pension expense of $535,000 and a CSRS-related pension expense of $100,000,[21] and

ii. it makes a total pension payment to the trust fund — excluding its employees' contribution — of $630,000 reflecting $570,000 for its FERS employees and $60,000 for its CSRS employees,

iii. then it would off-set the $35,000 FERS-related excess payment ($570,000 - $535,000) against the $40,000 CSRS-related under payment ($100,000 - $60,000) and recognize the net $5,000 underpayment as an imputed financing as follows:

	Debit	Credit
Pension Expense (FERS $535,000 + CSRS $100,000)	$635,000	
Funds with Treasury (FERS $570,000 + CSRS $60,000)		$630,000
Imputed Financing ($40,000 - $35,000)		$5,000

[I4, ¶12]

.1104 Example #2: Assuming the same facts as in the paragraph immediately above except that the employer entity makes a payment of $640,000 ($580,000 FERS-related and $60,000 CSRS-related) instead of $630,000, then the entity would recognize a net transfer-out of the amount that the FERS-related excess payment ($580,000 - $535,000 = $45,000) exceeded the CSRS-related under payment ($100,000 - $60,000 = $40,000) as follows:

	Debit	Credit
Pension Expense (FERS $535,000 + CSRS $100,000)	$635,000	
Transfer-out ($45,000 - $40,000)	5,000	
Funds with Treasury (FERS $580,000 + CSRS $60,000)		$640,000

[I4, ¶13]

[21] The amounts used for CSRS are from the example in SFFAS No. 5; see paragraph .121 in this Subject Area.

Administrative Entity Intragovernmental Entries

.1105 The administrative entity should account for funds received from employer entities in excess of the normal cost of pension expense as a transfer-in. The administrative entity should include the transfer-in when determining results of operations on its statement of changes in net position. [I4, ¶14]

Adjusting Entries

.1106 Employer entities that recorded total FERS payments as pension expense during FY 1997 will need to adjust their accounts. The following examples use the amounts from paragraphs .1102 and .1103 above.

a. Example #3 - if the entity had originally recorded the following pension expense based on an earlier provided normal cost rate:

	Debit	Credit
Pension Expense (FERS $570,000 + CSRS $100,000)	$670,000	
Funds with Treasury (FERS $570,000 + CSRS $60,000)		$630,000
Imputed Financing (CSRS) ($40,000 - $35,000)		$40,000

then, when the revised estimate is provided, the entry would recalculate pension expense as $635,000 (FERS-related $535,000 + CSRS-related $100,000) and adjust the accounts accordingly by means of the following two simultaneous entries:

	Debit	Credit
(1) to reduce pension expense from $670,000 to $635,000 (FERS $535,000 + CSRS $100,000):		
Transfer-out	$35,000	
Pension Expense		$35,000
(2) to off-set the transfer-out against imputed financing:		
Imputed Financing	$35,000	
Transfer-out		$35,000

These entries adjust the accounts to the amounts that would have been entered had the original entry reflected the revised normal cost as shown in paragraph .1104 above.

b. Example #4 – Also, if the entity's accounting resulted in a net transfer-out, an adjustment may be necessary. For example, using the illustration in paragraph .1105 above, the entity may have originally recorded pension expense based on an earlier provided normal cost rate as follows:

	Debit	Credit
Pension Expense (FERS $580,000 + CSRS $100,000)	$680,000	
Funds with Treasury (FERS $580,000 + CSRS $60,000)		$640,000
Imputed Financing (CSRS) ($40,000 - $35,000)		$40,000

then the adjustments would be the following two simultaneous entries:

	Debit	Credit
(1) to reduce pension expense from $680,000 to $635,000 (FERS $535,000 + CSRS $100,000):		
Transfer-out (FERS $580,000 - $535,000 = $45,000)	$45,000	
Pension Expense		$35,000
(2) to off-set the transfer-out against imputed financing:		
Imputed Financing	$40,000	
Transfer-out		$40,000

These entries adjust the accounts to the amounts that would have been entered had the original entry reflected the revised normal cost as shown in paragraph .1104 above. [I4, ¶15]

Pensions, Other Retirement Benefits, and Other Post-Employment Benefits—Non-Authoritative Guidance

.4000 Illustration: Employee Benefits – Liability Recognition and Measurement Matrix [SFFAS5, Appendix B]

Federal Program Category		Expense	Liability
Employee Benefits	• Federal employee pension and ORB benefits • Military pension and ORB benefits	Recognize expense as employee services are performed	Recognize actuarial accrued liability.
	• VA disability compensation[a] • FECA—workers' compensation • OPEB	Recognize expense when relevant event occurs and program participant is determined eligible for compensation.	Recognize any amount due or the present value of future payments due, which ever is applicable.

[a]Disability compensation is paid to veterans who are disabled by injury or disease incurred or aggravated during active military service in the line of duty. The service of the veterans must have been terminated through separation or discharge under conditions that were other than dishonorable. Monetary benefits are related to the residual effects of the injury or disease. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

Glossary

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.

Attribution – The process of assigning pension benefits or costs to periods of employee service. [SFAS 87]

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 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.

Exchange transaction – A transaction that arises when each party to the transaction sacrifices value and receives value in return.

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.

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]

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)

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*)

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.

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)

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.

Prior Period Adjustments—P40

Source: SFFAS6, SFFAS7, SFFAS16, & SFFAS21

Related Reference(s): L40 Liabilities

Summary

In SFFAS 21, FASAB amended earlier guidance related to prior period adjustments related to correction on errors and changes in accounting principles. The amendment requires that when material errors are discovered in prior period financial statements, all statements presented must be restated to correct the error.

The Board retained the 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 standard. The language addressing the requirements, however, was revised to improve clarity and to require certain disclosures.

This subject area section also includes excerpts from standards that include implementation guidance requiring prior period adjustments.

Prior Period Adjustments

Correction of Errors

.100 "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

[1] Accounting Principles Board Opinion No. 20, par. 13.

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. Financial statements of subsequent periods need not repeat the disclosures [SFFAS21, ¶10]

.101 Prior period financial statements should only be restated for corrections of errors that would have caused any statements presented to be materially misstated. [SFFAS21, ¶11]

Changes in Accounting Principles

.102 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. [SFFAS21, ¶12]

.103 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. [SFFAS21, ¶13]

Implementation Guidance Requiring Prior Period Adjustments

Cleanup Costs

.104 Two implementation approaches have been provided for clean up cost liabilities related to general PP&E in service at the effective date of SFFAS6:

- A liability shall be recognized for the portion of the estimated total cleanup 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 Subject Area C40 paragraphs .112 through .114.
- 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 re-estimates occur and the liability balance adjusted. The provisions for cost allocation provided in Subject Area C40 paragraphs .112 through .114 shall not apply under this implementation method. [SFFAS6, ¶104]

.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. [SFFAS6, ¶105]

General Property, Plant, and Equipment

.106 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. [SFFAS6, ¶43]

Heritage Assets

.107 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. [SFFAS16, ¶14]

.108 For published financial statements presenting prior year information, no prior year amounts shall be restated. [SFFAS6, ¶65]

Stewardship Land

.109 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. [SFFAS6, ¶75]

.110 For published financial statements presenting prior year information, no prior year amounts shall be restated. [SFFAS6, ¶76]

Multi-Use Heritage Assets

.111 Implementation guidance for general PP&E, in SFFAS No. 6, (See Subject Area G20 paragraphs .122 through .126.) 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. [SFFAS16, ¶15]

Stewardship PP&E

.112 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. [SFFAS6, ¶106]

Receivables—R10

Source: SFFAS1. SFFAS7

Related Reference(s): A 30 Advances and Pre-Payments; E30 Entity and Non-Entity Assets and Liabilities; G60 Governmental and Intragovernmental Assets and Liabilities; L60 Loans and Loan Guarantees

Summary

Receivables are the amounts that the entity claims for payment from others. Receivables can result from such activities as the sales of goods or services, the non-payment of taxes, the making of loans or loans assumed from defaults on previously made loan guarantees, the earning of interest, the advance or prepayment of monies, etc. This Subject Area includes the SFFAS1 standards for Accounts Receivable and Interest Receivable and excerpts from SFFAS7 regarding the recognition of accounts receivable from nonexchange transactions, specifically taxes.

Receivables

Accounts Receivable

.100 Accounts receivable arise from claims to cash or other assets. The accounting standard for accounts receivable is set forth below. [SFFAS1, ¶40]

Recognition of Receivables

.101 A receivable should be recognized[1] when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made. [SFFAS1, ¶41 as amended by SFFAS7, ¶53.]

[1] 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.]

.102 Accounts receivable from Nonexchange transactions 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. [SFFAS7, ¶53]

Separate Reporting

.103 Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities. [SFFAS1, ¶42}

Entity vs. Non-Entity Receivables

.104 Receivables should be distinguished between entity receivables and non-entity receivables. "Entity receivables" are amounts 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.[2] 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. [3] Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity. [SFFAS1, ¶43]

Recognition of Losses Due to Uncollectible Amounts

.105 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. [SFFAS1, ¶44]

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[2] 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.

[3] 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.

.106 An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value.[4] The allowance for uncollectible amounts should be re-estimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct. [SFFAS1, ¶45]

Measurement of Losses

.107 Losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole. [SFFAS1, ¶46]

Individual Account Analysis

.108 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. [SFFAS1, ¶47]

.109 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. [SFFAS1, ¶48]

Group Analysis

.110 To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics. [SFFAS1, ¶49]

.111 The groups should reflect the operating environment. For example, accounts receivable can be grouped by: (a) debtor category

[4] In SFFAS2, Accounting for Direct Loans And Loan Guarantees, receivables resulting from loan and loan guaranty transactions are accounted for on a net present value basis. See Subject Area Section L 60 Loan and Loan Guaranties in this Volume.

(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. [SFFAS1, ¶50]

.112 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. [SFFAS1, ¶51]

Disclosure

.113 Agencies should disclose the major categories of receivables by amount and type, the methodology used to estimate the allowance for uncollectible amounts, and the total allowance. [SFFAS1, ¶52]

Interest Receivable

.114 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.)[5] [SFFAS1, ¶53]

.115 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

[5] Accounting for imputed interest, interest on long-term leases, interest on loans, and interest on amounts deposited in credit reform accounts is addressed in SFFAS2, Accounting for Direct Loans and Loan Guarantees. See Subject Area Section L60 in this Volume.

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). [SFFAS1, ¶54]

.116 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. [SFFAS1, ¶55]

.117 Interest receivable from federal entities should be accounted for and reported separately from interest receivable from the public. [SFFAS1, ¶56]

Receivables from Tax Assessments

.118 Accounts Receivable from nonexchange transactions should be recognized on the basis of completion of the assessment processes. 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. [Excerpt from SFFAS7, ¶53]

.119 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. 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[6] or pre-assessment work in process. [SFFAS7, ¶54]

Compliance Assessments and Pre-Assessment Work in Process

.120 Compliance assessments and pre-assessment work in process may or may not be legally assessed depending on the resolution of subsequent events.

A. 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.

[6] Customs refers to "compliance assessment" as protested assessment amounts.

B. 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 preassessment 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. [SFFAS7, ¶55]

Allowance for Uncollectible Amounts

.121 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.[7] A provision to increase or decrease the allowance will result in an adjustment of nonexchange revenue, rather than a bad debt expense. [SFFAS7, ¶56]

[7] Paragraphs .105 - .112 above provide the basis for determining this allowance.

Research and Development—R20

Source: SFFAS8

Related Reference(s): S70 Stewardship Reporting

Summary

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.

Research and Development

Definition

.100 "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.[1] [SFFAS8, ¶96]

Measurement

.101 "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.[2] Amounts shall be reported in nominal dollars. [SFFAS8, ¶97]

.102 Expenses incurred for programs, contracts, or grants with split purposes[3] 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. [SFFAS8, ¶98]

.103 By no later than the third year after the effective date of SFFAS8, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported.[4] 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.

[1] See OMB Circular A-11, section 44.

[2] See Subject Area Section M20 Managerial Cost Accounting for a full discussion of Federal cost accounting principles and standards.

[3] 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.

[4] 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.

- “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 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).[5]
- “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. [SFFAS8, ¶99]

[5] Research Funding as an Investment: Can We Measure the Returns?, A Technical Memorandum, Congress of the United States, Office of Technology Assessment (Apr. 1986).

Minimum Reporting

.104 Minimum reporting shall consist of the following:

- The annual investment[6] 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. [SFFAS8, ¶100]

[6]As defined in SFFAS8, "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. See Subject Area Section M20, Managerial Cost Accounting in this Volume.

Recommended Reporting

.105 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. [SFFAS8, ¶101]

Research and Development—Non-Authoritative Guidance

.4000 Sample Report Illustration [SFFAS 8, Appendix B]

Annual Stewardship Information

For the Fiscal Year Ended September 30, 199Z

Federal investment in research and development comprises those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other benefits. Expense data are expressed in nominal dollars for the fiscal year being reported upon and the preceding 4 FYs.

Following is a summary of stewardship data for the Ceramic Materials Research Program[7] for the 5 fiscal years ending September 30, 199V through 199Z:

Program: Ceramic Materials Research Program

Dollars in millions					
	199V	**199W**	**199X**	**199Y**	**199Z[a]**
Program Expenses[b]					
Basic Research	$106	$124	$136	$132	$143
Applied Research	93	101	107	118	121
Development[c]	46	62	73	68	82
Administration	14	16	17	19	21
Total	**$259**	**$303**	**$333**	**$337**	**$367**
Program Outputs and Outcomes					
Interagency Agreements and Contracts					
New	45	38	41	37	44
Continuation	28	52	55	61	68
Articles in Journals	9	12	23	34	41
Patents from funded R&D	3	8	14	18	21
Rights to Inventions from funded R&D[d]	0	1	0	3	2

[a] Included as expenses in calculating net cost.

[b] Expenses are reported on an accrual basis and include an allocation of overhead costs.

[c] Development grants are for a fixed amount, not to exceed 50 percent of the cost of the project.

[d] Indicates inventions financed with Federal funds to which the government has patent rights, in accordance with the Bayh-Dole Act.

[7] This hypothetical program is for illustration only.

Programs Outcomes

The increasing number of articles published on the basis of funded research, including announcements of several newly discovered properties of certain composite ceramics, is evidence of the utility of this part of the program. The number of patents emerging from the program is also increasing, primarily from the development component of the program.

Narrative Discussion

This program was authorized in 19XX (by P.L. XX-XXX) to accelerate the development of this industry in the United States. The research element of the program operates through interagency agreements with the Federal laboratories and grants to university researchers. The researchers are selected through peer review procedures. The development component provides grants to private firms to develop improved manufacturing procedures for ceramic materials-based products and to accelerate the development of marketable products incorporating advanced ceramic materials.

Revenue, Gains & Losses, and Other Financing Sources—R40

Source: SFFAS7[1]; SFFAS20, SFFAS22, I1, I5, TB 2002-2

Related Reference(s): B60 Budgetary Information; P40 Prior Period Adjustments; S30 Seized and Forfeited Property; T30 Transactions Not Recognized as Revenue, Gains & Losses, or Other Financing Sources

Summary

In SFFAS 7: *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, the FASAB issued standards on revenue and other financing sources and amended Concepts Statement 2, Entity and Display to require the reporting of information that reconciles budgetary and financial accounting.

SFFAS7 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 of Revenue and Other Financial Sources

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 SFFAS7 includes accounting standards for them.

[1] SFFAS 13: Deferral of Paragraph 65.2Material Revenue-Related Transactions Disclosures deferred the effective date of SFFAS7, ¶65.2, making it effective for periods beginning after September 30, 2000. The paragraph’s requirements covered material revenue-related transactions disclosures.

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 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.

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.

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).[2]

In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power 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.

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.

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.

[2] As explained in SFFAS1, Accounting for Selected Assets and Liabilities, ¶44, FASAB defined "more likely than not" to mean more than a 50 percent chance. "Not probable" means the converse, i.e., less than a 50 percent chance. See Subject Area Section R10.105 in this Volume.

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 a way that helps users relate the two.

Disclosures, Supplementary Information, and Other Information

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. The SFFAS7 accounting standards provide for –

- Extensive disclosures and other information about taxes and duties
- Certain disclosures about exchange transactions where the full cost of goods and services sold is not recovered.
- Limited disclosure concerning accountability for dedicated collections. 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.
- Disclosures are required about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

Revenue, Gains & Losses, and Other Financing Sources

Accounting for Revenue and Other Financing Sources

Scope

.100 SFFAS7, as amended, determines 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. [SFFAS7, ¶30]

.101 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. [SFFAS7, ¶31]

Exchange Revenue

.102 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. [SFFAS7, ¶33]

Recognition and Measurement of Exchange Revenue

.103 Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price. [SFFAS7, ¶34]

.104 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. [SFFAS7, ¶35]

.105 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.

[3] SFFAS7's requirement is an exception to the general principle of SFFAS No. 5, Accounting for Liabilities of the Federal Government, which, but for this exception, would require a loss on a contract to be recognized at the time when expected costs exceeded expected revenue. However, the expected loss must be disclosed: see the disclosure requirement in paragraph .115 (D).

(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. [SFFAS7, ¶36]

.106 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.[4] [SFFAS7, ¶37]

.107 The measurement basis for revenue from exchange transactions should be the actual price that is received or receivable under the established pricing arrangements. [SFFAS7, ¶38]

.108 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. [SFFAS7, ¶39]

[4] SFFAS1, ¶41 as amended by SFFAS7, ¶53 , provides that such request should be recorded if a claim to cash is established based on legal provisions, such as a payment due date. See Subject Area Section R10.101-.102.

.109 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.[5] The amount of the bad debt expense should be separately shown. [SFFAS7, ¶40]

.110 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. [SFFAS7, ¶41]

.111 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. [SFFAS7, ¶42]

.112 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. [SFFAS7, ¶43]

.113 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

[5] SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 40-52, is the standard for estimating bad debts. (See Subject Area Section R10.100-.133 in this Volume..) The standard is further explained in SFFAS No.1's "Basis for Conclusions," ¶¶116-133.

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. [SFFAS7, ¶44]

.114 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.

A. 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

B. If the collecting entity transfers the exchange revenue to other entities, similar recognition by other entities is appropriate.

1. 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.

2. 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.

C. Because the revenue is exchange revenue regardless of whether related costs are recognized, it should be recognized and measured under the exchange revenue standards. [SFFAS7, ¶45]

Disclosures and Other Accompanying Information

.115 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;[6]

(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). [SFFAS7, ¶46]

.116 When making the disclosures called for by (a) and (b) in paragraph .115, 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. [SFFAS7, ¶47]

[6] The pricing guidance in OMB Circular No. A-25 does not apply to prices set by law or executive order.

Nonexchange Revenue

Recognition and Measurement of Nonexchange Revenue – The General Standard

.117 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 .118 through .132 describe the application of this general standard. [SFFAS7, ¶48]

Taxes and Duties

.118 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 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 (paragraph 117) to accrue amounts now required to be presented as supplementary information (paragraphs .136. A and 136. B) and make other changes that would result in a fuller and more complete application of accrual accounting. [SFFAS7, ¶49]

.119 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. [SFFAS7, ¶50]

.120 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. [SFFAS7, ¶51]

.121 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 .122 to .126. [SFFAS7, ¶52]

.122 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.[7] 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. [SFFAS7, ¶53]

[7] SFFAS No. 1, Accounting for Selected Assets and Liabilities, ¶41, as originally issued, required that "a receivable should be recognized . . . based on legal provisions, such as a payment due 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. See Subject Area Section R40.101-.102 in this Volume.

.123 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[8] or pre-assessment work in process. [SFFAS7, ¶54]

.124 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.

A. 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.

B. Pre-assessment work in process is assessments not yet officially asserted by the collecting entity which are subject to a taxpayer's

[8] Customs refers to "compliance assessments" as protested assessment amounts.

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. [SFFAS7, ¶55]

.125 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.[9] A provision to increase or decrease the allowance will result in an adjustment of nonexchange revenue, rather than a bad debt expense. [SFFAS7, ¶56]

.126 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. [SFFAS7, ¶57]

.127 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. [SFFAS7, ¶58]

[9] SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 44 to 51, provides the basis for determining this allowance. (See Subject Area Section R10.105-.112 in this Volume.)

A. 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.

B. Unasserted claims for refund such as unfiled claims for refunds or drawbacks for which no claim has been filed, are not recognized.[10] These amounts may be reasonably estimable, but are not presently included in dollar-based accounting systems. [SFFAS7, ¶58]

.128 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. [SFFAS7, ¶59]

.129 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 .129 A through 129 D, below.

[10] 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.

A. 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.

B. 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.

C. 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.

D. 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. [SFFAS7, ¶60]

Fines and Penalties

.130 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.[11] 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. [SFFAS7, ¶61]

Donations

.131 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[12] and should be measured at the estimated fair value of the contribution. [SFFAS7, ¶62]

Other Nonexchange Revenue

.132 The various types of nonexchange revenue are described in the following Section "Guidance for the Classification of Transactions."

[11] SFFAS No. 1, paragraphs. 44-51. See Subject Area Section R10.105-.113 in this Volume.

[12] For the recognition criteria for donated property, plant and equipment, see SFFAS No. 6, Accounting for Property, Plant, and Equipment, paragraphs 30 and 71. See Subject Area Sections GS20, ¶¶ .110 and S60 Stewardship Land, ¶.108 in this Volume.

Some of these are not specifically mentioned in this standard. They should be recognized and measured in accordance with the general rule (see paragraph .117) except where other Board standards apply. [SFFAS7, ¶63]

Disclosures, Supplementary Information, and Other Accompanying Information

Disclosures

.133 Basis of Accounting. Collecting entities should disclose the basis of accounting when the application of the general rule of paragraph .117 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 .118, then the disclosure should describe that change in accounting and point out how it differs from that prescribed by this standard. [SFFAS7, ¶64]

.134 Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

A. Accounts receivable**.** Factors affecting collectability and timing of categories of accounts receivable and the amounts involved.

B. 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. [SFFAS7, ¶65 as amended by SFFAS20, ¶6]

.135 If trust fund revenues are not recorded in accordance with applicable law, both the collecting and recipient entities should disclose the reasons. [SFFAS7, ¶66]

Supplementary Information

.136 Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial responsibilities:

A. 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.

B. 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.

C. 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.

D. If reasonably estimable, the amounts by which trust funds may be over- or under-funded in comparison with the requirements of law. [SFFAS7, ¶67]

.137 Recipient entities that are trust funds should provide the same information as required for collecting entities in .136 D. [SFFAS7, ¶68]

Other Accompanying Information

.138 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.

A. 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.

B. 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 (paragraph .136 A above).

C. 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 help the reader assess

the possible impact of specific tax expenditures on the success of the related programs.

D. 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. [SFFAS7, ¶69]

Other Financing Sources

.139 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.[13] 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. [SFFAS7, ¶70]

Recognition and Measurement of Other Financing Sources

Appropriations

.140 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

[13] Other accounting standards will determine the criteria for the imputation of costs and how those costs shall be measured. This standard provides guidance for accounting for the corresponding financing source that is reported in such cases.

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. [SFFAS7, ¶71]

.141 Appropriations Used. When used, appropriations should be recognized as a financing source in determining net results of operations.[14] 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. [SFFAS7, ¶72]

Financing Imputed for Cost Subsidies

.142 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. [SFFAS7, ¶73]

Transfers of Assets

.143 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

[14] As is explained in the Basis for Conclusions, in the private sector, the term "net results of operations" is synonymous with net income and net income is the "bottom line" measure of performance for profit-seeking businesses. For most Government reporting entities, on the other hand, this is not the "bottom line" for performance measurement. See SFFAS 7, Appendix A, Basis for Conclusions, paragraph 224 and following.

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. [SFFAS7, ¶74]

.144 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 in determining the net result of operations.[15] [SFFAS7, ¶75]

Accountability for Dedicated Collections

.145 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. [SFFAS7, ¶83]

.146 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

[15] These transfers are distinguished from custodial transfers in that transfers involve assets that have been earned or in use by the entity in carrying out its programs whereas custodial transfers involve funds that have been collected on behalf of another entity. Accounting for custodial transfers is described in the section covering nonexchange revenue.

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. [SFFAS7, ¶84]

.147 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 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 .146, 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.” [SFFAS7, ¶85]

.148 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.[16] [SFFAS7, ¶86]

.149 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. [SFFAS7, ¶87]

Guidance for the Classification of Transactions [SFFAS7, Appendix B]

.150 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

[16] When information on funds is reported separately and the basis of accounting is not in accordance with applicable accounting standards, the report should state that it is prepared on the basis of legal requirements.

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 section provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources. [SFFAS7, ¶235]

.151 To serve that purpose, this section 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 different considerations. [SFFAS7, ¶236]

.152 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. [SFFAS7, ¶237]

.153 Exchange transactions are classified as producing gains or losses if they are likely to be unusual or nonrecurring. If the transactions classified in this section 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. [SFFAS7, ¶238]

.154 The following Table of Transactions lists in order the transactions that are illustrated, group by group. 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. [SFFAS7, ¶240]

.155 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. [SFFAS7, ¶241]

Table 8: TABLE OF TRANSACTIONS

	R40 Ref.
TRANSACTIONS WITH THE PUBLIC	
Nonexchange transactions with the public	
Individual income taxes, corporation income taxes, social insurance taxes and contributions, excise taxes, estate and gift taxes, and customs duties	.156
Social insurance taxes and contributions paid by Federal employees	.160
Deposits by states for unemployment trust fund	.161
User fees, Harbor Maintenance trust fund	.163
Customs Service fees	.164
Deposits of earnings, Federal Reserve System	.170
Donations: except types of property, plant, and equipment that are expensed	.172
Fines and penalties	.174
Penalties due to delinquent taxes in connection with custodial activity	.177
Forfeitures	.178
Exchange transactions with the public: revenue	
Sales of goods and services	.184
Sales of goods and services in undercover operations	.185
Interest (unless classified elsewhere), dividends, and rents (except for mineral rights) on Government property	.186
Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights	.188
Proceeds from the auction of the radio spectrum	.192
Interest on post-1991 direct loans	.194
Interest on delinquent taxes and other receivables that arise as the result of custodial operations	.195
Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees	.196
Diversion fees, Department of Justice	.197

(Continued From Previous Page)

	R40 Ref.
Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance	.198
Federal employee contributions to pension and other retirement benefit plans	.199
Federal employee contributions to health benefits plan for current coverage	.201
Reimbursement for collecting revenue	.203
Reimbursement for cleanup costs	.206
Exchange transactions with the public: gains and losses	
Sales of Government assets: other than property, plant, and equipment and forfeited and foreclosed property	.208
Sales of property, plant, and equipment	.209
Acquisition of property, plant, and equipment through exchange	.211
Sales of foreclosed property: associated with pre-1992 direct loans and loan guarantees	.214
Sales of receivables: except direct loans	.215
Sales of direct loans	.216
Retirement of debt securities prior to maturity	.217
Other financing sources from the public	
Seigniorage	.219

(Continued From Previous Page)

	R40 Ref.
INTRAGOVERNMENTAL TRANSACTIONS	
Nonexchange transactions—intragovernmental: revenue	
Interest on Treasury securities held by trust funds and special funds (except trust revolving funds)	.220
Interest received by one fund from another	.223
Employer entity contributions to social insurance programs	.224
Nonexchange transactions—intragovernmental: gains and losses	
Retirement of debt securities prior to maturity: trust funds and special funds (except trust revolving funds)	.225
Cancellation of debt	.227
Exchange transactions—intragovernmental: revenue	
Intragovernmental sales of goods and services by a revolving fund	.228
Intragovernmental sales of goods and services by a fund other than a revolving fund	.229
Employer entity contributions to pension and other retirement benefit plans for Federal employees	.230
Employer entity contributions to health benefit plans for current coverage of Federal employees	.232
Employer entity payments for unemployment benefits and workers compensation	.234
Interest on Treasury securities held by revolving funds	.236
Interest on Treasury securities held by trust revolving funds	.238
Interest on uninvested funds received by direct loan and guaranteed loan financing accounts	.240
Interest received by Treasury	.241
Exchange transactions—intragovernmental: gains and losses	
Retirement of debt securities prior to maturity: revolving funds and trust revolving funds	.243
Other financing sources—intragovernmental	
Appropriations	.245
Cost subsidies: difference between internal sales price (reimbursement) and full cost	.247
Cost subsidies: difference between the service cost of pensions (and other retirement benefits), less the employee contributions, if any, and the employer entity contributions	.249
Contribution by the General Fund to the SMI trust fund	.252
Transfer by CCC to Federal Crop Insurance Corporation	.254
Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds	.255
Transfer of cash and other capitalized assets without reimbursement	.258
Transfer of property, plant, and equipment without reimbursement: types that are expensed	.259
REVALUATIONS	
Revaluation of capitalized property, plant, and equipment	.261
Revaluation of inventory and related property	.263

Transactions with the Public

Nonexchange transactions with the Public

.156 Individual income taxes, corporation income taxes, social insurance taxes and contributions,[17] 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 tranquility: 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. [SFFAS7, ¶242]

.157 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 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

[17] "Social insurance" does not include programs established solely or primarily for Federal employees, such as pension and other retirement plants. "Social insurance" taxes and contributions do, however, include payments made by or on behalf of Federal employees to social insurance plans, such as Social Security and Medicare.

determined through the exercise of the power of the Government to compel payment. Therefore, like other taxes, they are classified as producing nonexchange revenue. [SFFAS7, ¶243]

.158 Board members have differing views on whether social insurance programs result in exchange or nonexchange transactions.[18] 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. [SFFAS7, ¶244]

.159 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. [SFFAS7, ¶245]

[18] See discussion of social insurance programs in FASAB, Exposure Draft, Supplementary Stewardship Reporting (August 1995).

.160 Social insurance taxes and contributions paid by Federal employees.[19] – Federal employees may be covered by social insurance programs such as Social Security[20] 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. [SFFAS7, ¶246]

.161 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. [SFFAS7, ¶247]

.162 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

[19] "Social insurance" does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

[20] Most Federal civilian employees hired before 1984 are not covered by Social Security.

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.) [SFFAS7, ¶248]

.163 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. [SFFAS7, ¶249]

.164 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." [SFFAS7, ¶250]

.165 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. [SFFAS7, ¶251]

.166 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. [SFFAS7, ¶252]

.167 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. [SFFAS7, ¶253]

.168 The user fees consist of a group of flat fees charged on passengers and conveyances entering the country.[21] The collections are dedicated by law to a special fund whose receipts are made available by permanent indefinite appropriation to finance Customs Service operations. [SFFAS7, ¶254]

.169 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. [SFFAS7, ¶255]

.170 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.[22] 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. [SFFAS7, ¶256]

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[21] These fees are sometimes called the "COBRA user fees." This term comes from the Consolidated Omnibus Budget Reconciliation Act of 1985, which established these fees.

[22] SFFAC No. 2, Entity and Display, pp. 14-15.

.171 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. [SFFAS7, ¶257]

.172 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.[23] 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. [SFFAS7, ¶258]

.173 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.[24] Correspondingly, no revenue is recognized for such donations. [SFFAS7, ¶259]

.174 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. [SFFAS7, ¶260]

.175 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. [SFFAS7, ¶261]

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[23] The term "donations" includes wills disposing of property and judicial proceedings other than forfeitures.

[24] SFFAS No.6, Accounting for Property, Plant, and Equipment, pp. 18 and 20. See Subject Area Sections G20.101 and L20.100-.102.

.176 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 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. [SFFAS7, ¶262]

.177 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. [SFFAS7, ¶263]

.178 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).[25] [SFFAS7, ¶264]

[25] This amends SFFAS No. 3, Accounting for Inventory and Related Property, with respect to forfeitures related to satisfying tax liabilities.

.179 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 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.[26] [SFFAS7, ¶265]

.180 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. [SFFAS7, ¶266]

.181 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. [SFFAS7, ¶267]

.182 The disposition of the revenue from forfeiture is determined by law. Revenue or the 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

[26] 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.

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. [SFFAS7, ¶268]

.183 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. [SFFAS7, ¶269]

Exchange Transactions with the Public: Revenue

.184 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 sacrifices something of value. The sale is therefore an exchange transaction, and the revenue is exchange revenue for the entity making the sale. [SFFAS7, ¶270]

.185 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. [SFFAS7, ¶271]

.186 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. [SFFAS7, ¶272]

.187 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. [SFFAS7, ¶273]

.188 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. [SFFAS7, ¶274]

.189 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

[27] The partial recognition of associated cost distinguishes interest from rents, royalties, and bonuses on the Outer Continental Shelf and the auction of the radio spectrum. For the latter transactions, see the subsequent paragraphs.

are exchange revenue, they should not be subtracted from MMS's gross cost in determining its net cost of operations. [SFFAS7, ¶275]

.190 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. [SFFAS7, ¶276]

.191 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. [SFFAS7, ¶277]

.192 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. [SFFAS7, ¶278]

.193 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. [SFFAS7, ¶279]

.194 Interest on post-1991[28] direct loans.[29] I– 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.[30] [SFFAS7, ¶280]

.195 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

[28] Post-1991 direct loans consist of direct loans that were obligated after September 30, 1991, whereas pre-1992 direct loans consist of direct loans that were obligated before October 1, 1991. The same accounting that is used for post-1991 direct loans is also used for pre-1992 direct loans that were modified and transferred to financing accounts; loans receivable arising from defaulted post-1991 guaranteed loans; and loans receivable arising from defaulted pre-1992 guaranteed loans that were modified and transferred to financing accounts.

[29] For interest on pre-1992 direct loans, see the preceding section on "interest (inless classified elsewhere) …"

[30] See Subject Area Section L40.111-.112, .118,.133-.135, and .141-.142.

government's cost of borrowing; if transferred to another entity, it is recognized as nonexchange revenue by the entity that receives the transfer. [SFFAS7, ¶281]

.196 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. [SFFAS7, ¶282]

.197 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. [SFFAS7, ¶283]

.198 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. [SFFAS7, ¶284]

.199 Federal employee contributions to pension and other retirement benefit plans.[31] – 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. [SFFAS7, ¶285]

.200 In broad terms, the employee contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More 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.[32] [SFFAS7, ¶286]

.201 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

[31] Federal employee retirement plans do not include social insurance, such as Social Security and Medicare.

[32] 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. These standards are included in this Volume in Subject Area Section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits.

part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of the employees. [SFFAS7, ¶287]

.202 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. [SFFAS7, ¶288]

.203 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. [SFFAS7, ¶289]

.204 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. [SFFAS7, ¶290]

.205 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. [SFFAS7, ¶291]

.206 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. [SFFAS7, ¶292]

Exchange transactions with the public: gains and losses

.207 **Note:** As explained in the introduction to this section, 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. [SFFAS7, ¶293]

.208 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. [SFFAS7, ¶294]

.209 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[33] equals book value, there is no gain or loss, because a cash inflow equal to book value is the

[33] The sales price may include the fair value of items received in exchange.

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. [SFFAS7, ¶295]

.210 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.[34] [SFFAS7, ¶296]

.211 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). [SFFAS7, ¶297]

[34] 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 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.) See Subject Area Sections G20 General Property, Plant, and Equipment and S60 Stewardship Land in this Volume.

.212 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.[35] 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. [SFFAS7, ¶298]

.213 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.[36] [SFFAS7, ¶299]

.214 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.[37] [SFFAS7, ¶300]

.215 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. [SFFAS7, ¶301]

[35] See SFFAS No. 6, Accounting for Property, Plant, and Equipment, pp. 10-11. See Subject Area Section G20 General Property, Plant, and Equipment in this Volume.

[36] Ibid., footnote 38.

[37] See SFFAS No. 3, Accounting for Inventory and Related Property, pp. 20-23. See Subject Area Section L60 Loans and Loan Guarantees in this Volume.

.216 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.[38] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[39] [SFFAS7, ¶302]

.217 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. [SFFAS7, ¶303]

.218 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.[40] [SFFAS7, ¶304]

Other financing sources from the public

.219 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

[38] This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is made and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

[39] See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 17 and 66-69. See Subject Area Section L60 Loans and Loan Guarantees in this Volume.

[40] SFFAS No. 5, Accounting for Liabilities of the Federal Government, p. 17. See Subject Area Section F10 Federal Debt and Related Interest in this Volume.

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. [SFFAS7, ¶305]

Intragovernmental Transactions

Nonexchange transactions—intragovernmental: revenue

.220 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. [SFFAS7, ¶306]

.221 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. [SFFAS7, ¶307]

.222 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 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. [SFFAS7, ¶308]

.223 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. [SFFAS7, ¶309]

.224 Employer entity contributions to social insurance programs.[41] – Federal employees may be covered by social insurance programs such as Social Security[42] 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

[41] "Social insurance" does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

[42] Most Federal civilian employees hired before 1984 are not covered by Social Security.

similar benefits. For these reasons, the employer entity contribution should have the same classification as private employer contributions, which is nonexchange revenue. [SFFAS7, ¶310]

Nonexchange transactions—intragovernmental: gains and losses

.225 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. [SFFAS7, ¶311]

.226 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. [SFFAS7, ¶312]

.227 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. [SFFAS7, ¶313]

Exchange transactions—intragovernmental: revenue

.228 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. [SFFAS7, ¶314]

.229 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. [SFFAS7, ¶315]

.230 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. [SFFAS7, ¶316]

.231 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.[43] [SFFAS7, ¶317]

.232 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. [SFFAS7, ¶318]

.233 In broad terms, the employer entity contribution 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 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. [SFFAS7, ¶319]

[43] 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. (Subject Area Section P40 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits in this Volume.) 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.

.234 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.[44] 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. [SFFAS7, ¶320]

.235 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. [SFFAS7, ¶321]

.236 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. [SFFAS7, ¶322]

[44] See SFFAS No. 5, Accounting for Liabilities of the Federal Government, p. 37 and p. 64, footnote 70. See Subject Area Section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits in this Volume.

.237 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. [SFFAS7, ¶323]

.238 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. [SFFAS7, ¶324]

.239 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. [SFFAS7, ¶325]

.240 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. [SFFAS7, ¶326]

.241 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. [SFFAS7, ¶327]

Exchange transactions—intragovernmental: gains and losses

.242 **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. [SFFAS7, ¶328]

.243 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. [SFFAS7, ¶329]

.244 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. [SFFAS7, ¶330]

Other financing sources—intragovernmental

.245 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. [SFFAS7, ¶331]

.246 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. [SFFAS7, ¶332]

.247 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.[45] [SFFAS7, ¶333]

.248 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. [SFFAS7, ¶334]

.249 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.[46] Therefore, the entire service cost is recognized as a cost to the employer entity and imputed to it. [SFFAS7, ¶335]

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[45] See SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, pp. 43-50. The accounting standards in SFFAS4 are included in this Volume in Subject Area Section M20 Managerial Cost Accounting

[46] Retired employees do pay premiums, however, and the service cost to the employer entity is defined net of the actuarial present value of those future premiums.

.250 The financing of the imputed cost is also imputed to the employer entity.[47] 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.[48] [SFFAS7, ¶336]

.251 (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.) [SFFAS7, ¶337]

.252 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. [SFFAS7, ¶338]

.253 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

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[47] The employer entity's own contribution, if any, is generally financed by an appropriation but could be financed by earned revenue or other sources.

[48] 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. (Subject Area Section P20 Pensions, Other Retirement Benefits, and Other Post-Employment Benefits in this Volume) 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.

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. [SFFAS7, ¶339]

.254 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. [SFFAS7, ¶340]

.255 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. [SFFAS7, ¶341]

.256 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 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. [SFFAS7, ¶342]

.257 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. [SFFAS7, ¶343]

.258 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. [SFFAS7, ¶344]

.259 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. [SFFAS7, ¶345]

.260 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. [SFFAS7, ¶346]

Revaluations

.261 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.[49] [SFFAS7, ¶347]

.262 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. [SFFAS7, ¶348]

[49] SFFAS No. 6, Accounting for Property, Plant, and Equipment, pp. 12-13. See Subject Area Section G20 General Property, Plant, and Equipment in this Volume.

.263 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.[50] [SFFAS7, ¶349]

.264 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. [SFFAS7, ¶350]

[50] See SFFAS No. 3, Accounting for Inventory and Related Property, pp. 6-7, 11, 13, 24, and 26. See Subject Area Section I50 Inventories: Inventory Held for Sale, Inventory Held in Reserve, Excess Obsolete and Unserviceable Inventory and Inventory Held for Repairs in this Volume.

Revenue, Gains & Losses, and Other Financing Sources—Interpretations

Interpretation 1: Reporting on Indian Trust Funds

Summary

The Department of the Interior requested guidance about how to report information on Indian trust funds in the general purpose financial report of the Department. The Indian trust funds are managed by Interior's Office of Special Trustee, Office of the Secretary. FASAB concluded that the assets, liabilities and operating transactions of the Indian trust funds are not part of the Department of Interior and should not be included in the balance sheet, statement of net cost, and statement of changes in financial position of the Department or of the United States Government. However, the Department does have a fiduciary responsibility for these funds and is required to report on them in footnotes to the financial statements by SFFAS 7.

Reporting on Indian Trust Funds

Background

.1000 The Department of the Interior requested guidance about how to report information on Indian trust funds in the general purpose financial report of the Department. The Indian trust funds are managed by Interior's Office of Special Trustee, Office of the Secretary. (Prior to FY 1996 the trust funds were managed by the Bureau of Indian Affairs.) Some of the funds belong to individual Indians, others belong to tribes. The funds are managed by the federal government in a trust arrangement. While the Government's

responsibility for all of these funds is of a fiduciary nature, some portion of the annual flows for some of the funds have been included in the Budget of the United States Government. [I1, ¶1]

.1001 According to SFFAC 2, *Entity and Display*, inclusion of a program in the section of the budget currently entitled "Federal Programs by Agency and Account" is conclusive evidence that the program should be part of the reporting entity. The question thus arises whether the assets and activities of the Indian trust funds should be reported in the Department of Interior's general purpose financial statements. Also, SFFAS 7, *Accounting for Revenue and Other Financing Sources*, requires certain disclosures regarding "dedicated collections," including fiduciary funds. During discussion of this issue at the FASAB, questions arose about what type of disclosures should be provided regarding the Indian trust funds. [I1, ¶2]

Interpretation

.1002 The assets, liabilities and operating transactions of the Indian trust funds are not part of the Department of Interior and should not be included in the balance sheet, statement of net cost, and statement of changes in financial position of the Department or of the United States Government. However, the Department does have a fiduciary responsibility for these funds and is required to report on them in footnotes to the financial statements by SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraphs 83-87. [I1, ¶3]

Scope

.1003 This Interpretation deals with what information about Indian trust funds should be included in the general purpose financial report of the Department of Interior and of the United State Government. It does not address issues regarding (1) reporting formats for the footnote disclosure required by SFFAS 7, (2) inclusion or exclusion of other fiduciary funds as components of the federal reporting entity, (3) inclusion or exclusion of any funds or entities in the *Budget of the United States Government*, or (4) reporting on other funds labeled "trust funds" in the federal budget, reporting for trust funds, or reporting on deposit funds generally.[51] [I1, ¶4]

Interpretation 5: Recognition by Recipient Entities of Receivable Nonexchange Revenue

Summary

Entities that receive nonexchange revenue collected on their behalf by another entity should recognize the revenue based on the best available evidence at the time the financial report is prepared. This provision of paragraph 60 of SFFAS 7 is intended to require recognition of the excise tax "true up" of the difference between amounts transferred to trust funds based on estimates by Treasury's Office of Tax Analysis and the actual amount subsequently determined by IRS. IRS certifies the third quarter actual amount in December. The intent of paragraph 60 is to recognize this "true up" amount as a receivable or payable. The Board did not intend to impose "push down" accounting that would require entities such as trust funds that receive taxes collected on their behalf to recognize a portion of IRS's net taxes receivable.

[51] This restriction on the scope of this interpretation does not imply that this treatment would be inappropriate for other fiduciary funds. Other funds were not included in the research supporting this Interpretation and are therefore excluded.

Recognition by Recipient Entities of Receivable Nonexchange Revenue

Issue

.1100 Paragraph 60 of SFFAS 7, Accounting for Revenue and Other Financing Sources, requires entities that receive nonexchange revenue collected for them by other entities to recognize ". . . the net change in any related inter-entity balances between collecting and receiving entities." The Internal Revenue Service (IRS) is the primary collecting entity for the United States Government, although Customs and other entities also collect substantial amounts of nonexchange revenue on behalf of the General Fund and other federal entities. Some of those involved with preparing and auditing IRS's financial statements have asked whether this should be interpreted to require entities such as trust funds that receive taxes collected on their behalf to recognize a portion of IRS's net taxes receivable. This is sometimes described as "push down" accounting. The Board did not intend to impose "push down" accounting, as is further explained by this interpretation. [I5, ¶1]

Interpretation

.1101 Entities that receive nonexchange revenue collected on their behalf by another entity should recognize the revenue based on the best available evidence at the time the financial report is prepared. This provision of paragraph 60 of SFFAS 7 is intended to require recognition of the excise tax "true up" of the difference between amounts transferred to trust funds based on estimates by Treasury's Office of Tax Analysis and the actual amount subsequently determined by IRS. IRS certifies the third quarter actual amount in December. The intent of paragraph 60 is to recognize this "true up" amount as a receivable or payable.[52] [I5, ¶2]

[52] Certification of the actual amount for the fourth quarter is not currently available from IRS until the end of March, which is too late to be included in the financial statements for the prior fiscal year.

Revenue, Gains & Losses, and Other Financing Sources—Technical Guidance

Technical Bulletin 2002-2: Disclosures Required By Paragraph 79(g) of SFFAS 7 *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*

Summary

SFFAS7, paragraph 79(g) calls for "explanations of any material differences between certain budgetary information and the amounts described as 'actual' in the *Budget of the United States Government*" (also known as the "President's Budget"). In this technical bulletin, FASAB advised that it would be inappropriate to delay publication of the entire financial report until the President's Budget with actual numbers for the fiscal year is published. In such circumstances, the intent of paragraph 79(g) can best be accomplished as described in paragraph .2003 below.

Disclosures Required By Paragraph 79(g) of SFFAS 7 *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*

Question

2000. Paragraph 77 of SFFAS 7 calls for presentation of certain budgetary information by federal financial 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." [TB2002-2, ¶1]

2001. Paragraph 79(g) of SFFAS 7 calls for disclosure of "explanations of any material differences between the information required by paragraph 77 and the amounts described as 'actual' in the *Budget of the United States Government*" (also known as the "President's Budget"). [TB2002-2, ¶2]

2002. If a federal financial reporting entity issues financial statements for a given fiscal year before the President's Budget with actual numbers for the same fiscal year is published, what disclosure, if any, should the reporting entity make pursuant to paragraph 79(g) of SFFAS 7? [TB2002-2, ¶3]

Response

2003. The reporting entity should disclose that the President's Budget with actual numbers for the fiscal year has not yet been published, explain when it is expected to be published, and indicate where it will be available. The information called for by paragraph 79(g) for the prior fiscal year should be included in the current financial report (unless it was included in entity's prior report, as will be the case in the first year in which the financial report is published before the President's Budget). [TB2002-2, ¶4]

2004. For example, a department that issued its financial report for FY 2001 in March of 2002 would have included the information called for by paragraph 79(g) in that report, because the President's Budget with that information had been published before the department's financial report was published. If the department publishes its financial report for FY 2002 in December 2002, the department would disclose that the *Budget of the United States Government* with actual numbers for the fiscal year had not yet been published, explain when it is expected to be published, and indicate where it will be available. There would be no need to disclose the information called for by paragraph 79(g) with respect to FY 2001, because that information had already been reported in the FY 2001 report. If the department then publishes its financial report for FY 2003 in December 2003, that report would include the information called for by paragraph 79(g) with respect to FY 2002. [TB2002-2, ¶4]

Glossary

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.

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 – As used in SFFAS7, 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 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 (paragraph 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."

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.

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)

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)

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).

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.

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)

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)

Seized and Forfeited Property—S30

Source: SFFAS3; SFFAS6; SFFAS7; TR4

Related Reference(s): I60 Inventories: Inventory Held for Sale, Inventory Held in Reserve, Excess, Obsolete and Unserviceable Inventory, Inventory Held for Repairs

Summary

SFFAS3: *Accounting for Inventory and Related Property* and SFFAS7: *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary Information* provide guidance on the recording of, and revenue recognition for, seized and forfeited property. “Seized property” includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency. However, seized property, other than monetary instruments, is not recognized as an entity’s asset because it is not owned by the Federal government. Seized property is to be accounted for in the financial records of the entity operating as the central fund. 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.

“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. At the time for forfeiture, the property is recorded. Valuation depends upon whether the assets can be sold, transferred or donated, or must be destroyed. The timing of revenue recognition depends on how the property is forfeited and the nature of the property.

Seized and Forfeited Property

Background

.100 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. [SFFAS3, ¶57]

.101 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. [SFFAS3, ¶58]

Seized Property

Definition

.102 "Seized property" includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency. [SFFAS3, ¶59]

Recognition

.103 Seized property shall be accounted for in the financial records of the entity that is operating as the central fund.[1] [SFFAS3, ¶60]

.104 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. [SFFAS3, ¶61]

.105 Seized property other than monetary instruments shall be disclosed in the footnotes. The value of the seized property shall be accounted

[1] 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.

for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated. [SFFAS3, ¶62]

Valuation

.106 Seized property shall be valued at its market value[2] 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. [SFFAS3, ¶63]

Exceptions to Valuation

.107 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. [SFFAS3, ¶64]

.108 Seized monetary instruments shall be valued at their market value. [SFFAS3, ¶65]

Disclosure Requirements

.109 Disclosure Requirements include the following:

- Explanation of what constitutes a seizure and a general description of the composition of seized property.
- Method(s) of valuing seizures.
- Changes from prior year's accounting methods; if any.
- Analysis of change in seized property, including the dollar value and number of seized properties that are (1) on hand at the beginning of the year, (2) seized 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 seized property and method of disposition where material. [SFFAS3, ¶66]

[2] "Market value" is the estimated amount that can be realized by disposing of an item through arm's length transactions in the marketplace or 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 per-unit market price of a security times the number of units of that security held.

Forfeited Property

.110 This subsection defines "forfeited property" and presents the accounting and reporting standards for it. 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. [SFFAS3, ¶67]

.111 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. [SFFAS7, ¶264]

Definition

.112 "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. [SFFAS3, ¶68]

Recognition and Valuation

.113 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 of the monetary instrument and the associated liability for possible remittance shall be removed. [SFFAS3, ¶69] (See Revenue Recognition below.)

.114 Intangible property, real property and tangible personal property shall be recorded with an offsetting deferred revenue when forfeiture judgment is obtained. 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. [SFFAS3, ¶70]

.115 The cost of general PP&E acquired through forfeiture shall be determined in accordance with SFFAS3 [as described in paragraph .114 above]. Amounts recorded for forfeited assets based on these requirements shall be recognized as the cost of general PP&E when placed into official use. [SFFAS6, ¶33]

.116 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. [SFFAS3, ¶71]

.117 <u>Property not held for sale</u> 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. [SFFAS3, ¶73]

.118 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. [See Revenue Recognition below.] [SFFAS3, ¶74]

.119 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. [SFFAS3, ¶76, as amended by SFFAS7, ¶264] (See Revenue Recognition below.)

.120 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. [SFFAS3, ¶77]

Revenue Recognition

.121 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).[3] [SFFAS7, ¶264]

.122 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 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.[4] [SFFAS7, ¶265]

.123 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. [SFFAS7, ¶266]

.124 Revenue from the sale of property shall be recognized when the property is sold. [See Revenue Recognition below.] [SFFAS3, ¶72]

[3] These SFFAS7 standards amend SFFAS No. 3, Accounting for Inventory and Related Property, with respect to forfeitures related to satisfying tax liabilities.

[4] SFFAS3 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.

.125 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. [SFFAS7, ¶267]

.126 The disposition of the revenue from forfeiture is determined by law. Revenue or the 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. [SFFAS7, ¶268]

.127 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. [SFFAS7, ¶269]

Revenue Classification

.128 Revenue shall be classified as it arises from sale or from disposition, and this distinction shall be maintained in the entity's accounting reports. [SFFAS3, ¶75]

Disclosure Requirements

.129 Disclosure Requirements include the following:

- 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. [SFFAS3, ¶78]

Seized and Forfeited Property—Technical Guidance

Technical Release 4: Reporting on Non-Valued Seized and Forfeited Property

Summary

Technical Release 4 is intended to clarify the reporting of non-valued seized and forfeited property. It deals with issues related to seized and forfeited property disclosure requirements. TR4's summary conclusion is that an analysis of changes for all material non-valued seized property should be disclosed in the financial statement footnotes in the same manner as prescribed for non-valued forfeited property.

Reporting on Non-Valued Seized and Forfeited Property

Introduction

.3000 Guidance for the accounting and reporting of seized and forfeited property held by Federal entities is provided in the Statement of Federal Financial Accounting Standard No. 3, *Accounting for Inventory and Related Property* (SFFAS No. 3), issued in October 1993.

.3001 Technical Release 4 includes a discussion of the issues and recommended implementation guidance that is intended to clarify the reporting of non-valued seized and forfeited property.

Background

.3002 Federal entities implementing this standard have raised numerous questions requiring clarification of the reporting of non-valued seized and forfeited property. Numerous Federal entities' missions include the task of seizing non-valued property. Bureaus within the Departments of the Treasury and Justice are most directly affected by this issue.

.3003 Non-valued property either does not have a legal market in the United States, or does not have a salable value to the Federal government. These items may be abandoned, embargoed, prohibited, sensitive, or seized for forfeiture. Examples of such items could include illegal drugs, counterfeit currencies and monetary instruments, and firearms, which the Federal government, as a matter of law or policy, does not return to the owner or sell upon forfeiture. Federal agencies that seize these types of items have had difficulty in applying the concept of materiality and in the reporting of these types of items since they do not have monetary value. Consequently, Federal agencies have independently determined what types of non-valued property should be disclosed in the financial statements under SFFAS No. 3 and the units of measure, resulting in inconsistent disclosures between agencies and disclosures that lacked meaningful information.

.3004 While non-valued seized property does not have a monetary value to the Federal government, the sensitive nature of much of this type of property requires the same level of accountability and security as valued property, if not more. Agencies should ensure that their systems of internal control are adequate to provide sufficient accountability and security over this property in order to meet the reporting requirements provided in SFFAS No. 3.

.3005 SFFAS No. 3 prescribes that seized property shall be accounted for in the financial records of the entity that is operating as the central fund (see SFFAS No. 3, para. 60). Central funds are established to finance the costs of the seizure, management, and disposition of property, and to receive the proceeds from the sale or disposition of that property. However, since non-valued items do not have a financial value, the central fund is not responsible for reporting these items.[5] Accordingly, the seizing or custodial entity is responsible for maintaining sufficient internal records to maintain control over these items and would have reporting responsibility for non-valued items.

.3006 Chapter 3 of the Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting* (SFFAC No. 1), identifies the users of Federal financial reports and their information needs. Federal financial report users need information to assess the accountability, stewardship, and operating performance of Federal agencies and programs. To address the information needs of Federal financial report users, Chapter 4 of SFFAC No. 1 defines the objectives of financial reporting as budgetary integrity, operating performance, stewardship, and systems and control. The discussion of these objectives emphasizes the concepts of the entity's control over, accountability of, and accomplishment of Federal programs and activities.

.3007 Furthermore, to provide additional useful perspective, SFFAS No. 3 includes a discussion on the concept of materiality. Specifically, the concept of materiality includes both quantitative and qualitative considerations. Thus, an item that is not considered material from a quantitative standpoint may be considered qualitatively material. Accordingly, items would be considered qualitatively material if the judgment of a person relying on the information presented about such items would be influenced by the omission or misstatement of information presented about those items. SFFAS No. 3 states that 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. It should be noted that SFFAS No. 3 also clearly states that items of a sensitive

[5] This is generally because the central fund does not take custody of nonvalued items.

nature held by an entity that are not considered material to the entity's financial statements need not be reported.

Discussion of Issues

.3008 The disclosure requirements for seized and forfeited property are outlined in paragraphs 66 and 78 of SFFAS No. 3. [Paragraphs R30.109 and R20.128 of this Volume] Among the requirements is a footnote disclosure to contain: a description of the composition of the property; the methods of valuing the property; restrictions on the use of forfeited property; changes from prior year accounting methods, if any; and an analysis of changes in seized and forfeited property. The analysis of changes in seized and forfeited property should provide the dollar value and number of properties on hand at the beginning of the year, seizures and forfeitures made during the year, property disposed of and method of disposition, and property on hand at the end of the year. This information should be presented by type of property where material.

.3009 While SFFAS No. 3 provides adequate guidance for reporting seized and forfeited items with a financial value, the standard has not been interpreted and applied consistently with respect to non-valued items. Paragraph 148 of SFFAS No. 3 states that the standard was revised to address the disclosure requirements for non-valued items. For these items, the standard does not require the reporting of financial value, but it clearly requires the disclosure of all material forfeited property, including those items with no financial value. However, the standard does not address the disclosure of non-valued seized items. As a result, some reporting entities with seizing authority disclose non-valued seized items, and others do not. Clarification of the standard as it relates to non-valued seized items is needed to ensure consistent implementation.

.3010 With numerous professional disciplines involved in activities related to the seizure and reporting of non-valued items, some terminology has different meanings depending on whether it is used in a legal, accounting, or program management context. To provide for consistent and meaningful reporting, clarified definitions and standard units of measure are necessary.

Recommended Implementation Guidance

.3011 An analysis of changes for all material non-valued seized property should be disclosed in the financial statement footnotes in the same manner as prescribed for non-valued forfeited property.

.3012 The definitions in the Glossary provide for consistent and meaningful reporting among Federal agencies that seize and/or forfeit non-valued items. The units of measurement for non-valued items provided in the Attachment (paragraph .3013) are also designed to facilitate consistency in reporting among agencies. It is recognized that some agencies may be currently reporting in different measurement units and may be unable to convert their units of measurement for FY 1999 reporting. Such agencies may continue to report on their current basis for FY 1999 but should conform with the units of measurement provided in the Attachment for FY 2000 and subsequent years.

.3013 Measurement of Non-Valued Items:

Table 9: Attachment: Measurement of Non-Valued Items

Category[a]	Standard Unit of Measure
Illegal Drugs	
Cannabis	Kilograms
Cocaine	Kilograms
Heroin	Kilograms
Methamphetamine/Amphetamine	Various
Other Categories[6]	Various
Firearms and Explosives	
Legal Firearms	Number
Illegal Firearms	Number
Ammunition	Rounds
Explosives	Number
Counterfeit	
Currency – Completed (U.S. and Foreign)	Number of Counterfeit bills
Credit Cards	Number
Other (e.g., other counterfeit monetary instruments)	Number

[a]This is not intended to be an all-inclusive list. Other categories should be consider as appropriate.

[6] Other categories include material amounts of other drugs seized, to be separately reported by liquid weight, dry weight, tablets, or other appropriate measurement.

Glossary

Abandoned Property – Property of any type over which the rightful owner has relinquished possession and any claim of an ownership interest, without assertion of an adverse right to possession and control by the federal government. This would include property left at a government facility and unclaimed by the rightful owner following notice of intent to dispose. This property is a type of seized property.

Actual custody – Physical possession and control of property by government personnel.

Central Fund – A federal entity established to finance the costs of seizure, management and disposition of property seized for forfeiture, and to receive any proceeds from the sale or other disposition of that property.

Constructive custody – Legal possession of property by federal government personnel through a non-federal agent, such as a commercial contractor or state or local official, under a legal agreement or court order that the agent maintains physical possession and control of the property on behalf of, and subject to the orders of, the Federal government personnel.

Custodial agency – The federal agency that has actual possession of seized or forfeited property, or constructive possession of property through a non-federal agent. The custodial agency would be responsible for reporting material quantities of non-valued items.

Detained Property – Property taken into custody temporarily for purposes of preserving the status quo (items in or around a crime scene) or to protect the government from liability for loss (luggage of an arrested traveler, vehicle of an arrested drunk driver), or determining Customs admissibility, with the intent to release the property as soon as it is no longer necessary to preserve the status quo or the owner can assume responsible custody. This action is not a seizure under the law and thus detained property is not considered seized property.

Embargoed Property – Property that may be legal to possess or own in the U.S., but whose import/export is prohibited (e.g., Iranian carpets, Cuban cigars).

Forfeited property – Property of any type (currency, monetary interests, realty, intangible property, and tangible personal property) for which title

has vested in the Federal government, over any other asserted legal interest in the property, by exercise of a legal forfeiture process.

Prohibited Property – Property for which no private right of ownership is recognized under U.S. law, or of which mere private possession is prohibited under U.S. law. Examples include certain controlled substances, counterfeit currency, counterfeit monetary and financial instruments, and certain firearms. This property is a type of seized property.

Seizing agency – The federal agency that seizes property as part of its law enforcement activities.

Seized property – Property of any type (currency, monetary interests, realty, intangible property, and tangible personal property) over which the federal government has exercised its power under law to assert possession and control in opposition to any other party asserting a legal interest in the property.

Seized for evidence – Property the federal government has seized for the sole purpose of preserving and protecting the property for possible use in civil or criminal judicial proceeding. The expectation is that the property will be returned to its rightful owners upon conclusion of the judicial proceedings. However, circumstances can allow the status of property seized for evidence to change to property seized for forfeiture.

Seized for forfeiture – Property the federal government has seized for the purpose of transferring title to the federal government through exercise of a legal forfeiture process. This includes property seized for forfeiture that also may be used in an evidentiary proceeding.

Seized for tax purposes – Property the federal government has seized for the purpose of satisfying a tax liability to the federal government through exercise of a legal tax enforcement process. This includes property seized for tax purposes that also may be used in an evidentiary proceeding.

Seized for other purposes – Property the federal government has seized for purposes other than for evidence, for forfeiture, or for tax purposes. Examples of property in this category include seizures for satisfaction of debts owed the government, for protection of public safety or navigation (adrift vessel), and for preservation of environmental conditions (sinking vessel). This includes property seized for these other governmental purposes that also may be used in an evidentiary proceeding.

Sensitive items – Items that could be a hazard or threat to public safety or the economy in Federal custody that would cause discredit or embarrassment to the Federal government if it lost accountability over those items.

Social Insurance Programs—S40

Source: SFFAS17 as amended by SFFAS 25

Related Reference(s): L40 Liabilities; S70 Stewardship Reporting

Summary

SFFAS17, *Accounting for Social Insurance* 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.

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).

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.

The standards require that a liability be recognized when payments are due and payable to beneficiaries or service providers. Presently, 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.

However, SFFAS 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment requires changes in reporting for reporting periods beginning after September 30, 2004. For these reporting years, 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.

For reporting periods ending prior to October 1, 2004, 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;

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.

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.

Accounting for Social Insurance

Accounting Standards

.100 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. [SFFAS17, ¶14]

Characteristics of Social Insurance Programs

.101 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.

These characteristics are briefly described below. [SFFAS17, ¶15]

Financing From Participants

.102 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. [SFFAS17, ¶16]

.103 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. [SFFAS17, ¶17]

Eligibility from Taxes/Fees Paid and Time Worked in Covered Employment

.104 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. [SFFAS17, ¶18]

Benefits Not Directly Related to Taxes/Fees Paid

.105 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. [SFFAS17, ¶19]

Benefits Prescribed in Law

.106 Social insurance programs normally have uniform sets of entitling events; and 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. [SFFAS17, ¶20]

Intended for the General Public

.107 These programs are intended for the general public and not solely for present or former federal employees. [SFFAS17, ¶21]

Component Entity Accounting & Reporting Standard

Expense & Liability Recognition

.108 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). [SFFAS17, ¶22

.109 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. [SFFAS17, ¶23

Required Supplementary Stewardship Information Including Reporting Changes for Reporting Periods Beginning After September 30, 2004

.110 For reporting periods ending prior to October 1, 2004, 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. [SFFAS17, 24]

.111 For periods beginning after September 30, 2004, the information required by paragraph .114(3) and .119(3) shall be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, 24 as amended by SFFAS 25, 6 and 7]

.112 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. [SFFAS17, ¶25

.113 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. [SFFAS17, ¶26

.114 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,[1] 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 borrowing/lending (the "cross-over points"), and an explanation of the significance of the "cross-over points".

(b) The actuarial estimate provided in .114(1)(a)(i)2) and .114(1)(a)(ii) immediately above as a percentage of

(i) taxable payroll[2] and

(ii) Gross Domestic Product (GDP).[3]

(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.[4] 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:

[1] "Interest on intragovernmental borrowing" refers to interest earned by the social insurance program on obligations of the U.S. Government.

[2] 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.

[3] This requirement does not apply to the RRB, Black Lung, and UI programs.

[4] 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."

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,

(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;[5] For fiscal years beginning after September 30, 2004, this information shall be presented as a basic financial statement rather than as required supplementary stewardship information.

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.

[5] 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.

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:

(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 .113(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 .113(1) and .113(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 .113(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).

(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. [SFFAS17, ¶27 as amended by SFFAS 25, ¶6 & 7]

Transition

.115 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. [SFFAS17, ¶28]

Consolidated Governmentwide Entity – Accounting & Reporting Standard

.116 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. [SFFAS17, ¶29]

Expense & Liability Recognition

.117 Expense and liability recognition for the consolidated governmentwide entity are the same as for the component entities (see paragraphs .108 & .109 above). [SFFAS17, ¶30]

Required Supplementary Stewardship Information

.118 For reporting periods ending prior to October 1, 2004,[6] 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 111). 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. [SFFAS17, ¶31]

.119 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 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,

[6] For periods beginning after September 30, 2004, the information required by paragraph .114(3) and .119(3) shall be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, 24 as amended by SFFAS 25, ¶6 and 7]

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 114 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 paragraph .114(2)).

(3) *Actuarial Present Values* - For all programs except UI provide a statement combining the entity statements required in paragraph .114(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. For fiscal years beginning after September 30, 2004, this information shall be presented as a basic financial statement rather than as required supplementary stewardship information.

(4) *Sensitivity Analysis* - For all social insurance programs provide a summary of the sensitivity analyses required under the standard for component entities (see paragraph .114(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 required for the UI program (see paragraph .113 (5) above). [SFFAS17, ¶32 as amended by SFFAS 24, ¶6 & 7]

Transition

.120 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. [SFFAS17, ¶33]

Social Insurance Programs—Non-Authoritative Guidance

Social Insurance Programs – Sample Reporting [SFFAS 17, Appendix B]

Summary

The sample report sections in Appendix B provide non-authoritative illustrations of possible RSSI that would comply with SFFAS 17 as it was originally issued.[7] 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.

For fiscal years prior to FY 2005, OMB provides specific form and content guidance on financial reports. For these example reports, most data are taken from various reports for FY 1996 and are "actual data." Certain data

[7] As described in paragraph .111, for periods beginning after September 30, 2004, the information required by paragraph .114(3) and .119(3) shall be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, ¶24 as amended by SFFAS 25, ¶6 and 7]

are hypothetical. Although the data are realistic, readers should not rely on the validity of the data in the sample reports.

Note however, that beginning in FY 2005, SFFAS 25 calls for the information required by paragraph .114(3) and .119(3) of this Subject Area Section to be presented in a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, ¶24 as amended by SFFAS 25, ¶6 and 7]

.4000 Social Security – Required Supplementary Stewardship Information (Note that SFFAS 25 requires that this information be presented as Required Supplementary Information (RSI) for reporting periods beginning after September 30, 2004.)

Table 10: Statement of Social Insurance Old-Age, Survivors and Disability Insurance – 75-Year Projection[1] as of September 30, 1996 [HYPOTHETICAL DATA]

Dollars in trillions

		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	X

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.

Program Description

.4001 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. [SFFAS17, ¶110]

.4002 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. [SFFAS17, ¶111]

.4003 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 [SFFAS17, ¶112]

Program Finances and Sustainability

.4004 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. [SFFAS17, ¶113]

.4005 No liability has been recognized on the balance sheet for future payments to be made to present and 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. [SFFAS17, ¶112]

.4006 ***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

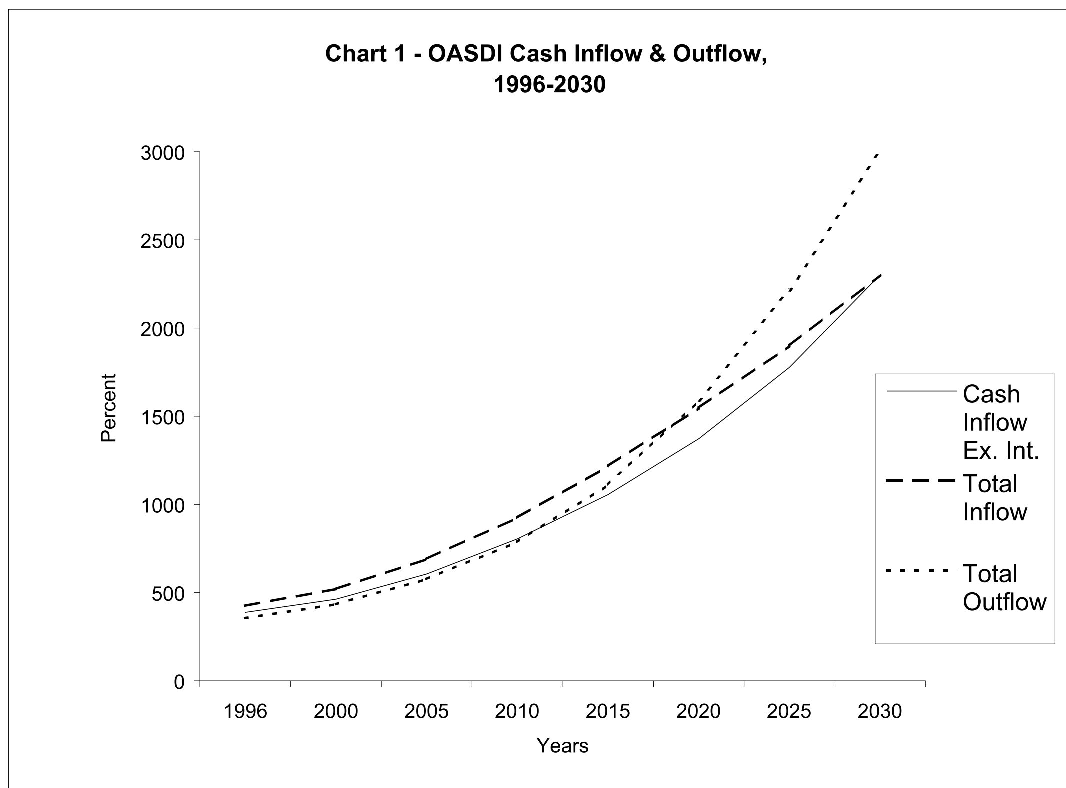
(4) an analysis of the sensitivity of the projections to changes in assumptions

.4007 *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. [SFFAS17, ¶116]

.4008 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.[8] 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. [SFFAS17, ¶117]

[8] [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.]

Chart 1 - OASDI Cash Inflow & Outflow 1996-2030



Source: Data from Tables III B1, B3, &C1, 1996 OASDI Trustee's Report

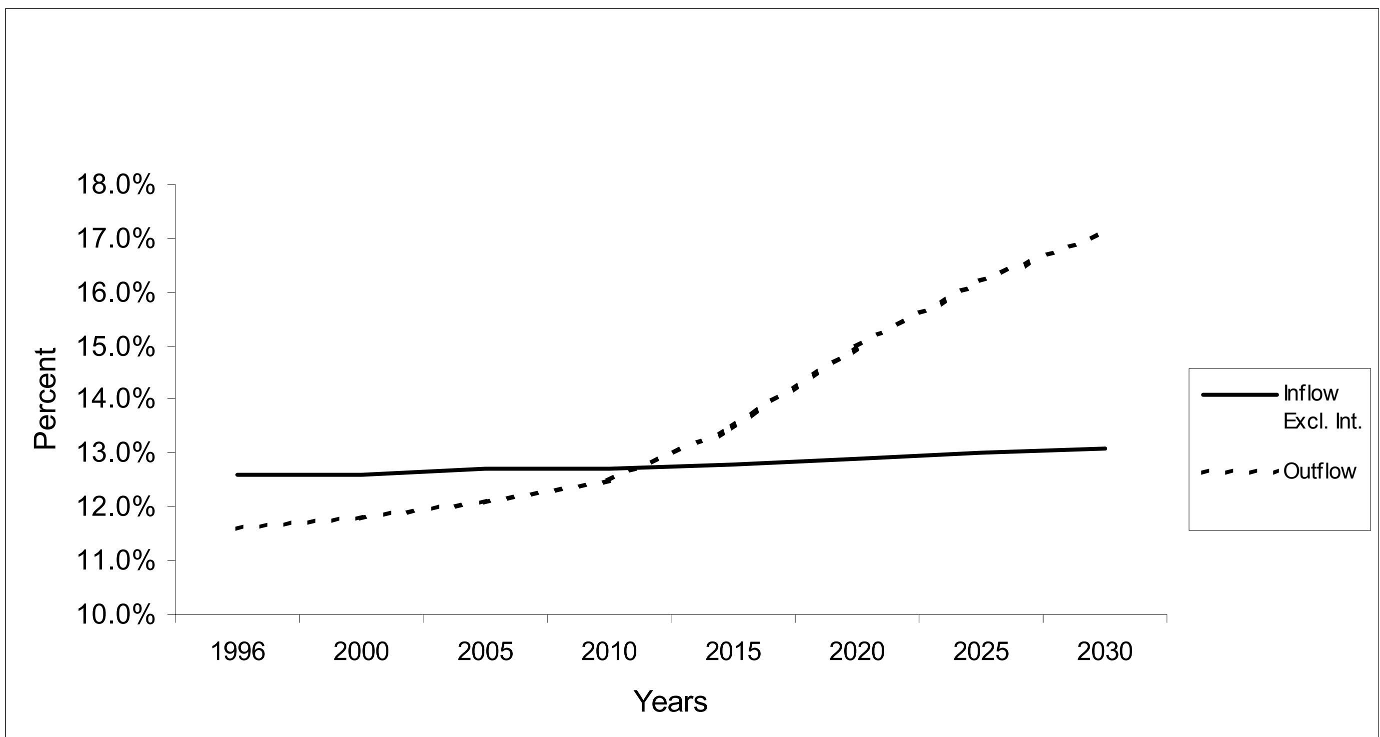
Terms Used In Chart 1

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.

.4009 *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. [SFFAS17, ¶118]

Chart 2 - OASDI Cash Inflow/Outflow as a Percent of Taxable Payroll 1996-2030



Source: Data from Tables III A2, 1996 OASDI Trustee's Report

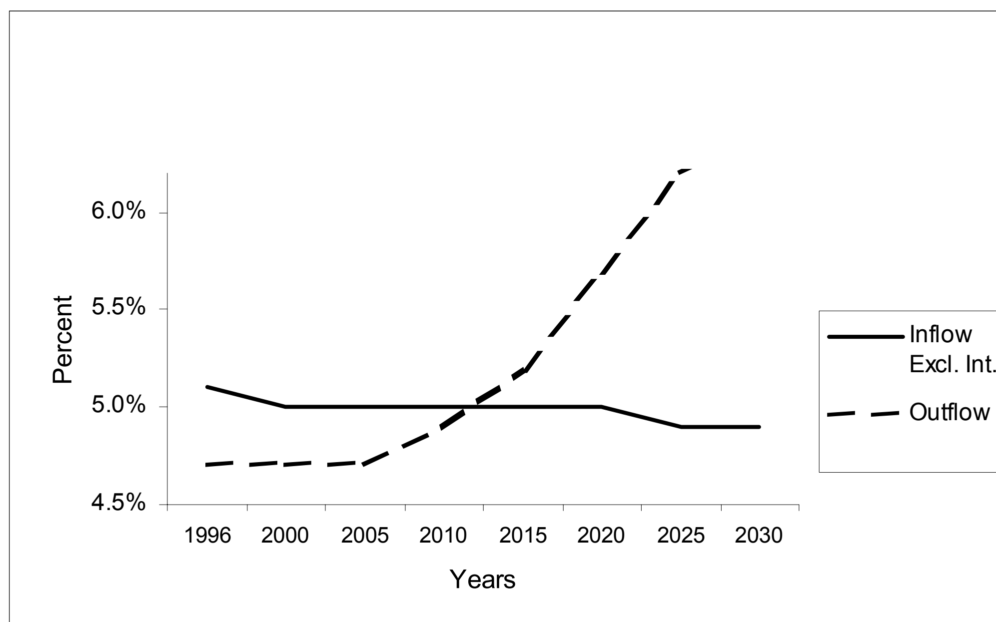
.4010 The total excess of cash outflow over inflow for OASDI over the next 75 years is estimated to be 2.17 percent of taxable payroll; in other words, a tax increase today of about 1.09 percent of taxable payroll each on employees and employers, over the 6.2 percent they each now pay, would produce enough inflow over 75 years to pay all benefits due under current law.[9] 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. [SFFAS17, ¶119]

.4011 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. [SFFAS17, ¶120]

.4012 *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 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. [SFFAS17, ¶121]

[9] [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.]

Chart 3 - OASDI Cash Inflow/Outflow as a Percent of GDP 1996-2030



Source: Data from Tables III C1, 1996 OASDI Trustee's Report

.4013 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. [SFFAS17, ¶122]

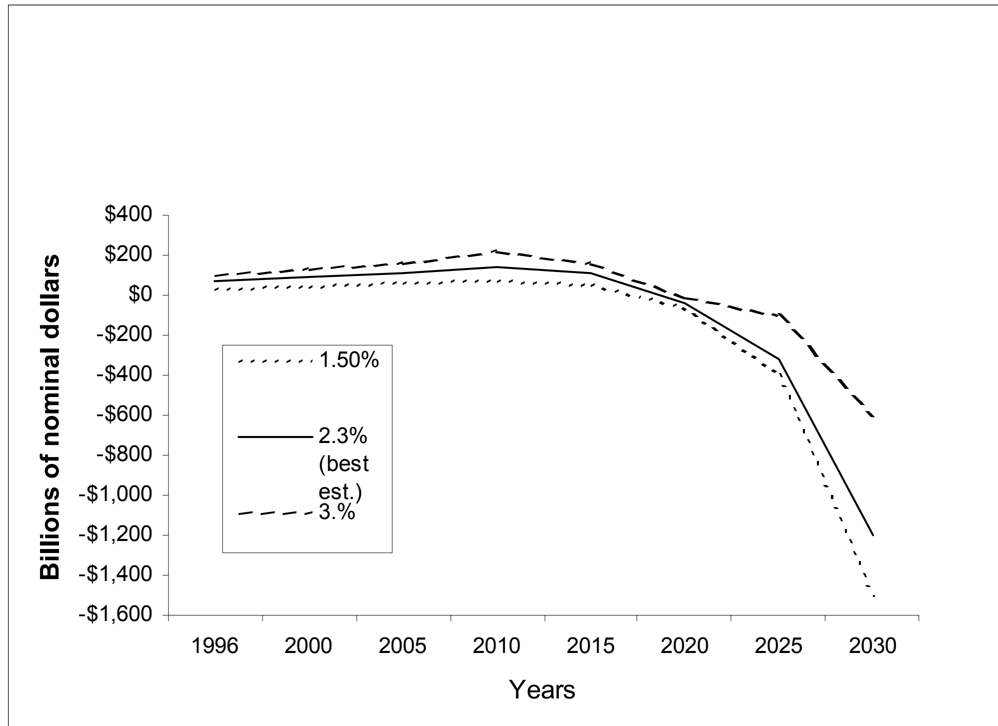
.4014 _Sensitivity Analysis. –_- As indicated by the assumptions shown at the end of this section, the future cashflow of the OASDI program depends on many economic and demographic assumptions, including GDP, labor factors, unemployment, average wages and self-employment earnings, interest rates on Treasury 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 composition of the beneficiary population and the general level of benefits. Precise long-range projections of these factors is impossible. [SFFAS17, ¶123]

.4015 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. [SFFAS17, ¶124]

.4016 *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. [SFFAS17, ¶125]

Chart 4 - OASDI Net Cashflow with Alternative Assumptions about the Real Interest Rate 1996-2030

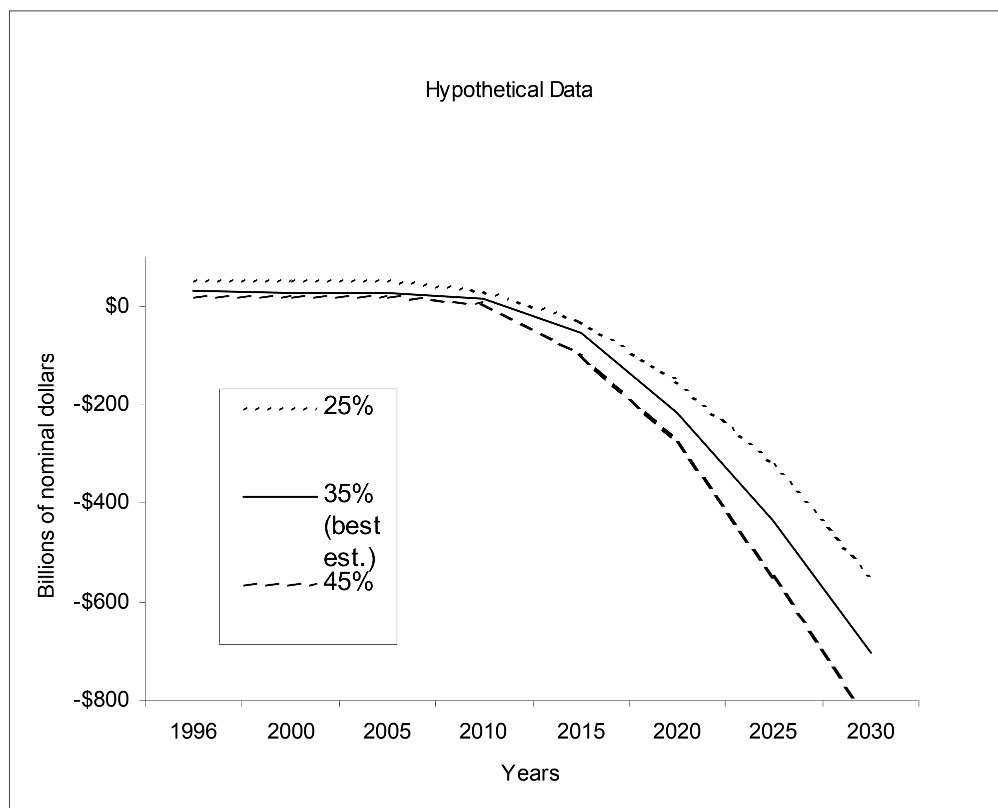


Source: Data regarding "best estimate" is from Tables III B1, B3, and C1, 1996 OASDI Trustees Report

As stated above, the estimated total excess of OASDI cash outflow over cash inflow over the next 75 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.

.4017 *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. [SFFAS17, ¶126]

Chart 5 - OASDI Net Cashflow with Alternative Assumptions about the Death Rate 1996-2030



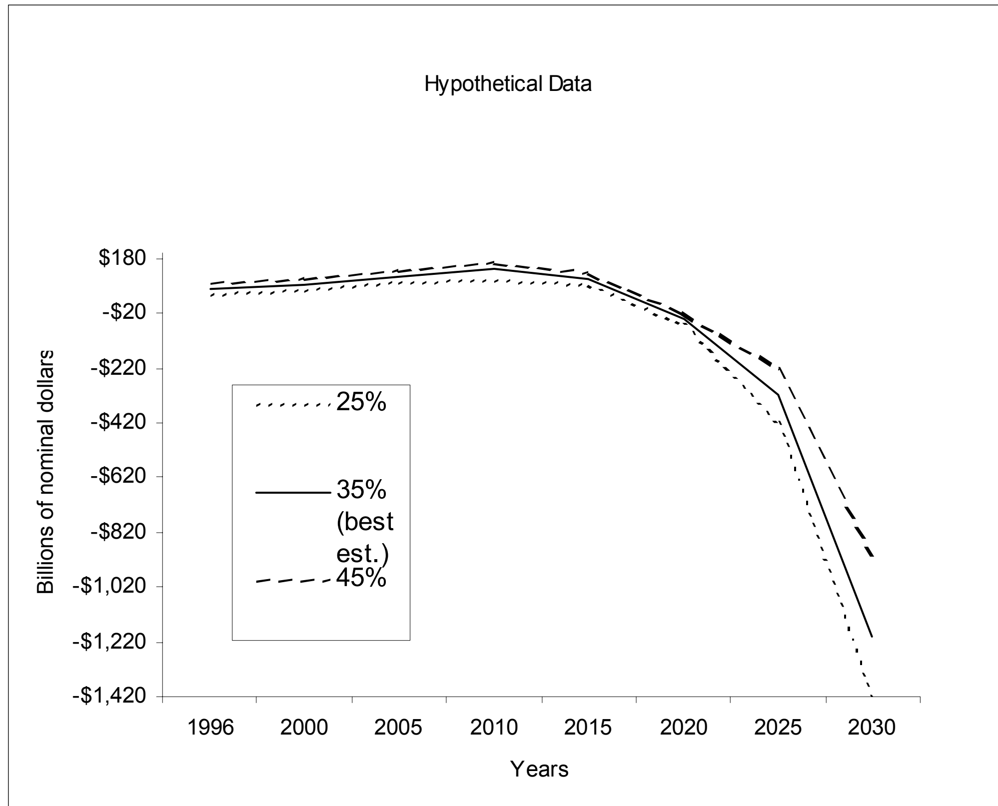
Source: Data regarding “best estimate” is from Tables III B1, B3, &C1, 1996 OASDI Trustee’s Report

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 $4.2 trillion.

.4018 *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. [SFFAS17, ¶127]

Chart 6 - OASDI Net Cashflow with Alternative Assumptions about the Birth Rate 1996-2030



Source: Data regarding "best estimate" is from Tables III B1, B3, &C1, 1996 OASDI Trustee's Report

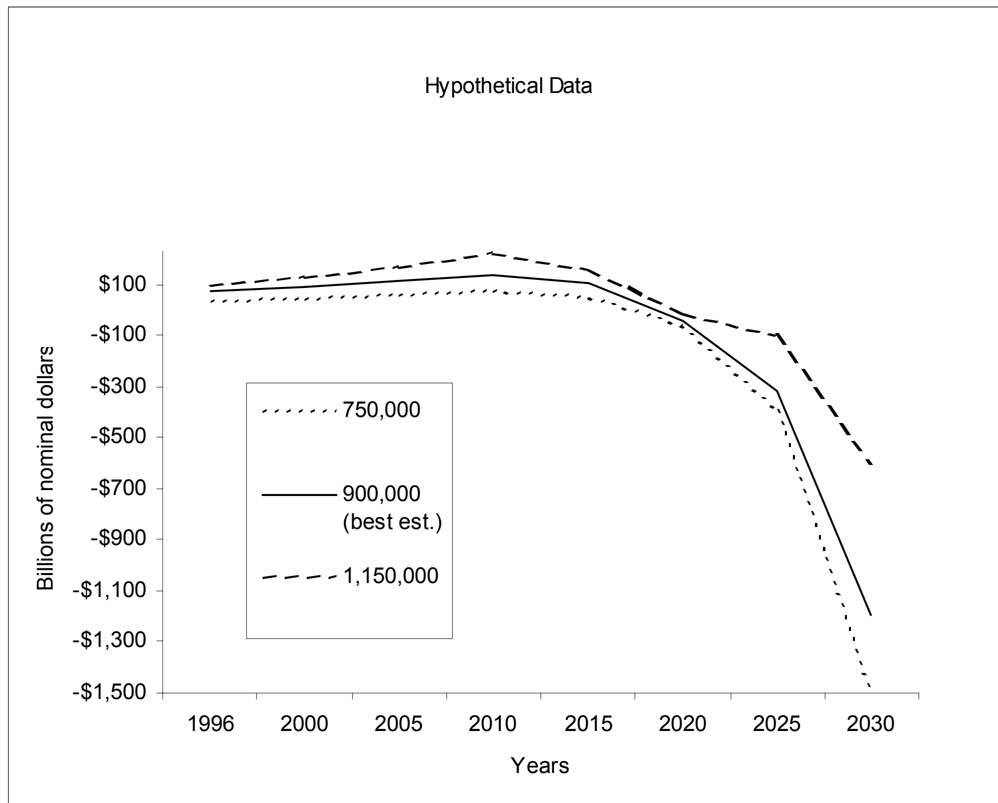
Table1 presents the affect of using rates of 1.6 and 2.2 on the excess of cash outflow over inflow during the projection period. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions

	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow (trillions of dollars)	$3.7	$3.0	$2.5

.4019 *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. [SFFAS17, ¶128]

Chart 7 - OASDI Net Cashflow with Alternative Assumptions about Net Immigration 1996-2030



Source: Data regarding “best estimate” is from Tables III B1, B3, &C1, 1996 OASDI Trustee’s Report

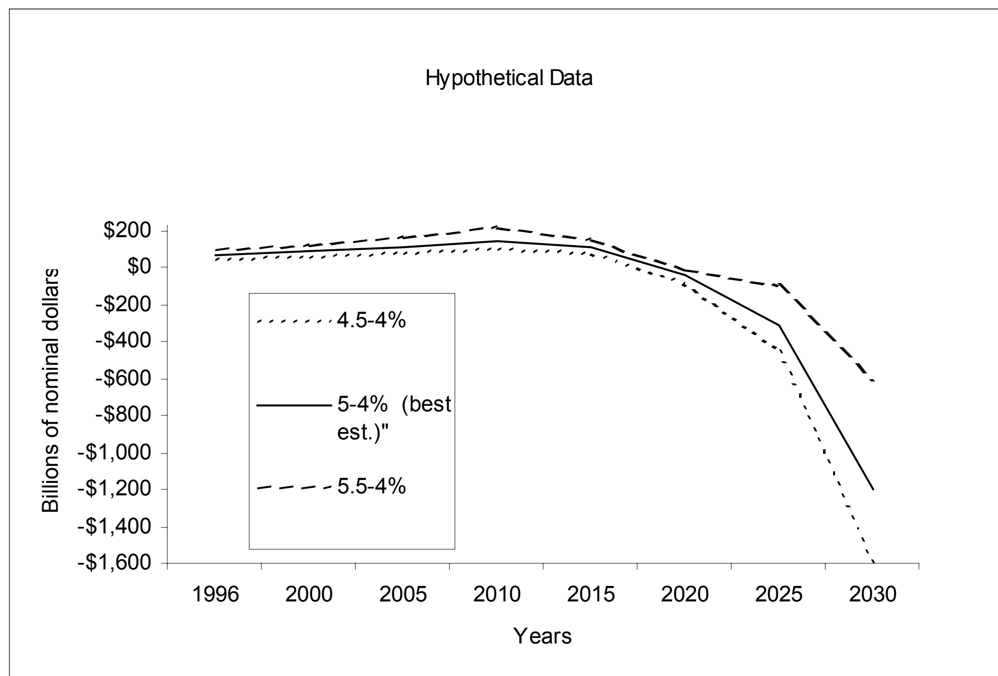
Regarding actuarial present values over 75 years, table 2 below shows the estimated total excess of OASDI cash outflow over inflow with assumptions that differ from those used for the "best estimate" projection.

Table 2 - Estimated Total Excess OASDI Cash Outflow over Inflow with Various Net Immigration Assumptions

	Net immigration per year		
Valuation Period: 1996-2070	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over cash inflow (trillions of dollars)	$3.2	$3.0	$2.9

.4020 *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. [SFFAS17, ¶129]

Chart 8 - OASDI Net Cashflow with Alternative Assumptions about Real Wage Differential 1996-2030



Source: Data regarding "best estimate" is from Tables III B1, B3, &C1, 1996 OASDI Trustee's Report

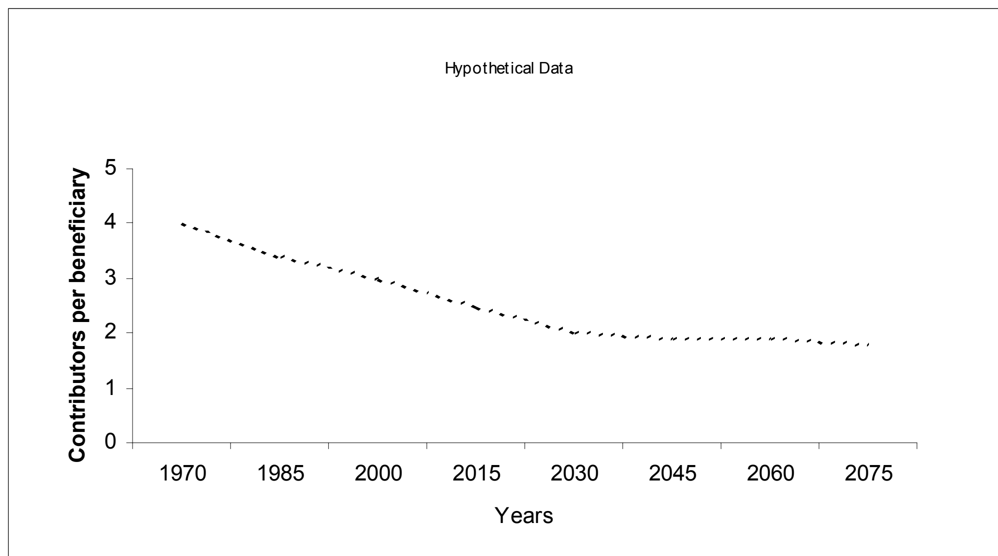
Regarding actuarial present values over 75 years, table 3 below shows the estimated total excess of OASDI cash outflow over inflow with various assumptions about the real-wage differential.

Table 3 - Estimated Total Excess OASDI Cash Outflow over Inflow with Various Real-Wage Assumptions – Valuation Period: 1996-2070

	Ultimate percentage in wages-CPI *[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 of cash outflow over cash inflow (trillions of dollars)	$3.2	$3.0	$2.9

.4021 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. [SFFAS17, ¶130]

Chart 9 - OASDI Contributors per Beneficiary 1970-2075



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							Life expectancy	
	GDP	Wages	CPI	Average Annual Interest Rate on Treasury Securities (%)	Average Annual Unempl.. Rate	Average no. of children per woman	Death rate per 100,000	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.

Unemployment Insurance Programs

.4022 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.[10] [SFFAS17, ¶131]

Program Description

.4023 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. [SFFAS17, ¶132]

.4024 *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. [SFFAS17, ¶133]

.4025 *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

[10] As described in paragraph .111, for periods beginning after September 30, 2004, the information required by paragraph .114(3) and .119(3) shall be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, 24 as amended by SFFAS 25, ¶6 and 7]

the UTF established to account for their receipt, investment, and disbursement are discussed below. [SFFAS17, ¶134]

.4026 *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. [SFFAS17, ¶135]

.4027 *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. [SFFAS17, ¶136]

.4028 *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: [SFFAS17, ¶137]

.4029 *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. [SFFAS17, ¶138]

.4030 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. [SFFAS17, ¶139]

.4031 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 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. [SFFAS17, ¶140]

.4032 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. [SFFAS17, ¶141]

.4033 *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. [SFFAS17, ¶142]

.4034 *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. [SFFAS17, ¶143]

.4035 *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. [SFFAS17, ¶144]

.4036 *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 base period to unemployment, (2) unemployment not the fault of the unemployed, and (3) availability of the unemployed for work. [SFFAS17, ¶145]

.4037 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. [SFFAS17, ¶146]

.4038 *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. [SFFAS17, ¶147]

.4039 *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. [SFFAS17, ¶148]

.4040 *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. [SFFAS17, ¶149]

Program Finances and Sustainability

.4041 At September 30, 1996, total assets within the UTF exceeded liabilities by $54.0 billion.[11] 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 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. [SFFAS17, ¶150]

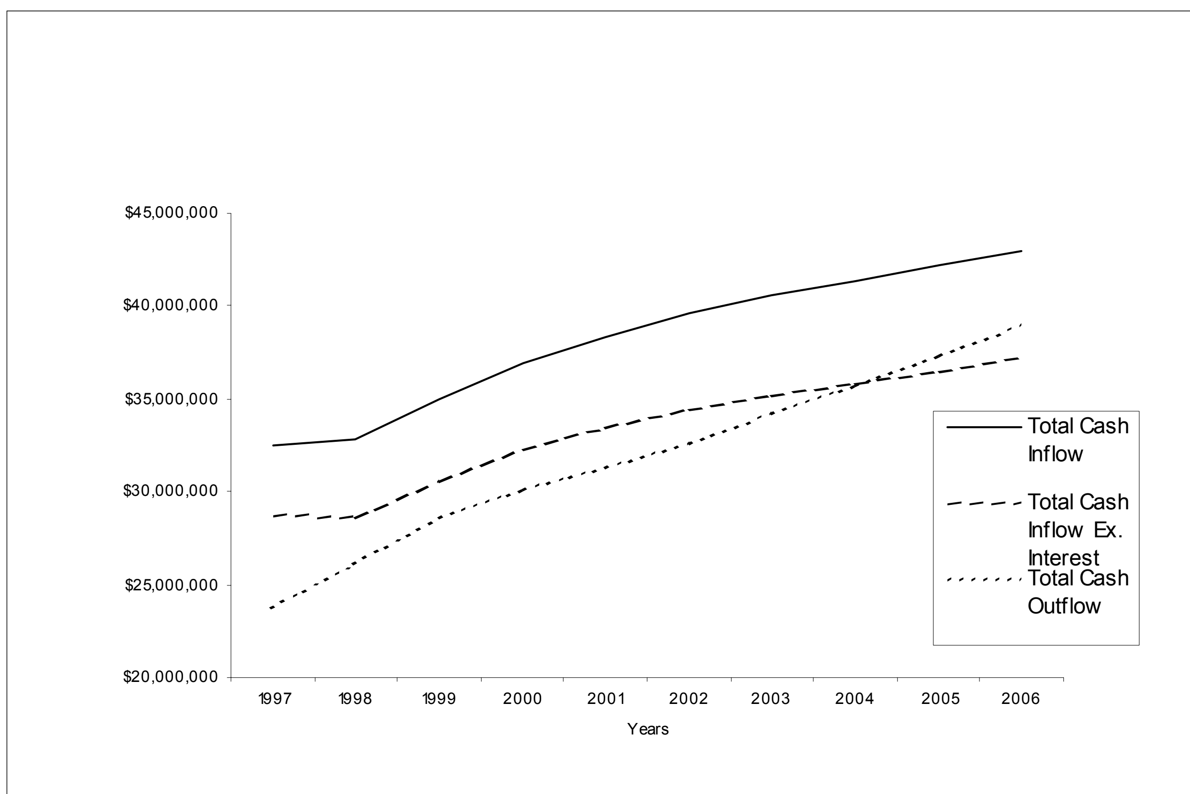
.4042 *Effect of Projected Cash Inflows and Outflows on the Accumulated Net Assets of the UTF* - The ability of the UI programs to meet a participant's future benefit payment needs depends on the availability of accumulated taxes and earnings within the UTF. The DOL measures the effect of projected benefit 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. [SFFAS17, ¶151]

.4043 *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

[11] [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.]

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. [SFFAS17, ¶152]

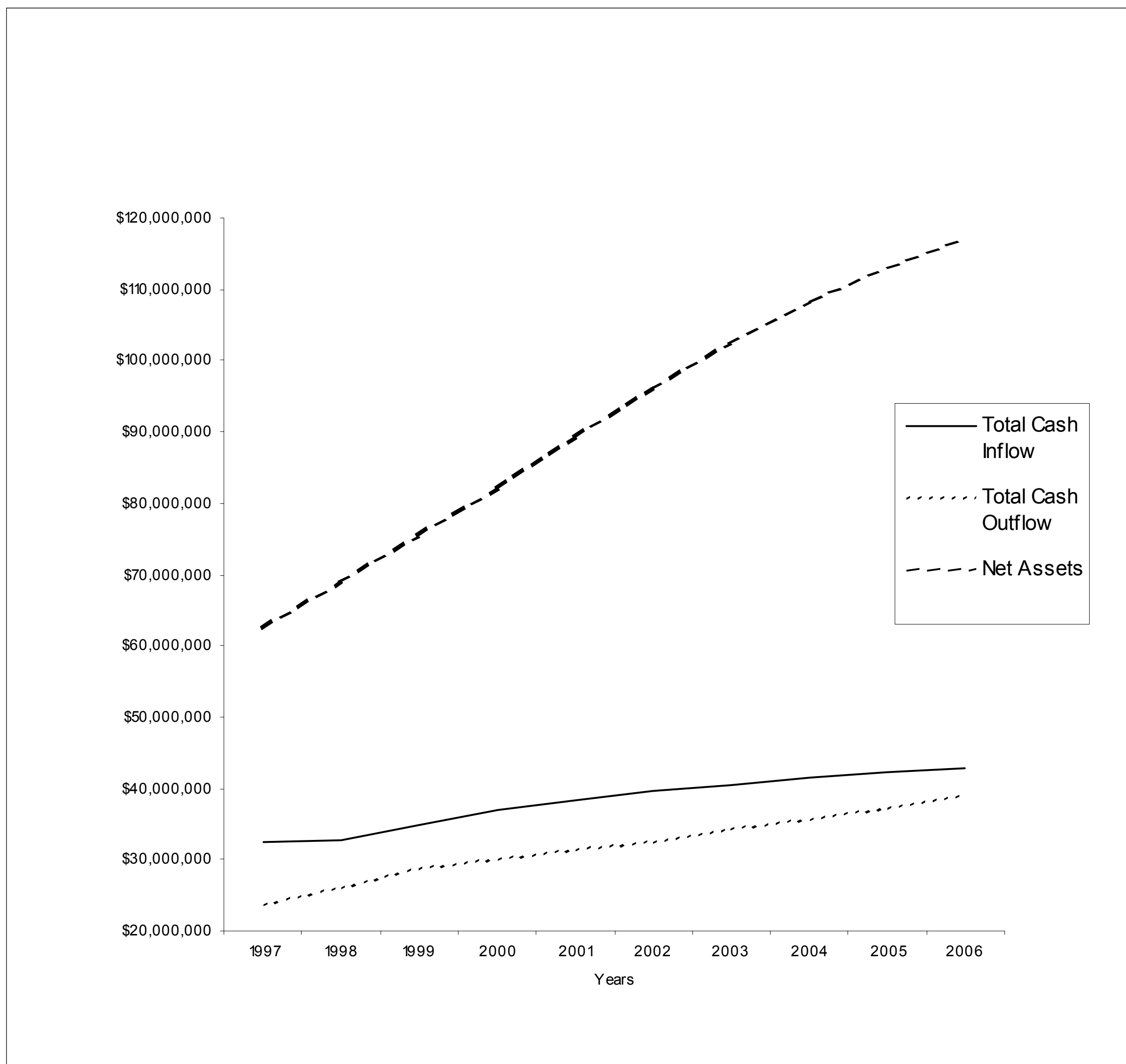
Chart I: Unemployment Trust Fund Cash Inflow and Outflow



.4044 *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.

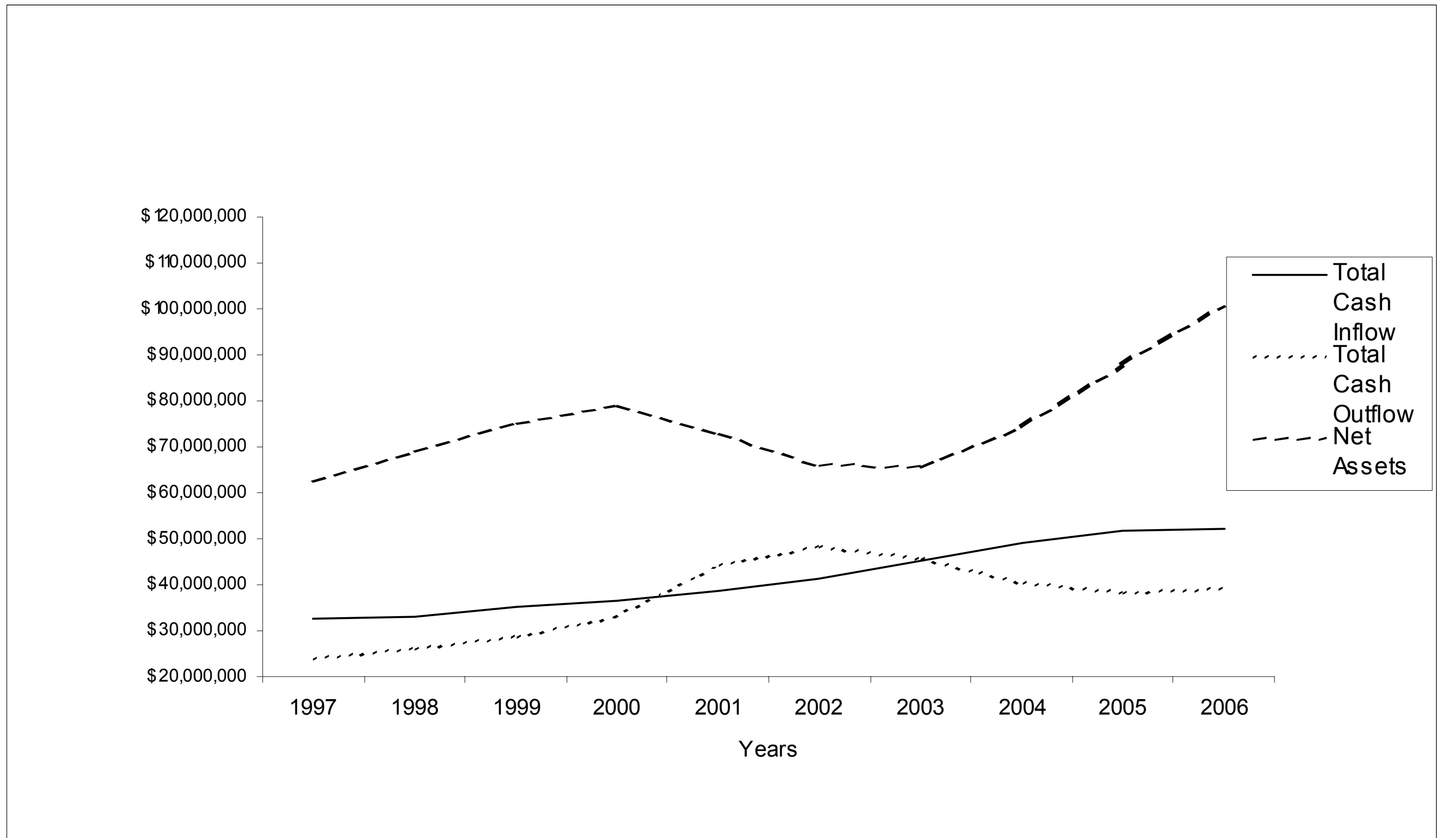
Chart II: Unemployment Trust Fund Effect of Net Cash Flow on Net Assets



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. [SFFAS17, ¶153]

.4045 *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. [SFFAS17, ¶154]

Chart III: Unemployment Trust Fund Effect of Net Cash Flow on Net Assets



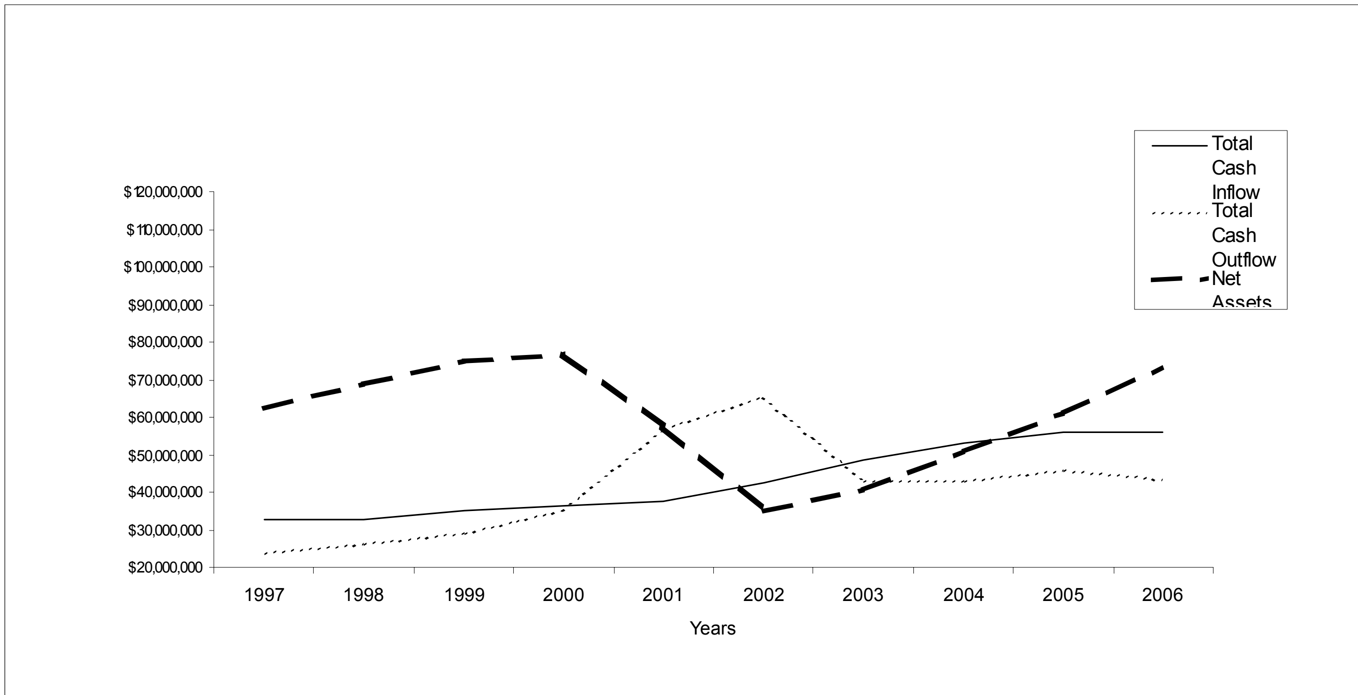
.4046 *Effect on UTF Assets of Mild Recession* - Chart III shows the projected effects of moderate recession on the cash inflow and outflow of the UTF. Under this scenario, which utilizes a rising unemployment rate peaking at 7.4 percent in FY 2002, net cash outflows are projected to begin in FY 2001, 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. [SFFAS17, ¶155]

.4047 *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 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.*) [SFFAS17, ¶156]

.4048 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. [SFFAS17, ¶157]

Chart IV: Unemployment Trust Fund Effect of Net Cash Flow on Net Assets



.4049 Tables containing the yearly cash inflow, interest earnings, and cash outflow for each scenario are presented in the following pages. Note: This presentation of information as required supplemental stewardship information is suitable for financial statement reporting under SFFAS 17 for fiscal years ending prior to October 1, 2004. However, for periods beginning after September 30, 2004, components of this information is required to be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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. Earlier implementation is encouraged. [SFFAS17, ¶158 and [SFFAS17, ¶24 as amended by SFFAS 25, ¶6 and 7]

U. S. Department of Labor Required Supplemental Stewadship 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

(Dollars in thousands)

	(1) Expected 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	$ 75,410,218	$ 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

(Continued From Previous Page)

(Dollars in thousands)

	(1) Expected Unemployment Rate									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
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
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	$ 102.591.615	$ 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

Dollars in thousands

	(2) Mild Recessionary 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
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	$ 101,070,223
Total unemployment rate	**5.09%**	**5.12%**	**5.38%**	**5.60%**	**6.57%**	**7.43%**	**7.07%**	**6.42%**	**5.62%**	**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

Dollars in thousands

	(3) Deep Recessionary 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	$ 75,247,218	$ 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
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%**

.4050 ***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. [SFFAS17, ¶159]

.4051 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. [SFFAS17, ¶160]

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

(Continued From Previous Page)

Minimally Solvent		Not Minimally Solvent	
State	**Ratio**	**State**	**Ratio**
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		

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 paragraph .118.)

Stewardship Information for the Consolidated Statement of Social Insurance 75-Year Projection[1] as of September 30, 1996 [Hypothetical Data]

Dollars in trillions

		Prior Year			
	1996	**1995**	**1994**	**1993**	**1992**
Actuarial present value of future benefit payments[1,2] 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]

Dollars in trillions					
		Prior Year			
	1996	1995	1994	1993	1992
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
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

Dollars in trillions					
		Prior Year			
	1996	1995	1994	1993	1992
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

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.

Program Description

.4052 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. [SFFAS17, ¶161]

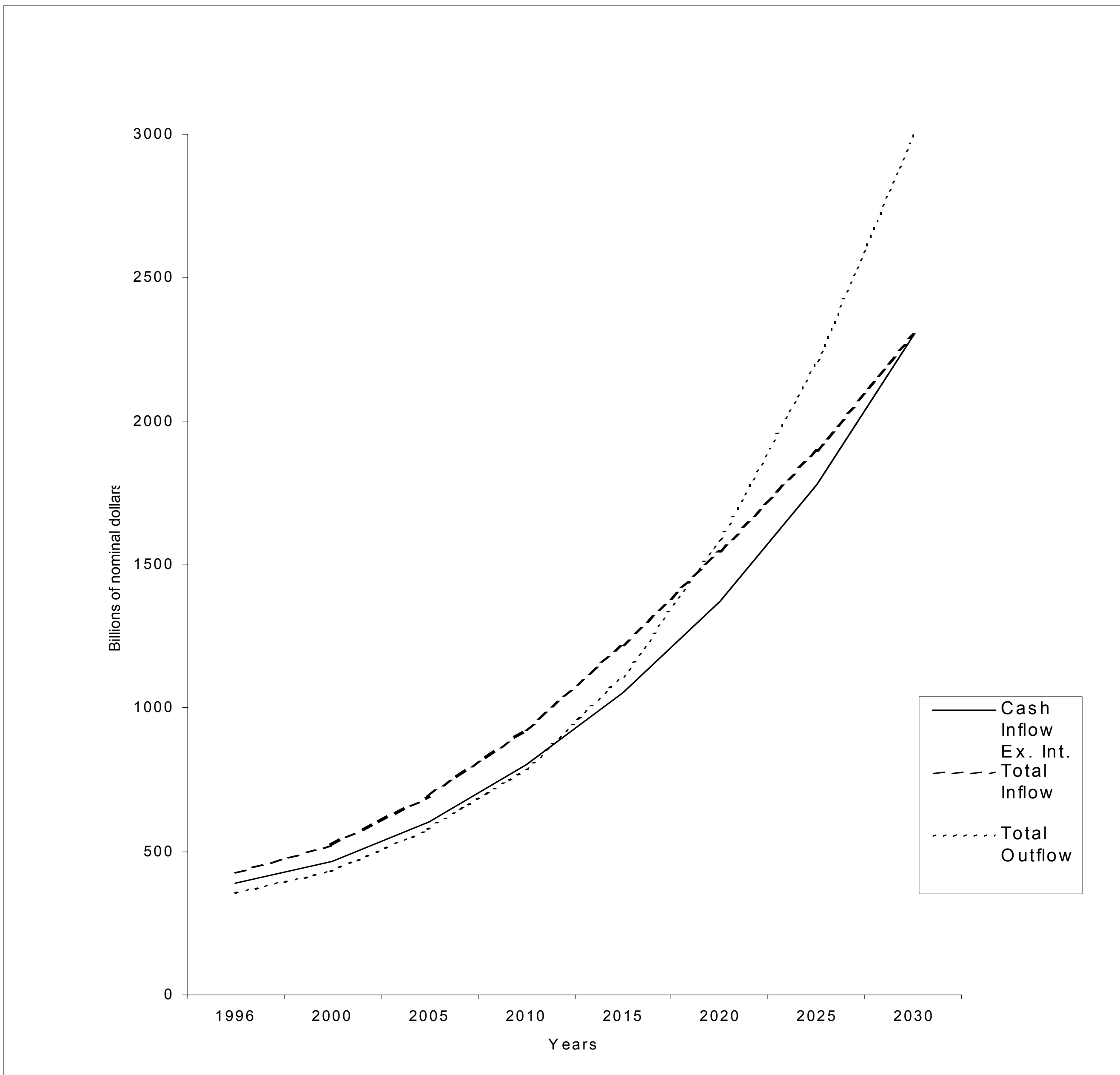
.4053 While no liability has been recognized on the balance sheet for future payments beyond the amount due as of September 30, actuarial estimates of future program activities have been prepared for the social insurance programs. Long-term actuarial views are a critical element in assessing the financial 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. [SFFAS17, ¶162]

.4054 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. [SFFAS17, ¶163]

.4055 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. [SFFAS17, ¶164]

.4056 As shown in Chart 1, under current policies Social Security cash outflow will exceed inflow from the public in about 2012. [SFFAS17, ¶165]

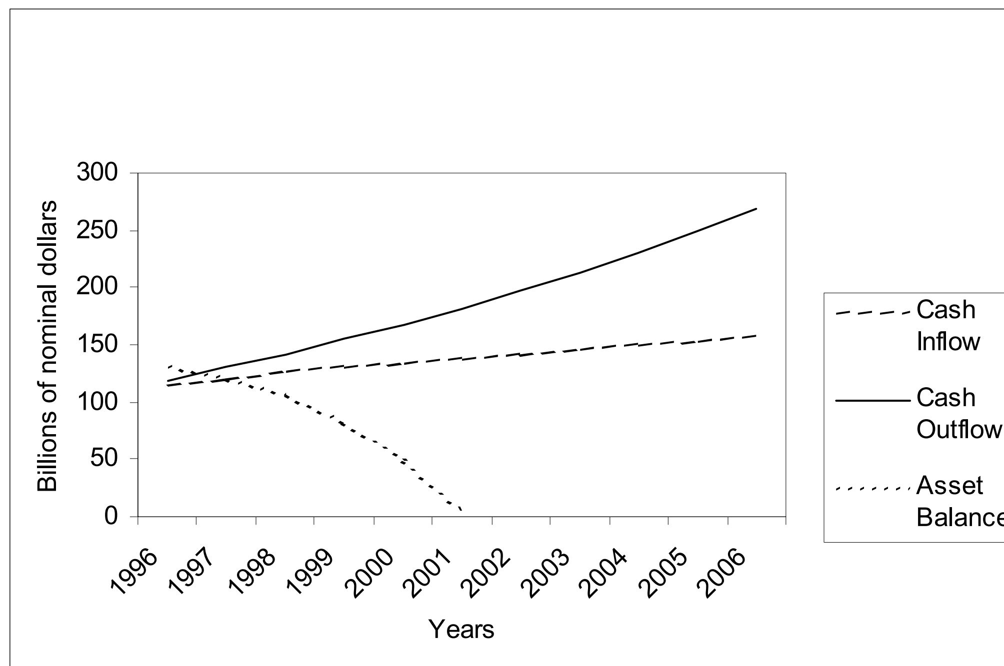
Chart 1 - OASDI Cash Inflow & Outflow, 1996-2030



Source: Data is from Tables III B1, B3, &C1, 1996 OASDI Trustee's Report

.4057 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. [SFFAS17, ¶166]

Chart 2 - HI Cash Inflow, Outflow, Asset Balances, 1996-2006



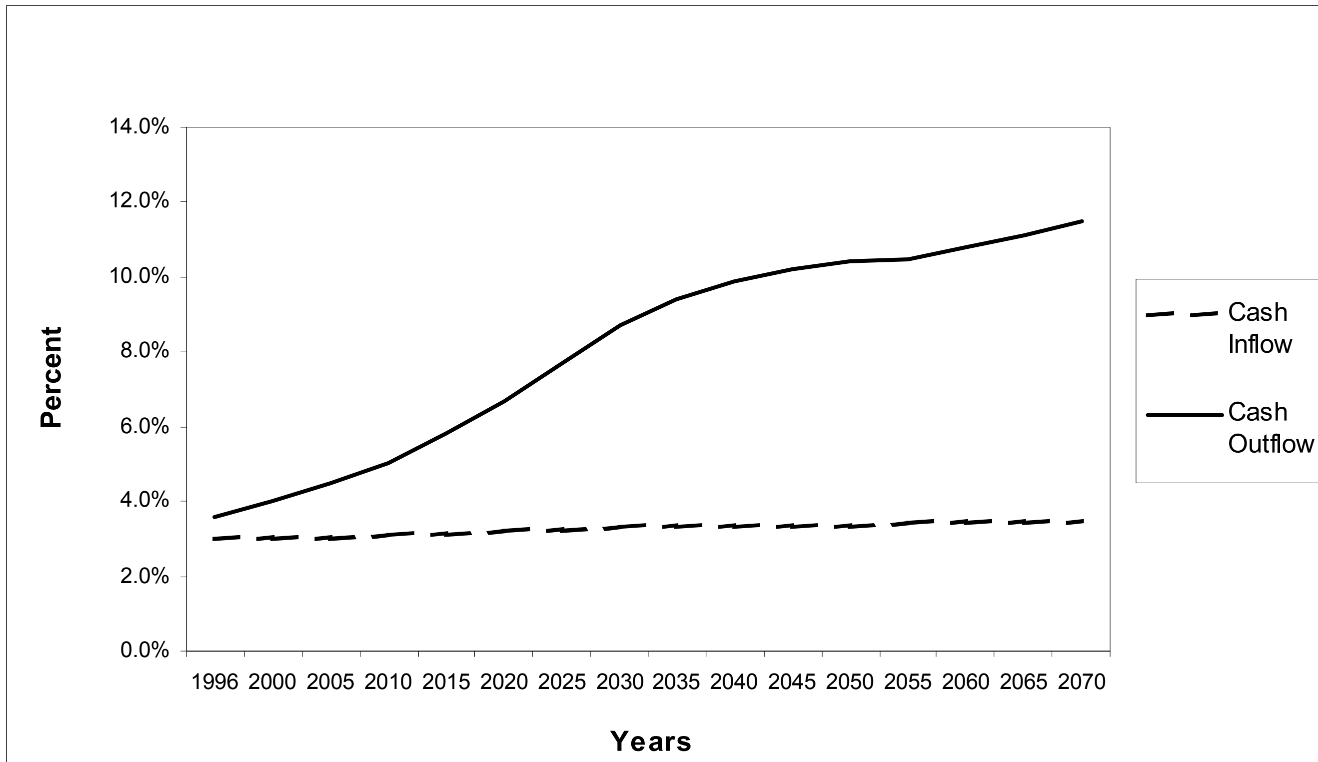
Source: Data is from Tables II D3, 1997 HI Trustee's Report

.4058 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. [SFFAS17, ¶167]

.4059 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. [SFFAS17, ¶168]

.4060 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. [SFFAS17, ¶169]

Chart 3 - HI Cash Inflow & outflow as a Percent of Taxable Payroll



Source: Data is from Tables II A.2, 1997 OASDI Trustee's Report

.4061 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 equaled 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. [SFFAS17, ¶170]

.4062 ***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.[12] 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. [SFFAS17, ¶171]

.4063 ***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. [SFFAS17, ¶172]

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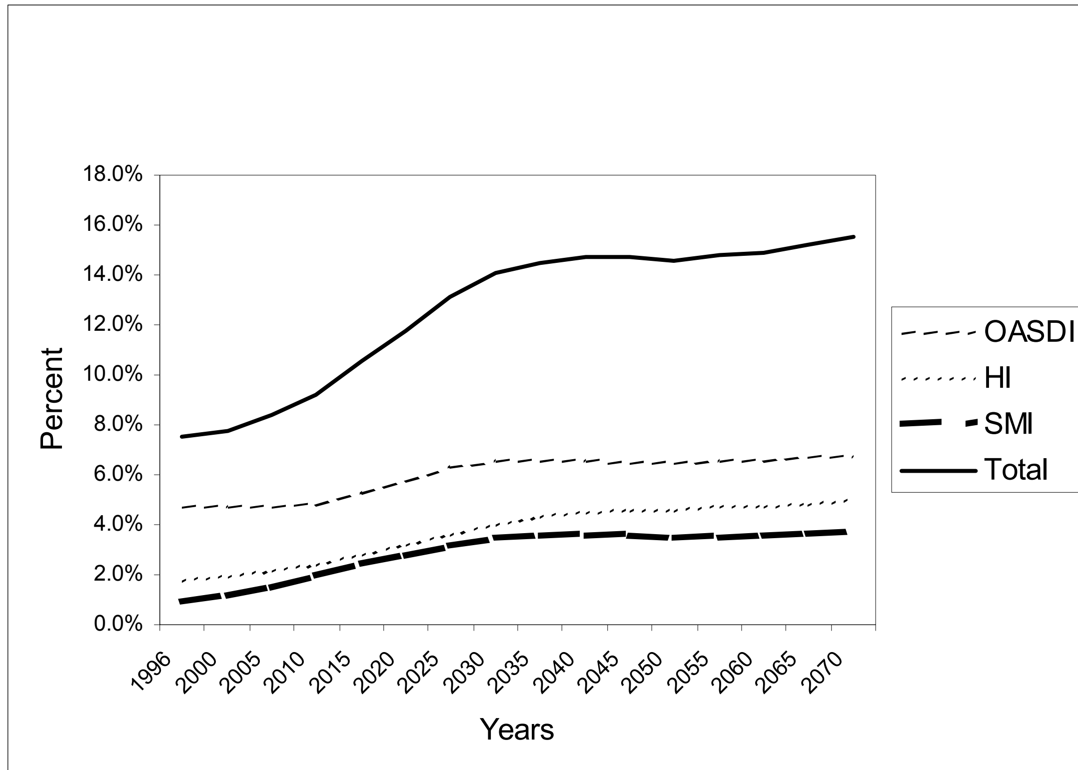
[12] [Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 3.]

Chart 4 - OASDI, Hi & SMI Cash Outflow as a Percent of GDP, 1996-2070



Source: Data is from Tables III C1, 1996 OASDI Trustee's Report and Table III B1, 1997 HI Trustee's Report

.4064 This projected increase needs to be understood in the context of other projected future claims on future 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. [SFFAS17, ¶173]

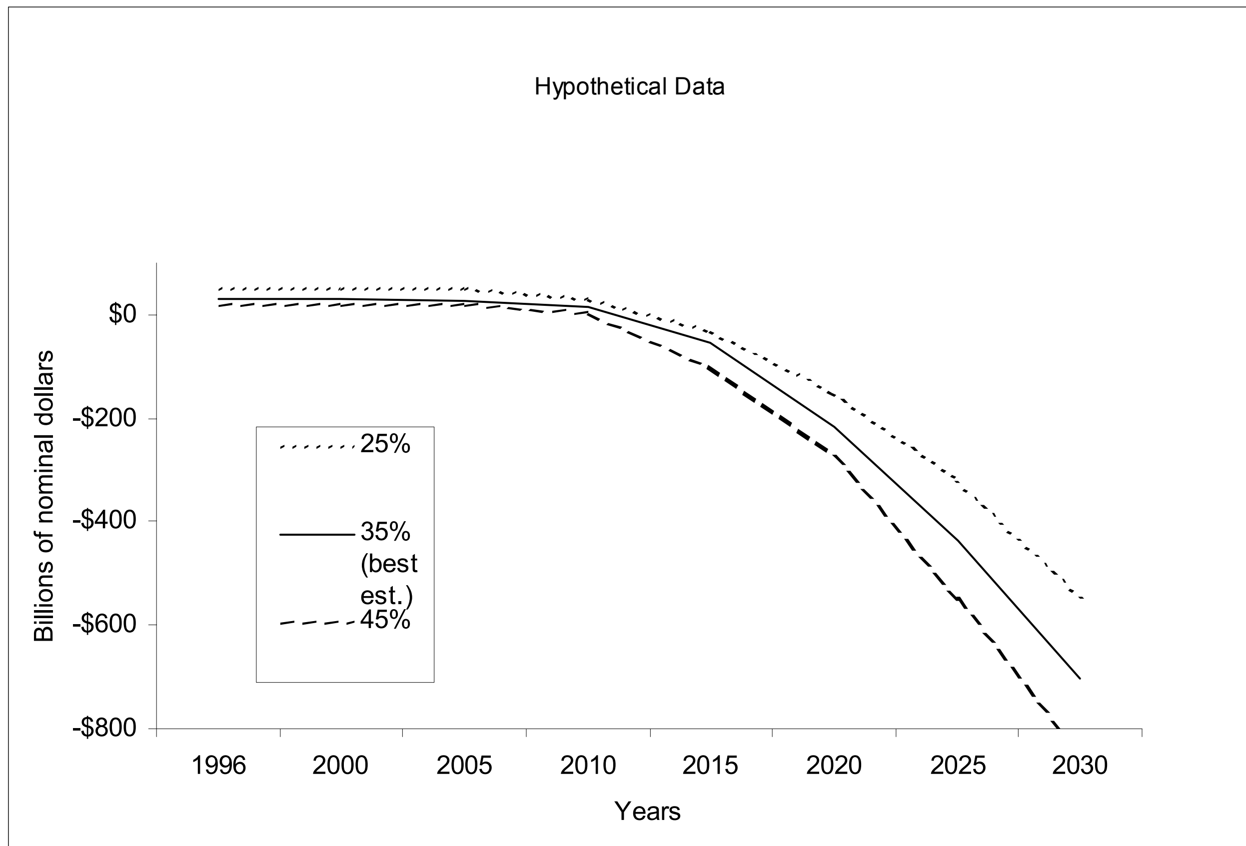
.4065 *Sensitivity Analysis*[13] - The future cashflow of the OASDI, Medicare, and other social insurance programs depends on many economic and demographic assumptions. Precise long-range projections of these factors is impossible. [SFFAS17, ¶174]

.4066 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. [SFFAS17, ¶175]

.4067 *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. [SFFAS17, ¶176]

[13] [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.]

Chart 5 - OASDI Net Cashflow with Alternative Assumptions about the Death Rate 1996-2030



Source: Data for "best estimate" is from Tables III B1, B3, &C1, 1996 OASDI Trustee's Report

.4068 *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 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. [SFFAS17, ¶177]

.4069 *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. [SFFAS17, ¶178]

Table 1: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions

	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow (trillions of dollars)	$3.7	$3.0	$2.5

.4070 *Net Immigration* — Table 2 below shows the total excess of OASDI cash outflow over inflow with various assumptions about the magnitude of net immigration. [SFFAS17, ¶179]

Table 2: Estimated OASDI Actuarial Balances with Various Net Immigration Assumptions

	Net immigration per year		
Valuation Period: 1996-2070	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over cash inflow (trillions of dollars)	$3.2	$3.0	$2.9

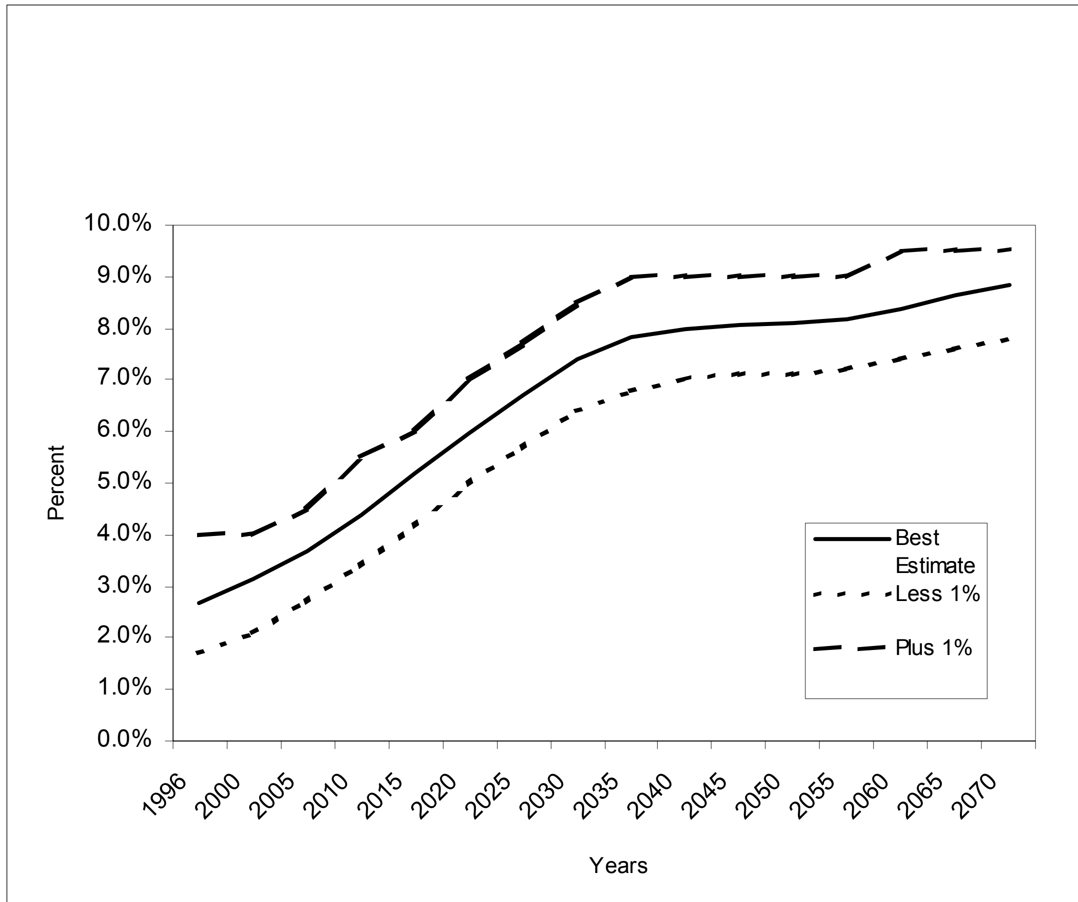
.4071 *Real-Wage Differential* - Table 3 below shows the total excess OASDI cash outflow over inflow with various assumptions about the real-wage differential. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the Consumer Price Index. [SFFAS17, ¶180

Table 3: Estimated OASDI Actuarial Balances with Various Real-Wage Assumptions – Valuation Period: 1996-2070

	Ultimate percentage in wages-CPI *[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 of cash outflow over cash inflow (trillions of dollars)	$3.9	$3.0	$2.3

.4072 *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. [SFFAS17, ¶181

Chart 6 - HI & SMI Net Cash Outflow with Alternative Health Care Cost Trend Assumptions as a Percent of GDP, 1996-2070



Source: Data for "best estimate" is from Tables III B1,1997 HI Trustee's Report

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.

- 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, 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 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 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.

Software—S50

Source: SFFAS10

Related Reference(s): G20 General Property, Plant, and Equipment; M20 Managerial Cost Accounting; L20 Leases

Summary

SFFAS10, *Accounting for Internal Use Software*, 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*.[1] 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).

SFFAS10 requires the capitalization of the cost of internal use software whether it is COTS,[2] 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.

Accounting for Internal Use Software

Definitions

.100 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.

[1] Subject Area Section G20 in this Volume

[2] Software that is purchased from a vendor and is ready for use with little or no changes

Normally software is an integral part of an overall system(s) having interrelationships between software, hardware, personnel, procedures, controls, and data. [SFFAS10, ¶8]

.101 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. [SFFAS10, ¶9]

Software Development Phases

.102 Software's life-cycle phases[3] include planning, development, and operations. This standard provides a framework for identifying software development phases and processes to help isolate the

[3] There are no federal requirements regarding the phases that each software project must follow. The life-cycle phases of a software application described here are compatible with and generally reflect those in the Office of Management and Budget's (OMB) Circular A-130, Management of Information Resources, and Capital Programming Guidance; the Government Accountability Office's (GAO), Measuring Performance and Demonstrating Results of Information Technology Investments (GAO/AIMD-98-89, Mar. 1998); and the American Institute of CPA's Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (Mar. 4, 1998). Successful software projects normally would have at least an initial design phase, an application development phase, and a post-implementation/operational phase. Also, software eventually would become obsolete or otherwise be replaced and therefore have a termination phase. Circular A-130 acknowledges that the "life cycle varies by the nature of the information system. Only two phases are common to all information systems–a beginning and an end. As a result, life cycle management techniques that agencies can use may vary depending on the complexity and risk inherent in the project." (A-130, "Analysis of Key Sections," p. 63).

capitalization period for internal use software that the federal entity is developing. [SFFAS10, ¶10]

.103 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. [SFFAS10, ¶11]

Preliminary design phase	Software development phase	Post-Implementation/ operational phase
• Conceptual formulation of alternatives[a] • 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[b] • Coding • Installation to hardware • Testing, including parallel processing phase	• Data conversion • Application maintenance

[a] 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.”

[b] See OMB Circular A-109, Major Systems Acquisitions, par. 13, “Full-Scale Development and Production.”

.104 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.

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. [SFFAS10, ¶12]

.105 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. [SFFAS10, ¶13]

.106 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 the original plan.

d. Track and accumulate life-cycle cost and compare it with the original plan. [SFFAS10, ¶14]

Recognition, Measurement, and Disclosure

Software Used as General PP&E

.107 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.[4] [SFFAS10, ¶15]

Capitalizable Cost

.108 For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.[5] 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). [SFFAS10, ¶16]

.109 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. [SFFAS10, ¶17]

[4] General PP&E, as distinguished from stewardship PP&E, is defined in pars. 23-25, in SFFAS No. 6, Accounting for Property, Plant, and Equipment.

[5] 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. See Subject Area Section M20.126-.128 in this Volume. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

.110 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. [SFFAS10, ¶18]

Data Conversion Cost

.111 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. [SFFAS10, ¶19]

Cutoff for Capitalization

.112 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. [SFFAS10, ¶20]

Multiuse Software

.113 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). [SFFAS10, ¶21]

Integrated Software

.114 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. [SFFAS10, ¶22]

Bundled Products and Services

.115 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. [SFFAS10, ¶23]

Capitalization Thresholds

.116 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 collective cost should be capitalized. [SFFAS10, ¶24]

Enhancements

.117 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. [SFFAS10, ¶25]

.118 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. [SFFAS10, ¶26]

.119 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.[6] [SFFAS10, ¶27]

Impairment

Post-implementation/ Operational Software

.120 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). [SFFAS10, ¶28]

.121 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. [SFFAS10, ¶29]

[6] 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 that such 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. However, an enhancement could presumably provide enhanced capabilities and at the same time, as an integral part of the new code and other software enhancements, cure the Y2K problem. The total cost of such an enhancement should be capitalized rather than allocated between the Y2K cost and all other cost.

.122 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.[7] 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. [SFFAS10, ¶30]

Developmental Software

.123 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. [SFFAS10, ¶31]

[7] Presumably, NRV will be zero for software. However, in the rare case that it is not zero, NRV should be recognized.

Amortization

.124 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 consistent with that used for planning the software's acquisition.[8] [SFFAS10, ¶32]

.125 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. [SFFAS10, ¶33]

.126 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. [SFFAS10, ¶34]

Disclosures

.127 The disclosures required by SFFAS6, paragraph45, 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. [SFFAS10, ¶35]

[8] For example, federal agencies use the following planning guidance: OMB Circulars A-11, Budget Planning, Budgeting, and Acquisition of Fixed Assets; A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs; and A-109, Acquisition of Major Systems; OMB's Capital Programming Guide (July 1997); GAO's Assessing Risks and Returns: A Guide for Evaluating Federal Agencies' IT Investment Decision-making (Feb. 1997); and other federal guidance.

Implementation

.128 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. 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. [SFFAS10, ¶36]

Software—Technical Guidance

TR5: Implementation Guidance on Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software

Summary

This Technical Release (TR) is intended to provide guidance on implementing SFFAS10.[9]

[9] This Technical Release is based on the provisions of the following Federal standards:
- SFFAS 10, *Accounting for Internal Use Software*
- SFFAS 5, *Accounting for Liabilities of the Federal Government* (See Subject Area Section L40 in this Volume.)
- SFFAS 6, Accounting for Property, Plant, and Equipment. (See Subject Area Section G200 in this Volume.)

Questions and Responses

Question 1

.3000 *Trigger Point for Capitalization and Amortization*[10] - How can management determine the point in time when it is more likely than not that a proposed software project will be implemented, and thus the capitalization and amortization periods start?

Response

.3001 SFFAS 10 states that "for internally developed software, capitalized costs should include the full cost (direct and indirect costs) incurred during the software development stage. Such costs 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). "[11] Each Federal agency should develop and document agency specific policies and procedures for this determination so that it is consistently implemented across new software developments.

.3002 In terms of amortization, SFFAS 10 states that "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 the 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. "[12] Generally, this point in time is before the Federal agency starts to realize the benefits of the new computer software system.

[10] FFAS 10, paragraph 16a. (Paragraph S50.102 above)

[11] Ibid., Paragraph 16.

[12] Ibid., Paragraph 33. (See S50.124 above.)

Question 2

.3003 *Capability vs. Functionality* - Certain costs extend the ability of a computer software system to perform tasks or make the application easier to use. Neither of these terms is defined in the Glossary, which may lead to a wide variety of interpretations. Are these terms synonymous within the context of SFFAS 10?

Response

.3004 The meaning of the term “capability” used in SFFAS 10 is very similar to the meaning of “functionality.” “Capability” is used in SFFAS 10 in the sense meaning an ability to perform an indicated use. “Functionality” is used in the sense meaning an ability to perform a specific function (an action for which a person or piece of equipment is specially fitted or used). SFFAS 10 states that an “enhancement” occurs when, for example, a new “capability or function [is added] to existing software.” [13] In applying the provisions of SFFAS 10, “capability” is synonymous with “functionality.”

Question 3

.3005 *Useful Life of Software Based on Hardware* - To what extent should the useful life of software be based on the hardware on which it runs?

Response

.3006 In situations where software and the hardware on which it runs have independent service lives, the determination of the useful life of the software should be viewed independently of the useful life of the hardware. This determination should be made on a case by case basis for each Federal agency and is at the discretion of management of the agency. The rationale for this determination should be documented.

.3007 For integrated software, SFFAS 10, Paragraph 22, states the following:

“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

[13] SFFAS 10, paragraph 25. (See S50.117 above.)

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."

Question 4

.3008 *Capitalizing License Fees* - Full ownership of commercial software is rarely, if ever, transferred from the owner of the software to a Federal agency that desires to implement the functionality provided by that software. Rather, agencies acquire the right to use the software through the purchase of a license. When should software license fees be capitalized?

Response

.3009 Although SFFAS 10 did not address licensing within the body of the standard, the FASAB did state its belief in the Basis for Conclusions[14] that it would be appropriate for Federal entities to apply lease accounting concepts to licenses. The Committee therefore believes that when Federal agencies are making the determination as to whether software license fees should be capitalized, it would be appropriate for the agency to follow the lease accounting concepts as provided in SFFAS 5[15] and SFFAS 6[16], as well as appropriate policies for capitalization thresholds.

.3010 The Committee noted that the following Financial Accounting Standards Board (FASB) and AICPA standards provide guidance on accounting for software and licensing in general, and may be relevant to this topic.

- SFAS 50, *Financial Reporting in the Record and Music Industry*
- SFAS 63, *Financial Reporting by Broadcasters*
- SFAS 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

[14] SFFAS 10, paragraphs 66-67.

[15] SFFAS 5, paragraphs 43-46. (See Subject Area L20.100 & .104-.105 in this Volume.)

[16] SFFAS 6, paragraph 20. (See Subject Area L20.100 -.102 in this Volume.)

- SFAS 139, Rescission of SFAS 53, *Financial Reporting by Producers and Distributors of Motion Picture Films and Amendments to SFAS Nos. 63, 89, and 121*
- FASB Highlights, *Computer Software: Guidance on Applying Statement 86*
- AICPA SOP 97-2, *Software Revenue Recognition*
- AICPA SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*
- AICPA SOP 00-2, *Accounting by Producers or Distributors of Film*
- EITF 00-2, *Accounting for Web Site Development Costs*
- EITF 00-3, Application of AICPA Statement of Position 97-02 (*Software Revenue Recognition)* to Arrangements that Include the Right to Use Software Stored on Another Entity's Hardware.

Question 5

.3011 *Capitalizable Costs vs. Executory Costs* - How should a Federal agency capitalize a license agreement that may include executory costs (i.e., maintenance and technical support), as well as software upgrades? This may include upgrades that may either extend the useful life of the software or provide additional functionality.

Response

.3012 Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts[17] may be derived from the payment schedule contained in the license agreement. As stated in SFFAS 5, if the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.[18] Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, e.g., initial license, maintenance, enhancement, etc.

[17] SFFAS 5, paragraph 44 (See Subject Area Section L20.104 in this Volume.)

[18] Ibid., paragraph 44

Question 6

.3013 _Bulk Purchases_ - Rather than buy individual packages of typical desktop software, many Federal agencies will acquire either a site or enterprise license, which allows unlimited use of a single package at a site or across the enterprise, or will buy, at a single time, a sufficient number of individual licenses to cover the use of a large percentage of the site or enterprise population (frequently referred to as a “seat license”). These acquisitions will in most cases exceed the capitalization threshold, but would not exceed the threshold if purchased separately. Should these types of purchases be capitalized?

Response

.3014 For these types of bulk purchases Federal entities should follow the guidance as stated in SFFAS 10, paragraph 24.[19]

“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 collective cost should be capitalized.”

[19] S50.116d above

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.

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 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.

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.

Stewardship Land—S60

Source: SFFAS6, SFFAS8; SFFAS14

Related Reference(s): G20 General Property, Plant, and Equipment; M20 Managerial Cost Accounting; L20 Leases

Summary

Land not acquired for or in connection with[1] 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.

Stewardship Land

Definition

.100 "Land" is defined as the solid part of the surface of the earth. 33Excluded 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. [SFFAS8, ¶71; SFFAS6, ¶66-67]

[1] "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.

.101 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.[2] [SFFAS8, ¶72]

.102 Land and land rights[3] 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. [SFFAS8, ¶73]

.103 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. 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. [SFFAS8, ¶74; SFFAS6, ¶68]

Measurement

.104 Stewardship land shall be quantified in terms of physical units (for example, acres) rather than in monetary terms. [SFFAS8, ¶75]

.105 No asset amount shall be shown on the balance sheet of the Federal financial statements for stewardship land. [SFFAS8, ¶76]

.106 The acquisition cost of stewardship land shall be considered an expense in the period acquired when determining the net cost of operations. [SFFAS8, ¶77]

[2] The Board presently has an active project to address standards for natural resources.

[3] "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.

.107 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 judgment 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) 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. [SFFAS8, ¶78; SFFAS6, ¶70 as edited in SFFAS8]

.108 However, no amounts for stewardship land acquired through donation or devise[4] 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. [SFFAS6, ¶71; SFFAS8, ¶79]

.109 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. [SFFAS6, ¶72]

[4] A will or clause of a will disposing of property.

.110 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. [SFFAS6, ¶73; SFFAS8, ¶80]

Minimum Reporting

.111 The acquisition cost of stewardship land shall be recognized as a cost in the period incurred. The cost shall be disclosed[5] as “cost of stewardship land.” The cost shall include all costs incurred to bring the PP&E to its current condition and location.[6] [SFFAS6, ¶69]

.112 Reporting at the entity level for stewardship land shall be more specific than at the government-wide 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.

[5] 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.

[6] See Subject Areas Sections G20.108 or L10.107 for examples of the costs to be considered.

- The condition[7] of the stewardship land, unless it is already reported in with the deferred maintenance information included elsewhere in the report in which case a reference to the information will suffice.
- A reference to the information if deferred maintenance is reported for the assets.[8] [SFFAS8, ¶81 as amended by SFFAS14, ¶10 & 11]

Implementation Guidance

.113 For guidance relating to stewardship land that was previously recognized as assets for balance sheet reporting, see the SFFAS6 text in paragraphs .114 and .115 below. [SFFAS8, ¶82]

.114 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. [SFFAS6, ¶75]

.115 For published financial statements presenting prior year information, no prior year amounts shall be restated. [SFFAS6, ¶76]

[7] 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.

[8] For guidance on deferred maintenance reporting, see the Deferred Maintenance standard Accounting for Property, Plant, and Equipment, SFFAS No. 6, as amended by SFFAS No. 14. (Subject Area Section D20 in this Volume.)

Stewardship Land—Non-Authoritative Guidance

.4000 **Annual Stewardship Information** [SFFAS8, Appendix B]

"Land" is defined as the solid part of the surface of the earth. Excluded from the definition of land for reporting purposes here are materials beneath the surface (that is, depletable resources such as mineral deposits and petroleum), the space above the surface (that is, renewable resources such as timber), and the outer-continental shelf resources. These materials will be addressed in a future standard.

The Federal Government holds approximately 650 million acres of land. Land that is acquired for or in connection with items of general PP&E are reported on the balance sheet. Land that is not acquired for or in connection with items of general PP&E is considered stewardship land. Of the total amount of land held by the Federal Government, about 617 million acres are considered stewardship land.

The cost or value of stewardship land is often not determinable. The most relevant information about stewardship land is its existence, condition, and use. Therefore, stewardship land is reported in terms of physical units rather than cost, fair value, or other monetary values.

The major uses of stewardship land are for forests, wildlife, grazing, parks, recreation, and historic sites. Where parcels of stewardship land have more than one use, the predominant use of the land is considered the major use. Two Federal agencies are responsible for maintaining virtually all stewardship land held by the Federal Government: the Departments of the Interior and Agriculture.

Virtually all stewardship land is useable for its purposes at September 30, 1994. In some cases, however, scheduled maintenance has been deferred. Estimates of costs to complete critical maintenance range from $ 40 to $ 50 million. "Critical maintenance" refers to maintenance that, if not performed, could lead to irreparable damage to the assets or to unusability. On the basis of engineering estimates, the estimated cost of deferred maintenance ranges from $ 75 to $ 100 million in 199Z.

On the following page is a summary of the stewardship land by category of major use, broken down within each category by principal holding agency, at September 30, 199Z.

Stewardship Land:[a]
Annual Stewardship Information For the Fiscal Year Ended September 30, 199Z
Major Uses of Land by Holding Agency[b]
(Within the 50 States)

Use and Agency	Acres in millions	Percentage of Stewardship Land
Forest and Wildlife:		
The Interior	193.6	31.4
Agriculture	174.0	28.2
Total	367.6	59.6
Grazing		
The Interior	145.1	23.5
Agriculture	8.5	1.4
Total	153.6	24.9
Parks and Historic Sites		
The Interior	95.9	15.5
Grand Total	**617.1**	**100**

[a] See accompanying notes to the financial statements for the condition of stewardship land.

[b] Figures are based on information from the Summary Report of Real Property Owned by the United States Throughout the World as of September 30, 1991, December 1993.

Glossary

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

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.

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).

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)

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.

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 Reporting—S70[1]

Source: SFFAS8 as amended by SFFAS 25[2] ; SFFAS17 as amended by SFFAS 25

Related Reference(s): C40 Cleanup Costs; D20 Deferred Maintenance; G20 General Property, Plant, and Equipment; H20 Heritage Assets; H60 Human Capital; L10 Land; N60 Non-Federal Physical Property; R20 Research and Development; R40 Revenue, Gains & Losses, and Other Financing Sources; S 40 Social Insurance Programs; S60 Stewardship Land; T30 Transactions Not Recognized as Revenue, Gains & Losses, or Other Financing Sources

Summary

SFFAS 8, *Supplementary Stewardship Reporting*, establishes 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. Stewardship resources are investments 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 non-financial data.

[1] The text used for this Subject Area Section is taken from SFFAS8's introduction and Chapter 1 "Introduction and Background" in order to provide an overview of the intent of the Stewardship Reporting standards and requirements.

[2] As originally issued, SFFAS 8 required the reporting of projected current service assessments that estimated the financial impact of sustaining current services provided by the Government. SFFAS 25 rescinded these requirements for reporting periods beginning after September 30, 2002.

SFFAS8, as amended by SFFAS 23 and SFFAS 25, establishes reporting requirements based on the categories described in items a and b below.

a. Stewardship Property, Plant, and Equipment (PP&E) - property owned by the Federal Government and meeting the definition of one of the following two categories:

   - Heritage Assets - property, plant, and equipment of historical, natural, cultural, educational, or artistic significance. See Subject Area Section H20 in this Volume.

   - Stewardship Land - land other than that acquired for or in connection with general PP&E. See Subject Area Section S60 in this Volume.

b. 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. See Subject Area Section N60 in this Volume.

   - 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. See Subject Area Section H60 in this Volume.

     - Research and Development - basic and applied research and development. See Subject Area Section R20 in this Volume.

Under SFFAS 8, this information is reported as "required supplemental stewardship information (RSSI).

SFFAS 17 *Accounting for Social Insurance*, added requirements for accounting and reporting on Federal social insurance programs. SFFAS 25 amends these requirements for financial reporting for fiscal years beginning after September 30, 2004. Effective for fiscal years beginning after September 30, 2004, SFFAS 25 requires a new financial statement, the Statement of Social Insurance. The remaining information required by SFFAS 17 becomes required supplementary information. These standards are included in this Volume as Subject Area Section S40.

SFFAS 25 further amends SFFAS 8 by classifying information about Risk Assumed to be reported as required supplementary information (RSI) rather than RSSI and eliminated SFFAS 8's requirements for reporting the Current Services Assessment. These change are effective for financial reporting for fiscal years beginning after September 2002.

The audit requirements for this information are contained in OMB's Audit Bulletins, *Audit Requirements for Federal Financial Statements.*

Stewardship Reporting

Purpose

.100 The purpose of SFFAS8 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. [SFFAS8, ¶1]

.101 Specific descriptions of these stewardship-type resources are addressed later in Chapter 1 and in the individual standards established in chapters 2-7 of SFFAS8.[3] 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)[4].
- 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 benefiting more than the current reporting period) rather than a consumption basis (that is, as benefiting 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.

[SFFAS8, ¶2]

.102 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. [SFFAS8, ¶3]

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[3] See the following Subject Area Sections in this Volume: H20 Heritage Assets, S60 Stewardship Land, N60 Nonfederal Physical Property, H60 Human Capital, and R20 Research and Development.

[4] 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. See Subject Area Section G20 in this Volume.

Background and Rationale

.103 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. [SFFAS8, ¶5]

.104 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. [SFFAS8, ¶6]

Stewardship and the Reporting Objectives

.105 "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. [SFFAS8, ¶7]

.106 Assessing the overall performance of the Federal Government is not exclusively a matter of comparing revenue and expense, or its accumulated assets and liabilities. [SFFAS8, ¶8]

.107 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. [SFFAS8, ¶9]

Financial Condition

.108 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 presentation of entity performance. Moreover, assessment of financial condition could include analysis of trends, demands, commitments, events, and uncertainties.[5] [SFFAS8, ¶10]

Stewardship PP&E

.109 "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 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); and heritage assets (for example, Federal monuments and memorials and historically or culturally significant property). [SFFAS8, ¶11 as amended by SFFAS23]

[5] Chapter 7 of the *Objectives of Federal Financial Reporting* provides a full discussion of financial position and financial condition.

Stewardship Investments

.110 "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. [SFFAS8, ¶12]

.111 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 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.[6] [SFFAS8, ¶13]

Stewardship Categories or Elements

.112 In defining the specific categories of items, or elements, that would appear as stewardship information, the FASAB has 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; and

  - Investments in stewardship land,[7] that is, land not acquired for or in connection with general property, plant, and equipment, for example, national forests,

[6] See SFFAC No. 1, pp. 41-42.

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.

    - 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.

[SFFAS8, ¶17 as amended by SFFAS23& 25]

.113 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. [SFFAS8, ¶18]

[7] 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.

The Nature of Stewardship Reporting

.114 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. [SFFAS8, ¶19]

.115 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. [SFFAS8, ¶20]

.116 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 RSSI. [SFFAS8, ¶21]

Stewardship Information

.117 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. [SFFAS8, ¶22]

.118 Examples of selected portions of stewardship report sections are included in the Subject Area Sections: H20 Heritage Assets, S60 Stewardship Land, N20 Non-federal Physical Property, H60 Human Capital, R20 Research and Development, and S40 Social Insurance Programs. [SFFAS8, ¶23[8] as amended by SFFAS25, ¶5]

Measurement

.119 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).[9] [SFFAS8, ¶24]

.120 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. [SFFAS8, ¶25]

.121 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. [SFFAS8, ¶26]

.122 Generally, amounts shall be reported in nominal dollars. If trend data that span many years are reported and the entity believes that constant dollar information would be meaningful for data interpretation, constant dollar data may be provided in addition to nominal dollar data. [SFFAS8, ¶27]

Split Grants

.123 Frequently, stewardship elements are financed by grants. In some cases, the grants may have more than one purpose.[10] For such grants, the investment shall be allocated among stewardship elements on the basis of an estimate of the proportionate funding of

[8] This paragraph, as it is included in the SFFAS8 original pronouncement, refers to the statement's Appendix A. The information in that Appendix has been used as illustrations in the Volume 2 Subject Area Sections cited above.

[9] See *Managerial Cost Accounting Standards for the Federal Government*, SFFAS No. 4, (Subject Area Section M20 in this Volume) for a discussion of Federal cost accounting principles and standards.

[10] 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.

the various grant objectives. If allocation is not feasible, the investment shall be reported on the basis of the predominant use of the grant. [SFFAS8, ¶28]

Performance Indicators

.124 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. [SFFAS8, ¶29]

Reporting Program Expenses

.125 Trend data reported on stewardship investment elements should reflect the full cost[11] 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. [SFFAS8, ¶30]

.126 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. [SFFAS8, ¶31]

Reporting Requirements

.127 Within each of the specific Stewardship Reporting standards established in SFFAS8, (Heritage Assets, Stewardship Land, Nonfederal Physical Property, Human Capital, and Research and Development); minimum required and, in some cases, recommended reporting is described.[12] These requirements and recommendations,

[11] See *Managerial Cost Accounting Standards for the Federal Government*, SFFAS No. 4, (Subject Area Section M20 in this Volume) for a discussion of Federal cost accounting principles and standards.

[12] See the following Subject Area Sections in this Volume: H20 Heritage Assets, S60 Stewardship Land, N60 Nonfederal Physical Property, H60 Human Capital, and R20 Research and Development.

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. [SFFAS8, ¶34]

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. [SFFAS8, ¶35]

.128 SFFAS 17[13] establishes reporting requirements for social insurance programs. The standard requires that 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. [SFFAS17, ¶24]

.129 For periods beginning after September 30, 2004, the information required by SFFAS 17 (See S40 paragraph .114(3) and .119(3) shall be presented as a basic financial statement, the Statement of Social Insurance (SOSI). Other information required by SFFAS 17 and discussed in this Subject Area section shall be presented as required supplementary Information (RSI) rather than 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

[13] See Subject Area Section S40.

basic financial statements. Earlier implementation is encouraged. [SFFAS 25, ¶6 and 7]

Applicability

.130 SFFAS 8 requires that the consolidated financial reports[14] of the Federal Government and the financial reports[12] 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. [SFFAS8, ¶38]

[14] 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.

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.

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)

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 – 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)

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).

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. 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.

State and Local Governments – State and local governments generally include:

- the 50 States and the District of Columbia;
- cities, counties, townships, school districts, special 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.

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.

Stockpile Materials—S80

Source: SFFAS3

Related Reference(s): I60 Inventory: Inventory Held for Sale; Inventory Held in Reserve, Excess, Obsolete and Unserviceable Inventory, Inventory Held for Repairs

Summary

Stockpile materials are to be accounted for through the consumption method using the historical cost valuation or any method that reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. 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 material.

Stockpile Materials

Definition

.100 “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). [SFFAS3, ¶51]

Recognition

.101 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. [SFFAS3, ¶52

Valuation

.102 Stockpile materials shall be valued on the basis of historical cost. 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). [SFFAS3, ¶53]

Exception to Valuation

.103 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[1] in the period in which it occurs. [SFFAS3, ¶54]

Held for Sale

.104 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. [SFFAS3, ¶55]

[1] The decline in value shall be considered an expense if it is an expected decline in the normal course of operations.

Disclosure Requirements

.105 Disclosure requirements include the following:

- 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 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. [SFFAS3, ¶56]

Transactions Not Recognized As Revenue, Gains, or Other Financing Sources—T30

Source: SFFAS7

Related Reference(s): L60 Loans and Loan Guarantees; R10 Receivables R40 Revenue, Gains & Losses, and Other Financing Sources

Summary

SFFAS7's accounting standards are augmented by authoritative guidance in Appendix B. The Appendix provides guidance for classifying all major transactions that finance the Government's cost of operations and a significant number of lesser transactions. This Subject Area Section presents the final group of transactions listed in the Appendix. These transactions produce amounts that are not recognized as revenue, gains or other financing sources.

Transactions Not Recognized as Revenue, Gains or Other Financing Sources

.100 The final group of transactions in SFFAS7, Appendix B consists of transactions that produce amounts not recognized as revenue, 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 expenses according to the standards in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. (See Subject Area Section L60 Loans and Loan Guarantees in this Volume.)
- Deposit fund transactions. [SFFAS7, ¶239]

Table of Transactions

	T40 Ref.
Transactions Not Recognized as Revenue, Gains, or Other Financing Sources	
Borrowing from the public	.101
Borrowing from Treasury, the Federal Financing Bank, or other Government accounts	.102
Disposition of revenue to other entities: custodial transfers	.103
Sales of different types of Government assets	.104
Acquisition of property, plant, and equipment through exchange	.106
Transfer of property, plant, and equipment without reimbursement: types that are expensed	.108
Donation of property, plant, and equipment: types that are expensed	.111
Negative subsidies on post-1991 direct loans and loan guarantees	.112
Downward subsidy re-estimates for post-1991 direct loans and loan guarantees	.113
Fees on post-1991 direct loans and loan guarantees	.114
Repayment of post-1991 direct loans	.115
Repayment of pre-1992 direct loans	.116
Repayment of receivables: except direct loans	.117
Sales of direct loans	.118
Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees	.119
Deposit fund transactions	.120

.101 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. [SFFAS7, ¶351]

.102 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. [SFFAS7, ¶352]

.103 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.) [SFFAS7, ¶353]

.104 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. [SFFAS7, ¶354]

.105 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. [SFFAS7, ¶355]

.106 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).[1] [SFFAS7, ¶356]

.107 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. [SFFAS7, ¶357]

.108 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. [SFFAS7, ¶358]

.109 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. [SFFAS7, ¶359]

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[1] See SFFAS No. 6, Accounting for Property, Plant, and Equipment, pp. 10-11.

.110 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.[2] [SFFAS7, ¶360]

.111 Donation of property, plant, and equipment: types that are 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.[3] 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. [SFFAS7, ¶361]

.112 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.[4] [SFFAS7, ¶362]

.113 Downward subsidy re-estimates for post-1991 direct loans and loan guarantees. – A downward subsidy re-estimate 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 re-estimate is recognized as an expense; and a downward subsidy re-estimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source. [SFFAS7, ¶363]

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[2] SFFAS No. 6, Accounting for Property, Plant, and Equipment, pp. 17-18, 20. See Subject Area Sections G20 General Property, Plant, and Equipment and L20 Leases in this Volume.

[3] Ibid.

[4] For standards on direct loans and loan guarantees, see SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. (See Subject Area Section L60 Loans and Loan Guarantees in this Volume.) The accounting for negative subsidy costs is symmetrical to the accounting for positive subsidy costs.

.114 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.[5] [SFFAS7, ¶364]

.115 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.[6] [SFFAS7, ¶365]

.116 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.[7] [SFFAS7, ¶366]

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[5] The fee component of the subsidy cost is required to be disclosed separately.

[6] If the actual repayment is different from the previous estimate, the present value of the difference between cash inflows and outflows over the term of the loan—calculated as of the date of disbursement—is re-estimated and is recognized as a subsidy expense or a reduction in subsidy expense.

[7] If the loan is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

.117 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.[8] [SFFAS7, ¶367]

.118 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.[9] Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[10] 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. [SFFAS7, ¶368]

[8] If the receivable is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

[9] This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is disbursed and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

[10] SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 17 and 66-69. See Subject Area Sections L60 Loans and Loan Guarantees and S60 Stewardship Land in this Volume.

.119 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 re-estimate 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.[11] [SFFAS7, ¶369]

.120 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. [SFFAS7, ¶370]

[11] See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, pp. 18 and 79-82; and SFFAS No. 3, Accounting for Inventory and Related Property, pp. 20-23 and 37-38. See Subject Area Sections, L60 Loans and Loan Guarantees, I50 Inventories: …, and O20 Operating Materials and Supplies in this Volume.

Appendix A: Topical Index

This index provides references to documents contained in the *Original Pronouncements* and the *Current Text* by topic.

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
A		
Accounts Payable	SFFAS1¶74-80	A10
Accounts Receivable - See Receivables		
Accrual Accounting		
Acquisition Cost		
Advances and Prepayments	SFFAS1¶57-61	A30
Amortization		
Direct Loans - See Loans		
Treasury Securities - See Investment in Treasury Securities		
Appropriations		
See Budgetary Resources		
See Other Financing Sources		
Auditing Estimates for Direct Loan and Loan Guarantee Subsidies - See Loans and Loan Guarantees		
B		
Bad Debt - See Receivables		
- See Loans		
Bank Deposit Insurance - See Insurance and Guarantees		
Budgetary Information	SFFAS 7; SFFAS22	B60
Recognition and Measurement of Budgetary Resources	SFFAS7¶78	B60.101
Required Disclosures	SFFAS7¶79	B60.102
Required Reporting	SFFAS7¶77-82 as amended by SFFAS22¶6	B60.100.105
Reconciling Budgetary and Financial Accounting	SFFAS7¶88	B60.106
- Consolidated Financial Statements of the U.S. Government	SFFAS24¶9-14	C60.100-.106
Statement of Financing		
- Consolidated Financial Statements of the		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
U.S. Government	SFFAS24 Appendix C	C60.3003
- See also SFFAC1 & SFFAC2		
C		
Cancellation of Debt - See Loans and Loan Guarantees		
- See Receivables		
Capital Leases - See Leases		
Capitalization Threshold - See General Plant, Property, and Equipment		
Cash	SFFAS1¶	C20
Entity Cash	SFFAS1¶28	C20.101
Non-entity Cash	SFFAS1¶29	C20.102
Restricted Cash	SFFAS1¶30	C20.103
Cash Basis of Accounting		
Civil Service Retirement System - See Pensions		
Cleanup Costs	SFFAS6; SFFAS7	C40
Disclosure Requirements	SFFAS6¶107-111	C40.122-.126
Implementation Guidance	SFFAS6¶104-106	C40.119-.121
Non-authoritative Guidance - Illustration	SFFAS6 Appendix D	C40.4000-.4007
Recognition and Measurement	SFFAS6¶94-103	C40.113-.122
Revenue Recognition	SFFAS7¶292	C40.127
Relevant Laws	TR2 Appendix 1	C40. 3020
Technical Guidance	TR2	C40.3000-.3020
Consolidated Financial Report of the U.S. Government	SFFAS 24¶8-14	C60.100-.106
	Appendices B-E	C60. 4000
Contaminated Property - See Cleanup Costs		
Commodities - See Goods Held under Price Support and Stabilization Programs		
Crop Insurance - See Insurance and Guarantees		
Concepts for Reconciling Budgetary and Financial Accounting	SFFAS7¶88	B60.106
Consolidation		
Contingencies - See Liabilities		
Contract Authority - See Budgetary Resources		
Contractor-Developed Software - See Software		
Costing Methodology - See Managerial Cost Accounting		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Current Services Assessment	SFFAS8	C80
Measurement	SFFAS8¶103-104	C80.101-.102
Minimum Reporting	SFFAS8¶105-108	C80.103-.106
Government-wide Report of the Federal Government	SFFAS8¶105-107	C80.103.-105
Reporting Entities of the Federal Government	SFFAS8¶108	C80.106
D		
Dedicated Collections - See Revenue, Gains & Losses and Other Financing Sources		
Deferred Maintenance	SFFAS6; SFFAS8	D20
as required supplementary information	SFFAS6¶77-84 as amended by SFFAS14¶6-9	D20.100-.106
Measurement	SFFAS680 as amended by SFFAS14¶6	D20.102
Condition Assessment Surveys	SFFAS6¶81	D20.103
Life-cycle costing	SFFAS6¶82	D20.104
Non-authoritative Guidance		
Deferred Maintenance Reporting Illustration	SFFAS6 Appendix C as amended by SFFAS14	D20.4000
Heritage Assets Deferred Maintenance Reporting Illustration	SFFAS8 Appendix B	D20.4001
As Required Supplementary Information	SFFAS14¶7-9	D20.105-.106
Deprecation - See General Property, Plant and Equipment		
Direct Loans - See Loans		
Disclosure Requirements		
Budgetary Information	SFFAS7¶79	B60.102
Cleanup Costs	SFFAS6¶107-111	C40.126-.130
	SFFAS5¶35-42 C as amended by SFFAS12¶11	L40.121-.123
Contingencies	SFFAS12¶11	L40.121-.123
Deferred Maintenance - Required Supplementary Information	SFFAS6¶77-84 as amended by SFFAS14¶6-9	D20.100-.106
General Property, Plant, and Equipment	SFFAS6¶44-45	G20.126-.127
	SFFAS16¶18	G20.128; H20.113
Goods Held Under Price Support and Stabilization Programs	SFFAS3¶109	G40.112; N80.108
Insurance and Guarantee Programs		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Administered by Government Corporations	SFFAS5¶106	I40.111
Insurance and Guarantee Programs -		
Non-authoritative Guidance -		
Liability Recognition, Disclosure, &		
Supplemental Reporting	SFFAS5¶107-113	I40.4000-.4007
Disclosure Requirements - Continued		
Inventories Including Inventory Held in Reserve:		
Excess, Obsolete and Unserviceable Inventory,		
& Inventory Held for Repair	SFFAS3¶35	I60.119
Investment in Treasury Securities -		
Disclosure of Market Value	SFFAS1¶72	I80.112
Land - See General PP&E- See Stewardship Land		
Loans & Loan Guarantees - Foreclosed Property	SFFAS3¶91	L60.156
Loan Guarantees Post-1991 Loan Guarantees	SFFAS2¶23	L60.102
Pre-1992 Loan Guarantees	SFFAS2¶39	L60.121
Modification	SFFAS2¶56	L60.138
Subsidy Disclosures	SFFAS18¶111	L60.114
Non-Recourse Loans & Purchase Agreements	SFFAS3¶109	G40.112; N80.108
Operating Material & Supplies	SFFAS3¶50	O20.114
Other Current Liabilities	SFFAS1¶86	O40.103
Pensions		
Administrative Entity - Pension Expense	SFFAS5¶72	P20.116
Assets	SFFAS5¶68	P20.112
Assumptions	SFFAS5¶67	P20.111
Other Retirement Benefits		
Assets	SFFAS5¶85	P20.129
Assumptions	SFFAS5¶83	P20.127
Expense	SFFAS5¶88	P20.132
Prior Period Adjustments	SFFAS21¶10 & 13	P40.100 & .103
Receivables	SFFAS1¶52	R10.113
Revenue, Gains & Losses, and Other Financing Sources		
Exchange Revenue	SFFAS7¶46-47	R40.115-.116
Nonexchange Revenue	SFFAS7¶64; 65 as amended by SFFAS20¶6; 66-69	R40.133-.138
Seized and Forfeited Property	SFFAS3¶78	S30.129
Social Insurance Programs	SFFAS17¶24 as amended by SFFAS25¶6&7, SFFAS17¶32	S40.110-.119
Software	SFFAS10¶15-34	S50.107-.126
Stockpile Materials	SFFAS3¶56	S80.105

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT

See also - Required Supplementary Information
- Required Supplementary Stewardship Information
Discount on Bonds - See Investment in Treasury Securities
Donations - as Nonexchange Revenue . . . . . . SFFAS7¶30 . . . . . . R40.100

E

Employee Benefits - See Pensions, Other Post-Employment Benefits & Other Retirement Benefits

Entity and Non-Entity Assets . . . . . . SFFAS1 . . . . . . E30
Excess, Obsolete and Unserviceable Inventory - See Inventories including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair
Exchange Liabilities - See Liabilities
Environmental Liabilities - See Cleanup Costs Liabilities
Exchange Revenue - See Revenue, Gains & Losses and Other Financing Sources

F

Fair Value - See Leases
Federal Credit Reform Act of 1990 - See Loans and Loan Guarantees

Federal Debt . . . . . . SFFAS5 . . . . . . F10
Accounting for . . . . . . SFFAS5¶49-55 . . . . . . F10.102-.108
Fixed Value Securities . . . . . . SFFAS5¶50 . . . . . . F10.103
Interest Method Required for Variable Value Securities . . . SFFAS5¶51 . . . . . . F10.104
Non-authoritative Guidance - Federal Debt Instruments - Various Categories & Examples of. . . . . . SFFAS5 Figure 2 . . . . . . F10.4004
Liability Recognition and Measurement . . . . . . SFFAS5 Appendix B F10.4001
Old Currencies . . . . . . SFFAS5¶55 . . . . . . F10.108
Related Interest Cost . . . . . . SFFAS5¶53 . . . . . . F10.106
Retirement prior to Maturity. . . . . . SFFAS5¶54 . . . . . . F10.107
Variable Value Securities . . . . . . SFFAS5¶52 . . . . . . F10.105
Federal Employee Contributions - See Pensions, Other Post-Employment Benefits and Other Retirement Benefits
Fees - See Revenue, Gains & Losses and Other Financing Sources
Financial Position
Financial Reporting

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT

See also Consolidated Financial Report of the U.S. Government
Financial Statements
Fines and Penalties - See Revenue, Gains & Losses and Other Financing Sources
Foreclosed Property - See Loans
Foreign Currency - See Cash
Full Cost - See Managerial Cost Accounting

Fund Balance with Treasury . . . . SFFAS1 . . . . F50
Authority to Borrow . . . . SFFAS1¶35 . . . . F50.103
Clearing Account Balances . . . . SFFAS1¶32 . . . . F50.101
Contract Authority . . . . SFFAS1¶34 . . . . F50.103
Obligated Balances . . . . SFFAS1¶37 . . . . F50.106
Unobligated Balances . . . . SFFAS1¶37-38 . . . . F50.106-.107

G
Gains - See Revenue, Gains & Losses and Other Financing Sources

General Plant, Property, and Equipment . . . . SFFAS6 as amended by SFFAS8, SFFAS10, SFFAS14, SFFAS16; & SFFAS 23 . . . . G20
Capitalization Threshold . . . . SFFAS6¶21 as amended by SFFAS23¶9 . . . . G20.103
SFFAS6¶45 . . . . G20.127
Cleanup Costs - See Cleanup Costs
Depreciation . . . . SFFAS635 as amended by SFFAS23¶9 . . . . G20.117
SFFAS6¶36-39 . . . . G20.118-121
Disclosure Requirements . . . . SFFAS6¶44-45 . . . . G20.126-.127
Expense Recognition . . . . SFFAS6¶35 as amended by SFFAS23¶9 . . . . G20.117
SFFAS6¶36-39 . . . . G20.118-.121
Implementation Guidance:
General PP&E . . . . SFFAS6¶40-43 . . . . G20.122-.125
Implementation Guidance:
General PP&E Previously Reported as “Multi-Use . . . . SFFAS16¶15 . . . . G20.138
Heritage Assets” . . . . SFFAS6¶44 . . . . G20.126
Implementation Guidance:
General PP&E Previously Reported

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
as "National Defense PP&E"	SFFAS23¶10-18	G20.129-.137
Revenue, Gains, and Losses Resulting from Property Plant, and Equipment Transactions	SFFAS7¶295-299	G20.139-.143
Acquisition of Property, Plant, and Equipment Through Exchange	SFFAS7¶297-299	G20.141-.143
Sales of Property, Plant, and Equipment	SFFAS7¶295-296	G20.139-.140
See Also Revenue, Gains & Losses and Other Financing Sources		
Standards and Categories for Plant, Property, and Equipment	SFFAS6¶21 as amended by SFFAS23¶9; SFFAS6¶22	G20.103-.104
Goods Held Under Price Support and Stabilization Programs	SFFAS3	G40
Governmental & Intragovernmental Assets and Liabilities	SFFAS1	G60
Intragovernmental Assets and Liabilities	SFFAS1¶18-20	G60.100-.102
Governmental Assets and Liabilities	SFFAS1¶21-23	G60.103-.105
Separate Reporting	SFFAS1¶24	G60.106
Guarantees - See Insurance and Guarantees - See Loans and Loan Guarantees		
H		
Heritage Assets	SFFAS6; SFFAS8; SFFAS16	H20
Definition	SFFAS6¶57-58; SFFAS8¶43-45	H20.100-.102
Illustrations of Annual Stewardship Information - Non-authoritative Guidance	SFFAS8 Appendix B	H20.4000 -.4003
Implementation Guidance - Heritage Assets	SFFAS6¶65; SFFAS16¶14	H20.103-.104
Multi-Use Heritage Assets	SFFAS16¶15	H20.112
Measurement Heritage Assets	SFFAS8¶46 &47 as amended by SFFAS16; SFFAS16¶10; & SFFAS6¶64	H20.105-.108
Multi-Use Heritage Assets	SFFAS16¶9&11	H20.110-.111
Minimum Reporting Requirements	SFFAS8¶50 as amended by SFFAS14¶10-11 & SFFAS16¶8	H20.113
Multi-Use Heritage Assets that serve two purposes	SFFAS16¶6	H20.109
Multi-Use Heritage Assets - As General Property, Plant and Equipment		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Implementation	SFFAS16¶15	
Recognition and Measurement	SFFAS16¶9&11	H20.110-.111
See also - General Plant, Property, and Equipment		
Human Capital	SFFAS8	H60
Definition	SFFAS8¶89-90	H60.100-.101
Non-authoritative Guidance - Illustration of Annual Stewardship Information	SFFAS8 Appendix B	H60.4000
Measurement	SFFAS8¶91-93	H60.102-.104
Reporting	SFFAS8¶91-95	H60.102.-106
I		
Indian Trust Funds	I1¶1-4	R40.1000-.1003
Insurance and Guarantee Programs	SFFAS5	I40
Accounting for Liabilities of	SFFAS5¶104-105, & 114	I40.107-.109
	SFFAS5¶117-120	I40.114-.116
Accounting for Revenue	SFFAS7¶284	I40.110
Additional Disclosure for - Insurance and Guarantee Programs Administered by Government Corporations	SFFAS5¶106	I40.111
Liability Recognition, Disclosure and Supplementary Reporting - Non-authoritative Guidance	SFFAS5¶107-113	I40.4000-.4007
Nature of	SFFAS5¶97-103	I40.100-.106
	SFFAS25¶4	I40.108
Whole life Policies	SFFAS5¶115-116	I40.112-.113
Whole life Policies - Accounting for	SFFAS5¶117-120	I40.114-.117
Additional Disclosure	SFFAS5¶121	I40.118
Interest - See Revenue, Gains & Losses and Other Financing Sources		
- On Direct Loans - See Loans		
- On Treasury Securities - See Investment in Treasury Securities		
Interest Method - See Investment in Treasury Securities		
Interest Payable	SFFAS1	I50
Intragovernmental Assets and Liabilities - See Governmental and Intragovernmental Assets and Liabilities		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Inventory Held for Sale - See Inventories including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair		
Inventory Held for Repair - See Inventories including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair		
Inventory Held In Reserve - See Inventories including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair		
Inventories Including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair	SFFAS3	I60
Computing Cost of Goods Sold	SFFAS3¶25	I60.108
Excess, Obsolete, and Unserviceable Inventory	SFFAS3¶29-31	I60.112-.114
Definitions & Categories	SFFAS3¶17-19	I60.100-.102
Disclosure Requirements.	SFFAS3¶35	I60.119
Other Categories of Inventory	SFFAS3¶27-34	I60.110-118
Inventory Held for Repair	SFFAS3¶32-34	I60.116-.118
Inventory Held in Reserve for Future Sale	SFFAS3¶27-28	I60.110-.111
Valuation	SFFAS3¶20-24	I60.103-.107
Valuation - Exception to	SFFAS3¶26	I60.109
Investment in Human Capital - See Human Capital		
Investment in Non-federal Property - See Non-federal Physical Property		
Investment in Research and Development - See Research and Development		
Investment in Treasury Securities	SFFAS1; SFFAS7	I80
Disclosure of Market Value	SFFAS1¶72	I80.112
Initial Recording	SFFAS1¶68-69	I80.108-.109
Interest on Treasury Securities Held by Revolving Funds	SFFAS7¶322-325	I80.127-.130
Interest on Treasury Securities Held by Trust Funds	SFFAS7¶228-229	I80.104-.105
Interest on Treasury Securities: Nonexchange Transfers - Intragovernmental Revenue	SFFAS7¶306-308 & 257	I80.121-.124

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Investment Reclassification	SFFAS1¶73	I80.113
Revenue Recognition -		
Classification of Interest on Intragovernmental Balances	SFFAS7¶154-160	I80.114-.120
Retirement of Treasury		
Securities Prior to Maturity: Trust Funds and Special Funds (except Trust Revolving Funds	SFFAS7¶311-312	I80.125-.126
Retirement of Debt Securities Prior to Maturity: Revolving and Trust Revolving Funds	SFFAS7¶329-330	I80.131-.132
Scope	SFFAS1¶62-65	I80.100-.103
Separate Accounting and Reporting for Federal and Nonfederal Securities	SFFAS1¶67	I80.107
Treasury Securities Expected to be Held to Maturity	SFFAS¶166	I80.106
Valuation Subsequent to Acquisition	SFFAS1¶70-71	I80.110-.111

J

K

L

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Land	SFFAS6	L10
as General Property, Plant, and Equipment	SFFAS6¶17,18,21 as amended by SFFAS23¶9,22-25	L10.2-.108
Categories of General PP&E Applicable to Land	SFFAS6¶21 as amended by SFFAS23; SFFAS6¶22	L10.105-.104
Definitions	SFFAS6¶66-67	L10.100-.101
Land and Land Rights Acquired for or in Connection with Other General PP&E	SFFAS6¶25	L10.108
Land Rights	SFFAS6¶18	L10.104
Recognition & Measurement	SFFAS6¶26	L10.110
See also Stewardship Land		
See also Stewardship Reporting		
Latest Acquisition Costs - See Inventories Including Inventory Held for Sale; Inventory Held in Reserve, Excess, Obsolete and Unserviceable Inventory		
Leases	SFFAS5; SFFAS6	L20
Capital Leases - Defined	SFFAS5¶43; SFFAS6¶20	L20.100-.101

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Classification	SFFAS5¶43; SFFAS6¶20	L20.100-.102
Capital Lease Recognition and Measurement	SFFAS5¶44-46	L20.103-.105
Cost of General PP&E acquired under a Capital Lease	SFFAS6¶29	L20.106
Operating Leases - Defined	SFFAS6¶20 Fn 22; SFFAS5¶43	L20.100-.102
Operating Leases - Recognition and Measurement	SFFAS1¶58, 59 & 74	L20.107-108
Legal Representation Letter Guidance - See Liabilities		
Liabilities	SFFAS5	L40
Accounting for Treasury Judgment Fund Transactions	I2¶3-5	L40.1000-.1002
Assigning To Component Entities Costs and Liabilities that Result from Legal Claims against the Federal Government	TB2002-1	L40.2000-.2002
Audit Legal Representation Letter Guidance	TR1	L40.3000-.3008
Contingencies	SFFAS5¶35-42 as amended by SFFAS12¶11	L40.116-.123
Criteria for Disclosure	SFFAS5¶40-42	L40.121-.123
Criteria for Recognition	SFFAS5¶38 as amended by SFFAS12¶11 SFFAS5¶39	L40.119-.120
Definition and General Principle for Recognition of a liability	SFFAS5¶19-34	L40.100-.115
Events and Transactions	SFFAS5¶20-32	L40.101-113
Government-related and Government-acknowledged Events	SFFAS5¶26-32	L40.107-.113
Exchange Transactions	SFFAS5¶20-23	L40.101-.104
Litigation	SFFAS12¶11	L40.114
Measurability	SFFAS5¶34	L40.115
Non-authoritative Guidance - Illustrative Journal Entries Liability	I2 Appendix B	L40.4000-.4003
Recognition Criteria	SFFAS5 Figure 1	L40.4004
Nonexchange Transactions	SFFAS5¶22, 24&25	L40.102, .105&.106
Probable Future Outflow or Other Sacrifice of Resources	SFFAS5¶33 as amended by SFFAS12¶10	L40.114

See Also -
- Accounts Payable
- Advances and Prepayments
- Capital Leases
- Cleanup Costs

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Governmental and Intragovernmental Assets and Liabilities		
Federal Debt		
Insurance and Guarantee Programs		
Interest Payable		
Other Current Liabilities		
Pensions, Other Retirement Benefits, and Other Post-employment Benefits		
Social Insurance Programs		
Life Insurance Premiums - See Insurance and Guarantee Programs		
Loans and Loan Guarantees	SFFAS2; SFFAS18; SFFAS19	L60
Applicability of Standards	SFFAS2¶21	L60.100
Auditing Estimates for Direct Loan & Loan Guarantee Subsidies	TR3 Revised	L60.3000-.3047
Default Cost Estimates, Criteria	SFFAS2¶33-36	L60.115-.118
Direct Loans -		
Post-1991 Direct Loans	SFFAS2¶22	L60.101
Write-off	SFFAS2¶61	L60.143
Direct Loans and Loan Guarantees - Pre 1992	SFFAS2¶39&40	L60.121-.122
Foreclosed Property - Assets Converted from Held-for-Sale Assets to Operating Assets	SFFAS3¶90	L60.155
Assets Subject to Claims of Other Parties	SFFAS3¶87	L60.152
Definition	SFFAS3¶79-80	L60.144-.145
Disclosure Requirements	SFFAS3¶91	L60.156
Net Present Value	SFFAS3¶82-84	L60.147-.149
Net Realizable Value	SFFAS3¶85-86	L60.150.151
Receipts and Disbursements during the Holding period for Post-1991 Foreclosed Property	SFFAS3¶88	L60.153
Sale of	SFFAS3¶89	L60.154
Valuation	SFFAS3¶81	L60.146
Foreclosure of Post-1991 Direct Loans and Guaranteed Loans	SFFAS2¶57 as amended by SFFAS19¶7, SFFAS2¶58, SFFAS2¶57 as amended by SFFAS19¶7;SFFAS2¶60	L60.139-.142
Guidance for the Classification of Transactions	SFFAS7 Appendix B	L60.157-.166
Loan Guarantees		
Post-1991 Loan Guarantees	SFFAS2¶23	L60.102
Modification Disclosure	SFFAS2¶56	L60.138

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Modification of Direct Loans and Loan Guarantees	SFFAS2¶41-44	L60.123-.126
Direct Loans	SFFAS2¶45 as amended by SFFAS19¶6; SFFAS246 as amended by SFFAS19¶7; SFFAS2¶47-48	L60.127-.130
Direct Loans - Loans Sales	SFFAS2¶53-55	L60.135-137
Loan Guarantees	SFFAS2¶49 as amended by SFFAS19¶6 SFFAS2¶50 as amended by SFFAS19¶7 SFFAS2¶51-52	L60.131-.134
Non-authoritative Guidance - Technical Explanations and Illustrations	SFFAS2 Appendix B	L60.4000-.4188
Illustrative Reporting Formats for Reconciling Schedules	SFFAS¶18 Appendix B	L60.4189
Revenue and Expenses	SFFAS2¶37&38	L60.119-.120
Sale of Loans - See Modifications of Direct Loans - Loan Sales		
Subsidies, Technical Guidance - Preparing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act	TR6	L60.3048-.3096
Subsidy Amortization and Re-estimation	SFFAS2¶30 as amended by SFFAS19¶7 SFFAS2¶31 as amended by SFFAS19¶7 SFFAS2¶32 as amended by SFFAS18¶9 SFFAS18¶10&11	L60.110-.114
M		
Managerial Cost Accounting	SFFAS4	M20
Standards		
Costing Methodology	SFFAS4¶116-162	M20.154-.202
Cost Accumulation	SFFAS4¶117-119	.M20.157.159
Cost Assignment (incl. cost allocation	SFFAS¶4120-141	M20.160-.181
Allocating Costs	SFFAS4¶133-137	M20.173-.177
Assigning Common Costs	SFFAS4¶138-141	M20.178-.181
Assigning cots on a cause-and-effect basis	SFFAS4¶129-132	M20.169-.172
Directly tracing costs to outposts	SFFAS4¶126-128	M20.166-.168
Cost Benefit Considerations	SFFAS4¶142-143	M20.182-.183

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Selecting a Costing Methodology		
Activity-based Costing	SFFAS4¶148-153	M20.188-.193
Job Order Costing	SFFAS4¶154-156	M20.194-.196
Process Costing	SFFAS4¶157-159	M20.197-.199
Standard Costing	SFFAS4¶160-162	M20.200-202
Full Cost	SFFAS4¶89-104	M20.124-.140
Certain Cost Elements	SFFAS4¶93-104	M20.129-.140
Employee Benefits	SFFAS4¶93-97	M20.129-.133
Non-Production Costs	SFFAS4¶104	M20.140
Property, Plant and Equipment	SFFAS4¶102-103	M20.138-.139
Public Assistance Social Insurance Programs	SFFAS4¶98-101	M20.134-.137
Direct Costs	SFFAS4¶90	M20.126
Indirect Costs	SFFAS4¶91-92	M20.127-.128
Inter-Entity Costs	SFFAS4¶105-115	M20.141 -.153
Accounting and Implementation Guidance	SFFAS4¶108-110	M20.146-.148
Activities	SFFAS4¶106-107	M20.144-.145
Recognition Criteria	SFFAS4¶111-115	M20.149-.153
Interpretation: Accounting for Imputed Intra-Departmental Costs	I6¶9-15	M20.1100-1106
Interpretation: Accounting for Treasury Judgment Fund Transactions	I2¶3-5	M20.1000-.1002
Responsibility Segments	SFFAS4¶77-88	M20.111-.123
Defining	SFFAS4¶78-81	M20.113-.116
Purposes of Segmentation	SFFAS4¶82-85	M20.117-.120
Structuring Responsibility Segments	SFFAS4¶86-88	M20.121-.123
Requirements for Cost Accounting	SFFAS4¶67-76	M20.100-.110
Basic Cost Accounting Processes	SFFAS4¶71	M20.105
Complexity of Cost Accounting Processes	SFFAS4¶72-73	M20.106-.107
Cost Findings, Studies and Analyses	SFFAS4¶74-76	M20.108-.110
Need for Consistent Cost Accounting on a Regular Basis	SFFAS4¶68-70	M20.102-.104
Management's Discussion and Analysis	SFFAS15	M10
Market Value, Investments - See Investments in Treasury Securities		
Multi-Use Heritage Assets - See General Property, Plant, and Equipment - See Heritage Assets		

N

Non-Entity Assets - See Entity and Non-Entity Assets
Nonexchange Revenue - See Revenue, Gains & Losses, and Other

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Financing Sources		
Non-Federal Physical Property	SFFAS8	N60
Definition	SFFAS8¶83	N60.100
Measurement	SFFAS8¶84-86	N60.101-.103
Minimum Reporting	SFFAS8¶87	N60.104
Recommended Reporting	SFFAS8¶88	N60.105
See Also Stewardship Reporting		
Non-Recourse Loans and Purchase Agreements	SFFAS3	N80
Disclosure Requirements	SFFAS3¶109	N80.108
Non-Recourse Loans	SFFAS3¶93-95	N80.100-.102
Recognition of	SFFAS3¶96	N80.103
Purchase Agreements	SFFAS3¶97-98	N80.104-.105
Valuation of	SFFAS3¶102-103	N80.106-.107
Non-Valued Seized and Forfeited Property, Reporting on	TR4	S30.3000-.3013
O		
Operating Materials and Supplies	SFFAS3	O20
Categories of	SFFAS3¶37	O20.101
Definition	SFFAS3¶36	O20.100
Disclosure Requirements	SFFAS3¶50	O20.114
Other Categories of Operating Materials and Supplies	SFFAS3¶45-49	O20.109-.113
Excess, Obsolete, and Unserviceable Operating Materials and Supplies	SFFAS3¶47-49	O20.111-.113
Operating Materials and Supplies Held in Reserve f or Future Use	SFFAS3¶45-46	O20.109-.110
Recognition	SFFAS3¶38-41	O20.102-.105
Valuation Under the Consumption Method	SFFAS3¶42-44	O20.106-.108
Other Current Liabilities	SFFAS1	O40
Definition	SFFAS1¶83	O40.100
Disclosures	SFFAS1¶86	O40.103
Other Financing Sources - See Revenue, Gains & Losses and Other Financing Sources		
Other Post-Employment Benefits - See Pensions, Other Post-Employment Benefits, and Other Retirement Benefits		
Other Retirement Benefits - See Pensions, Other Post-Employment Benefits, and Other Retirement Benefits		
Outcome	SFFAS8¶93	H60.104

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Outer Continental Shelf	SFFAS7¶274	R40.108
Output	SFFAS8¶93	H60.104
P		
Payables - See Accounts Payable		
- See Interest Payable		
Penalties	SFFAS7¶61	R40.130
Pensions, Other Retirement Benefits, and Other Post-Employment Benefits	SFFAS5; I3 & I4	P20
Interpretations		
Accounting for Pension Payments in Excess of Pension Expense	I4¶9-15	P20.1100-.1105
Measurement Date for Pension and Retirement Health Care Liabilities	I3¶3-4	P20.1000-1001
Other Post-Employment Benefits	SFFAS5¶94-96	P20.138-.140
Other Retirement Benefits	SFFAS5¶79-93	P20.123-.137
Accounting by the Administrative Entity	SFFAS5¶88-89	P20.132-.133
Accounting for the ORB Plan	SFFAS5¶82-87	P20.126-.131
Accrual Period	SFFAS5¶84	P20.128
Assets	SFFAS5¶85	P20.129
Assumptions	SFFAS5¶83	P20.127
Attribution Method	SFFAS5¶82	P20.126
Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses	SFFAS5¶86-87	P20.130-.131
Accounting Illustration	SFFAS5¶93	P20.137
Employer Entity Accounting	SFFAS5¶90-92	P20.134-.136
Non-authoritative Guidance - Liability Recognition and Measurement Matrix	SFFAS5 Appendix B	P20.4000
Pensions	SFFAS5¶61-78	P20.105-.122
Accounting by the Administrative Entity	SFFAS5¶71-73	P20.115-.117
Accounting for the Pension Plan	SFFAS5¶63-70	P20.107-.114
Assets	SFFAS5¶68	P20.112
Assumptions	SFFAS5¶65-67	P20.109-.111
Attribution Methods	SFFAS5¶64	P20.108
Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses	SFFAS5¶69-70	P20.113-.114

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Accounting Illustration	SFFAS5¶77-78	P20.121-.122
Employer Entity Accounting	SFFAS5¶74-76	P20.118-.120
Premium on Bonds - See Investment in Treasury Securities		
Prepayments - See Advances and Prepayments		
Prior Period Adjustments	SFFAS21; SFFAS6; SFFAS7; & SFFAS16	P40
Changes in Accounting Principles	SFFAS21¶12-13	P40.102-.103
Correction of Errors	SFFAS21¶10-11	P40.100-.101
Implementation Guidance Requiring Prior Period Adjustments - Cleanup Costs	SFFAS6¶104-105	P40.104.-.105 & C40.119-.120
General Property, Plant and Equipment	SFFAS6¶43	P40.106 & G20.125
Heritage Assets	SFFAS6¶65; SFFAS16¶14	P40.107-.108 & H20.103-.104
Stewardship Land	SFFAS6¶75-76	P40.108-.109
Multi-Use Heritage Assets	SFFAS16¶15	P40.110; G20.138; & H20.112
Stewardship PP&E	SFFAS6¶106	P40.112
Probable - See Liabilities		
Progress Payments - See Accounts Payable - See Advances and Prepayments		
Property, Plant, and Equipment - See General Property, Plant, and Equipment - Heritage Assets - Stewardship Land - Stewardship Reporting		
Purchase Agreements - See Non-Recourse Loans and Purchase Agreements		
R		
Receivables	SFFAS1; SFFAS7	R10
Accounts Receivable	SFFAS1¶40, 41 as amended by SFFAS7¶53, 42-56	R10.100-.117
Entity vs. Non-Entity Receivables	SFFAS1¶43	R10.104
Measurement of Losses	SFFAS1¶46-51	R10.107-.112
Group Analysis	SFFAS1¶49-51	R10.110-.112
Individual Account Analysis	SFFAS1¶47-48	R10.108-.109
Recognition	SFFAS1¶41 as amended by SFFAS7¶53	R10.101-.102
Recognition of Losses Due to Uncollectible Amounts	SFFAS1¶44-45	R10.105-.106
Separate Reporting	SFFAS1¶42	R10.103
Disclosure	SFFAS1¶52	R10.113

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Interest Receivable	SFFAS1¶53-56	R10.114-.117
Receivables from Tax Assessments	SFFAS7¶53-56	R10.118-121
Allowance for Uncollectible Amounts	SFFAS7¶56	R10.121
Compliance Assessments and Pre-Assessment Work in Progress	SFFAS7¶55	R10.120
Refunds - See Revenue, Gains & Losses, and Other Financing Sources: Exchange Revenue and Nonexchange Revenue		
Rents and Royalties - See Revenue, Gains & Losses, and Other Financing Sources: Guidance for the Classification of Transactions, Table of Transactions		
Repair Allowances - See Inventories Including Inventory Held for Sale; Inventory Held in Reserve; Excess, Obsolete and Unserviceable Inventory; & Inventory Held for Repair		
Research and Development	SFFAS8	R20
Definition	SFFAS8¶96	R20.100
Measurement	SFFAS8¶97-99	R20.101-.103
Minimum Reporting	SFFAS8¶100	R20.104
Non-Authoritative Guidance - Sample Report Illustration	SFFAS8¶Appendix B	R20.4000
Recommended Reporting	SFFAS8¶101	R20.105
Required Supplementary Information		
Deferred Maintenance	SFFAS6¶83-84 as amended by SFFAS14¶8-9	D20.105-.106
Insurance & Guarantee Programs	SFFAS5¶105 as amended by SFFAS25¶4	I40.108
Social Insurance Programs	SFFAS25¶6-7	S40.111 & .114
Required Supplementary Stewardship Information		
Heritage Assets - Minimum Reporting Requirements	SFFAS8¶50 as amended by SFFAS14¶10-11 & SFFAS16¶18	H20.113
Human Capital Reporting	SFFAS8¶91-95	H60.102.-106
Research and Development - Minimum & Recommended Reporting	SFFAS8¶100-101	R20.104-.105
Social Insurance Programs - Agency Reporting Requirements	SFFAS17¶24-28	S40.110 & .112-.114
Consolidated Government-wide Entity	SFFAS17¶31-33	S40.118.120
Stewardship Land	SFFAS8¶81 as amended by SFFAS14¶10-11	S60.112
Stewardship Reporting	SFFAS8¶34-35	S70.127-.128
Restricted Cash - See Cash		
Restricted Fund Balance - See Fund Balance with Treasury		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Revenue, Gains & Losses and Other Financing Sources	SFFAS7; SFFAS22; I1; I5; TB2002-2	R40
Accountability for Dedicated Collections	SFFAS7¶83-87	R40.145-.149
Appropriations - See Recognition and Measurement of Other Financing Sources below		
Exchange Revenue	SFFAS7¶33-47	R40.102-.116
Disclosures & Other Accompanying Information	SFFAS7¶46-47	R40.115-.116
Recognition & Measurement	SFFAS7¶34-45	R40.103-.114
Guidance for the Classification of Transactions - Revenue, Gains & Losses and Other Financing Sources	SFFAS7 Appendix B ¶235-238, 240-350	R40.150-.264
Table of Transactions: Reference Table follows R10.155		
Interpretations - Recognition by Recipient Entities of Receivable Nonexchange Revenue	I5¶1-2	R40.1100-.1101
Reporting on Indian Trust Funds	I1¶1-4	R40.1000-.1003
Nonexchange Revenue	SFFAS7¶48-69	R40.117-.138
Disclosures, Supplementary Information & Other Accompanying Information	SFFAS7¶64, 65 as amended by SFFAS20¶6, 66-69	R40.133-.138
Donations	SFFAS7¶62	R40.131
Fines & Penalties	SFFAS7¶61	R40.130
Other Nonexchange Revenue	SFFAS7¶63	R40.132
Recognition & Measurement - The General Standard	SFFAS7¶48	R40.117
Taxes and Duties - Measurement by the Collecting Entities	SFFAS7¶49	R40.118
Accrual Adjustment	SFFAS7¶52	R40.121
Accounts Receivable	SFFAS7¶53-54	R40.122-.123
Allowance for Uncollectible Amounts	SFFAS7¶56	R40.125
Amounts Payable for Refunds	SFFAS7¶57	R40.126
Cash Collections	SFFAS7¶50	R40.119
Cash Refunds	SFFAS7¶51	R40.120
Compliance Assessments & Pre-Assessment Work-in-Process	SFFAS7¶55	R40.124
Deposits	SFFAS7¶59	R40.128
Other Claims for Refunds	SFFAS7¶58	R40.127
Revenue Recognized by the Recipient Entity	SFFAS7¶60	R40.129
Other Financing Sources	SFFAS7¶70-75	R40.139-.144
Recognition and Measurement of		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Other Financing Sources	SFFAS7¶71-75	R40.140-.144
Appropriations	SFFAS7¶71-72	R40.141-.142
Financing Imputed for Cost Subsidies	SFFAS7¶73	R40.142
Transfers of Assets	SFFAS7¶74-75	R40.143-.144
Scope	SFFAS7¶30-31	R40.100-.101
Technical Guidance - Disclosures Required by Paragraph 79(g) of SFFAS7	TB2002-2	R40.2000-2004
See also Transactions not Recognized as Revenue, Gains, or Other Financing Sources		
Risk Assumed - See Insurance and Guarantee Programs		
S		
Seized and Forfeited Property	SFFAS3; SFFAS6; SFFAS7; TR4	S30
Forfeited Property	SFFAS3¶67-78, SFFAS6¶33, & SFFAS7¶264-269	S30.110-.129
Definition	SFFAS3¶68	S30.112
Disclosure Requirements	SFFAS3¶78	S30.129
Recognition and Valuation	SFFAS3¶69-77, SFFAS6¶33, & SFFAS7¶264-269	S30.113-.128
Revenue Recognition	SFFAS7¶264-269 SFFAS3¶72&75	S30.121-.128
Seized Property	SFFAS3¶57-66	S30.100-.109
Definition	SFFAS3¶59	S30.102
Disclosure Requirements	SFFAS3¶66	S30.109
Recognition	SFFAS3¶60-62	S30.103-.105
Valuation	SFFAS3¶63	S30.106
Exceptions to Valuation	SFFAS3¶64-65	S30.107-.108
Technical Guidance - Reporting on Non-Valued Seized and Forfeited Property	TR4	S30.3000-.3013
Social Insurance Programs	SFFAS17	S40
Accounting Standards - Scope of; - Applicability of	SFFAS17¶14	S40.100
Accounting and Reporting Standard - Component Entity -	SFFAS17¶22-28	S40.108-.114
Expense and Liability Recognition	SFFAS17¶22-23	S40.108-.109
Required Supplementary Information	SFFAS17¶24 as amended by SFFAS25¶6&7	S40.111

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Required Supplementary Stewardship Information	SFFAS17¶24 as amended by SFFAS25¶6&7, SFFAS17¶25-27	S40.110-.114
Transition	SFFAS17¶28	S40.114
Accounting and Reporting Standard - Government-wide Entity	SFFAS17¶29-33	S40.116-.120
Expense and Liability Recognition	SFFAS17¶30	S40.117
Required Supplementary Stewardship Information	SFFAS17¶31-32	S40.118-.119
Statement of Social Insurance	SFFAS¶17 as amended by SFFAS25¶6&7	S40.111
Transition	SFFAS17¶33	S40.120
Characteristics of Social Insurance Programs	SFFAS17¶15-21	S40.101-.107
Non-authoritative Guidance - Sample Reporting	SFFAS17 Appendix B	S40.4000-.4072
Software	SFFAS10	S50
Definitions	SFFAS10¶8	S50.100
Disclosures	SFFAS10¶35	S50.127
Implementation	SFFAS10¶36	S50.128
Recognition, Development & Disclosure	SFFAS10¶15-34	S50.107-126
Amortization	SFFAS10¶32-34	S50.124-.126
Capitalizable Cost	SFFAS10¶16-18	S50.108-.110
Capitalization Thresholds	SFFAS10¶24	S50.116
Cutoff for Capitalization	SFFAS10¶19	S50.112
Bundled Products & Software	SFFAS10¶23	S50.115
Data Conversion Cost	SFFAS10¶20	S50.111
Enhancements	SFFAS10¶25-27	S50.117-119
Impairment	SFFAS10¶28-31	S50.120-.123
Developmental Software	SFFAS10¶31	S50.123
Post-implementation/Operational Software	SFFAS10¶28-30	S50.120-.122
Integrated Software	SFFAS10¶22	S50.114
Multiuse Software	SFFAS10¶21	S50.113
Software Development Phases	SFFAS10¶10-14	S50.102-.106
Technical Guidance	TR5	S50.3000-.3014
Stewardship Land	SFFAS6; SFFAS8; SFFAS14	S60
Definition	SFFAS6¶66-68; SFFAS8¶71-74	S60.100-.103
Implementation Guidance	SFFAS8¶82; SFFAS6¶75-76	S60.113-.115
Measurement	SFFAS6¶70-73; SFFAS8¶75-80	S60.104-.110

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Minimum Reporting	SFFAS6¶69, SFFAS8¶81 as amended by SFFAS14¶10-11	S60.111-.112
Non-authoritative Guidance - Stewardship Land Reporting	SFFAS8 Appendix B	S60.4000
Stewardship Reporting	SFFAS8; SFFAS17; SFFAS25	S70
Applicability	SFFAS8¶38 as amended by SFFAS25TP6	S70.131
Background & Rationale	SFFAS8¶5-6	S70.103-.104
Financial Condition	SFFAS8¶10	S70.108
Nature of Stewardship Reporting	SFFAS8¶19-21	S70.114-.116
Measurement	SFFAS8¶24-27	S70.119-.122
Performance Indicators	SFFAS8¶29	S70.124
Reporting Program Expenses	SFFAS8¶30-31	S70.125-.126
Split Grants	SFFAS8¶28	S70.123
Purpose	SFFAS8¶1-3	S70.100-.102
Reporting Requirements	SFFAS8¶34-35; SFFAS17¶24; SFFAS25¶6&7	S70.127-.130
Stewardship Categories or Elements	SFFAS8¶17 as amended by SFFAS¶23 SFFAS8¶18	S70.112-.113
Stewardship Information	SFFAS8¶22-23	S70.117-.118
Stewardship Investments	SFFAS8¶12-13	S70.110-.111
Stewardship & the Reporting Objectives	SFFAS8¶7-9	S70.105-.107
Stewardship PP&E	SFFAS8¶11 as amended by SFFAS¶23	S70.109
See Also Cleanup Costs		
Deferred Maintenance		
Stockpile Materials	SFFAS3	S80
Definition	SFFAS3¶51	S80.100
Disclosure Requirements	SFFAS3¶56	S80.105
Held for Sale	SFFAS3¶55	S80.104
Recognition	SFFAS3¶52	S80.101
Valuation	SFFAS3¶53	S80.102
Exception to Valuation	SFFAS3¶54	S80.103

T

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT
Accounting for Treasury Judgment Fund Transactions	I2¶3-5	L40.1000-.1002; M20.1000-.1002
Treasury Securities - See Investment in Treasury Securities		

TOPIC	ORIGINAL PRONOUNCEMENTS #	CURRENT TEXT

Transactions Not Recognized as Revenue, Gains, or Other Financing Sources . . . . . SFFAS7 . . . . . T30
Table of Transactions . . . . . SFFAS7 Appendix B . . . . . Follows T30.100

U

V

W

Appendix B: Effective Dates of Statements, Interpretations, and Technical Releases

Concept		Effective for Fiscal Periods Ending After
SFFAC 1	Objectives of Federal Financial Reporting	
SFFAC 2	Entity and Display	
SFFAC 3	Management's Discussion and Analysis	
SFFAC 4	Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government	

Statement		
SFFAS 1	Accounting for Assets and Liabilities	9/30/93
SFFAS 2	Accounting for Direct Loans and Loan Guarantees	9/30/93
SFFAS 3	Accounting for Inventory and Related Property	9/30/93
SFFAS 4	Managerial Cost Accounting Standards	9/30/97
SFFAS 5	Accounting for Liabilities of the Federal Government	9/30/96
SFFAS 6	Accounting for Property, Plant, and Equipment	9/30/97
SFFAS 7	Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting	9/30/97
SFFAS 8	Supplementary Stewardship Reporting	9/30/97
SFFAS 9	Deferral of Implementation Date for SFFAS 4	9/30/97
SFFAS 10	Accounting for Internal Use Software	9/30/00
SFFAS 11	Amendments to Accounting for PP&E—Definitions	9/30/98
SFFAS 12	Recognition of Contingent Liabilities from Litigation	9/30/97
SFFAS 13	Deferral of Paragraph 65.2—Material Revenue-Related Transactions Disclosures	9/30/98
SFFAS 14	Amendments to Deferred Maintenance Reporting	9/30/98
SFFAS 15	Management's Discussion and Analysis	9/30/99
SFFAS 16	Amendments to Accounting for Property, Plant, and Equipment—Multi-Use Heritage Assets	9/30/99
SFFAS 17	Accounting for Social Insurance	9/30/99
SFFAS 18	Amendments To Accounting Standards For Direct Loans and Loan Guarantees In Statement of Federal Financial Accounting Standards No. 2	9/30/00
SFFAS 19	Technical Amendments to Accounting Standards for Direct and Guaranteed Loans	9/30/02
SFFAS 20	Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs and Others	9/30/00
SFFAS 21	Reporting Corrections of Errors and Changes in Accounting Principles	9/30/01
SFFAS 22	Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations	9/30/00
SFFAS 23	Eliminating the Category National Defense PP&E	9/30/02

(Continued From Previous Page)

SFFAS 24	Selected Standards for the Consolidated Financial Report of the United States Government	9/30/01
SFFAS25	Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessements	9/30/02

Technical Bulletin		**Date Issued**
2000-1	Federal Accounting Standards Advisory Board Technical Bulletin 2000-1	6/1/00
2002-1	Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government	7/1/02
2002-2	Disclosures Required by Paragraph 79(g) of SFFAS 7	9/1/02
2003-1	Certain Questions and Answers Related to the Homeland Security Act of 2002	6/1/03

Interpretations		**Date Issued**
I-1	Reporting on Indian Trust Funds	3/12/97
I-2	Accounting for Treasury Judgment Fund Transactions	3/12/97
I-3	Measurement Date for Pension and Retirement Health Care Liabilities	8/29/97
I-4	Accounting for Pension Payments In Excess of Pension Expense	12/19/97
I-5	Recognition by Recipient Entities of Receivable Nonexchange Revenue	12/98
I-6	Accounting for Imputed Intra-departmental Costs	6/00

Technical Releases		**Date Issued**
TR-1	Audit Legal Letter Guidance	3/1/98
TR-2	Environmental Liabilities Guidance	3/15/98
TR-3	Preparing and Auditing Estimates for Direct and Guaranteed Loans	2/99
TR-3 Revised	Auditing Estimates for Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act	1/04
TR-4	Reporting on Non-valued Seized and Forfeited Property	7/31/99
TR-5	Implementation Guidance on SFFAS 10: Accounting for Internal Use Software	5/14/02
TR-6	Preparing Estimates for Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act	1/04

Appendix C: 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

This Memorandum of Understanding reflects the agreement of the Government Accountability Office ("GAO"), the Department of the Treasury ("Treasury"), and the Office of Management and Budget ("OMB") on the procedures to be followed in setting federal government accounting standards and the composition and operation of the Federal Accounting Standards Advisory Board.

Whereas GAO, Treasury, and OMB conduct a continuous program for improving accounting and financial reporting in the federal government; and

Whereas the Comptroller General, the Secretary of the Treasury, and the Director of the Office of Management and Budget established an advisory board under the Federal Advisory Committee Act, as amended (5 U.S.C. App.), to consider and recommend accounting concepts and standards for the federal government;

The Comptroller General, the Secretary of the Treasury, and the Director of the Office of Management and Budget (the Sponsors) each hereby agree to continue and serve as sponsors of the Federal Accounting Standards Advisory Board ("Board"). The Board will work under the general oversight of its Sponsors. In addition, the Sponsors each hereby agree to take related actions regarding federal government accounting standards. The Board shall be established as follows:

Section 1. Establishment.

A. Composition. The Board shall have the following ten members:

- one GAO member,
- one OMB member,
- one Treasury member,
- one member from the Congressional Budget Office (CBO), and
- six non-federal members selected from the general financial community, the accounting and auditing community, and academia.

B. Selections and Appointments. The GAO, OMB, Treasury and CBO members will be selected by their respective agencies. The six non-federal members will be selected by the Sponsors. In selecting the non-federal members, the Sponsors shall:

(1) seek nominations from a wide variety of sources, including the Director of CBO;

(2) consider, among other criteria, an individual's

(A) broad professional background, and

(B) expertise in federal government accounting, financial reporting, and financial management; and consider the recommendations of a panel convened by the chairperson.

The Sponsors will select a chairperson, who will be a non-federal member. At least one Sponsor shall obtain the view of the Director of CBO before any appointments or selections of non-federal members are made.

C. Tenure. The GAO, OMB, Treasury and CBO members shall serve at the discretion of their respective agency heads. The six non-federal members will serve initial terms of up to five years with a possible reappointment for one additional term of up to five years.

D. Duties. The Board will consider accounting concepts and standards. The Board will not set or propose budget concepts, standards, and principles. In considering accounting concepts and standards, consideration will be given to the budgetary information needs of executive agencies and the needs of users of Federal financial information. Board recommendations on accounting concepts or standards will be submitted to the Comptroller General, the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Director of the Congressional Budget Office.

E. Meetings and Agendas. The Board will meet whenever necessary or at the request of the Comptroller General, the Secretary of the Treasury, or the Director of OMB, and will establish detailed working procedures. Board members will be expected to attend all meetings.

F. Funding. The Sponsors shall share in funding the Board on an equitable basis. The Director of CBO shall fund the Board to the same extent as the Secretary of the Treasury.

Section 2. Support Staff and Other Groups.

A. Staff. A core group of qualified technical staff will support the Board in carrying out its duties and functions. The staff will spend its time working on Board matters and, from time to time, may be augmented with staff assigned from government departments or agencies or other organizations.

B. Task Forces. The Board may appoint task forces as necessary to advise it on a variety of accounting matters. Task forces will play an important role in the accounting standard-setting process. They will provide expert views and recommend solutions to issues or problems. A task force shall include a CBO member if the Director of CBO wishes to participate in the task force and concludes that CBO has expertise in the issue or problem being addressed.

Section 3. Accounting Standard-Setting Process. The Board will follow a six-step process for considering accounting standards. The steps in the process are:

(1) Identification of accounting issues and agenda decisions,

(2) Preliminary deliberations,

(3) Preparation of initial documents (issues papers and/or discussion memorandums),

(4) Release of documents to the public, public hearings, and considerations of comments,

(5) Further deliberations, exposure draft, and consideration of comments, and

(6) General consensus (at least a majority vote) reached among Board members and documents submitted to the Comptroller General, the Secretary of the Treasury, the Director of OMB and the Director of CBO.

The Board will determine the detailed procedures necessary to implement these steps.

Section 4. Concepts and Standards. Concepts and standards provide a frame of reference for resolving accounting issues.

When the Board has developed a proposed concept or standard, the Board shall submit it to the Comptroller General, the Director of OMB, the Secretary of the Treasury and the Director of CBO for their review. If, within 90 days after its submission, the Comptroller General or the Director of OMB, or both, objects to the concept or standard, then it shall not be issued and will be returned to the Board for further consideration. If, within 90 days after its submission, neither of these officials objects to the concept or standard, then it shall be issued and become a final concept or standard of the Board. Concepts and standards will be announced in *The Federal Register*.

A proposed Interpretation or Technical Release shall be submitted to the members of the Board representing the three Sponsors for their review. If, within 45 days after its submission, any one of the members representing a Sponsor objects to the proposed Interpretation or Technical Release, then it shall be returned to the Board for further consideration. If, within 45 days after its submission, none of these officials objects to the Interpretation or Technical Release, then it shall become final. Final Interpretations and Technical Releases will be announced in *The Federal Register*.

The Sponsors agree that standards set and promulgated following the Board's Rules of Procedure are recognized to have substantial authoritative support, and those accounting standards contrary to such promulgation are not. The Sponsors retain their authorities, separately and jointly, to establish and adopt accounting standards for the federal government.

Section 5. Transition. Each of the non-federal members serving on January 11, 2002 shall have their current term extended to June 30, 2004, and be eligible for an additional term of up to five years to the extent total service on the Board does not exceed 10 years.

Section 6. Termination. Any modification to this memorandum shall be effective if agreed to by each of the three signatory agencies. This memorandum shall remain in effect until 120 days after one of the Sponsors provides notice of intent to terminate the agreement.

Section 7. Effective Date. This memorandum of understanding is effective when executed by the Sponsors except that provisions involving the Congressional Budget Office will become effective on October 1, 2003.

/s/

John W. Snow — May 7, 2003
Secretary of the Treasury

/s/

Mitchell Daniels — May 7, 2003
Director, Office of Management
and Budget

/s/

David M. Walker — May 7, 2003
Comptroller General of the
United States

Appendix D: Federal Accounting and Auditing Resources

[This appendix lists sources where one can get "individual documents that are issued between updates" of the Codification. "These and other relevant resources" are listed here.]

FASAB – www.fasab.gov

Office of Management and Budget – www.whitehouse.gov/omb

Government Accountability Office – www.gao.gov

Treasury Financial Management Service – www.fms.treas.gov

Appendix E: Cross-Reference Table
Original Pronouncements to Current Text

Original Pronouncement Reference	Current Text Reference(s)
Statements of Federal Financial Accounting Standards:	
SFFAS1¶1-14	Introduction
SFFAS1¶15	Effective Date
SFFAS1¶16-17	Discussion
SFFAS1¶18-24	G60.100-.106
SFFAS1¶25-26	E30.100-.101
SFFAS1¶27-30	C20.100-.103
SFFAS1¶31-39	F50.100-.108
SFFAS1¶40	R10.100
SFFAS1¶41 as amended by SFFAS7¶53	R10.101
SFFAS1¶42	R10.103
SFFAS1¶43	R10.104
SFFAS1¶44-56	R10.105-.117
SFFAS1¶57	A30.100
SFFAS1¶58-59	A30.101-.102; L20.107
SFFAS1¶60-61	A30.103-.104
SFFAS1¶62-65	I80.100-.103
SFFAS1¶66-73	I80.106-.113
SFFAS1¶74	A10.100; L20.108
SFFAS1¶75 - 80	A10.101-.106
SFFAS1¶81-82	I50.100-.101
SFFAS1¶83-86	O40.100-.103
SFFAS1¶87- 161 Appendix A	Basis for Conclusions
SFFAS1¶ Appendix B Illustration	I80.4000-4004
SFFAS1¶Appendix C Glossary	Glossaries by Subject Area Section
SFFAS2¶1-19	Discussion & Background
SFFAS2¶20	Effective Date
SFFAS2¶21-23	L60.100-.102
SFFAS2¶24 as amended by SFFAS19¶6	L60.103
SFFAS2¶25-26	L60.104-.105
SFFAS2¶27	Rescinded by SFFAS19
SFFAS2¶28-29	L60.108-.109
SFFAS2¶30-31 as amended by SFFAS19¶7	L60.110-111

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS2¶32 as amended by SFFAS18¶9	L60.112
SFFAS2¶33-44	L60.115-.126
SFFAS2¶45 as amended by SFFAS19¶6	L60.127
SFFAS2¶46 as amended by SFFAS19¶7	L60.128
SFFAS2¶47-48	L60.129-130
SFFAS2¶49 as amended by SFFAS19¶6	L60.131
SFFAS2¶50 as amended by SFFAS19¶7	L60.132
SFFAS2¶51-56	L60.133-.138
SFFAS2¶57 as amended by SFFAS19¶7	L60.139
SFFAS2¶58	L60.140
SFFAS2¶59 as amended by SFFAS19¶7	L60.141
SFFAS2¶60-61	L60.142-.143
SFFAS2¶62-128 Appendix A	Basis for Conclusions
SFFAS2 Appendix B Technical Explanations & Illustrations	L60.4000-.4188
SFFAS2¶ Appendix C Glossary	L60 Glossary
SFFAS3¶1-3	Discussion
SFFAS3¶4-15	Introduction
SFFAS3¶16	Effective Date
SFFAS3¶17-31	I60.100-.114
SFFAS3¶32-35	I60.106-.119
SFFAS3¶36-50	O20.100-.114
SFFAS3¶51-56	S80.100-.105
SFFAS3¶57-67	S30.100-.110
SFFAS3¶68-70	S30.112-.114
SFFAS3¶71	S30.116
SFFAS3¶72	S30.124
SFFAS3¶73-74	S30.117-118
SFFAS3¶75	S30.128
SFFAS3¶76 as amended by SFFAS7¶264	S30.119
SFFAS3¶77	S30.120
SFFAS3¶78	S30.129
SFFAS3¶79-91	L60.144-.156
SFFAS3¶92	G40.100
SFFAS3¶93-95	G40.101-.103; N80.100-.102

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS3¶96-98	N80.103.-.105
SFFAS3¶99-101	G40.104-.106
SFFAS3¶102-103	N80.106-.107
SFFAS3¶104-108	G40.107-.111
SFFAS3¶109	G40.112; N80.108
SFFAS3¶110-162; Appendix A	Basis for Conclusions
SFFAS3 Glossary	Glossaries by Subject Area Section
SFFAS4¶1-29	Discussion
SFFAS4¶30	Effective Date
SFFAS4¶1-40	Discussion
SFFAS4¶41-66	Managerial Cost Concepts Statement
SFFAS4 Standards ¶	M20.100
SFFAS4¶67-76	M20.101-110
SFFAS4 Standards ¶	M20.111
SFFAS4¶77-88	M20.112-.123
SFFAS4 Standards ¶	M20.124
SFFAS4¶89-104	M20.125-.140
SFFAS4 Standards ¶	M20.141-.142
SFFAS4¶105-115	M20.143-.153
SFFAS4 Standards ¶	M20.154-.155
SFFAS4¶116-162	M20.156-202
SFFAS4¶163-270 Appendix A	Basis for Conclusions
SFFAS4 Appendix B Glossary	M20 Glossary
SFFAS5¶ Figure 1	L40.4004
SFFAS5¶1-12	Background & Discussion
SFFAS5¶13	Effective Date
SFFAS5¶14-18	Discussion
SFFAS5¶19-32	L40.100-.113
SFFAS5¶33 as amended by SFFAS12¶10	L40.114
SFFAS5¶34-35	L40.115-.116
SFFAS5¶36 as amended by SFFAS12¶11	L40.117
SFFAS5¶37	L40.118
SFFAS5¶38 as amended by SFFAS12¶11	L40.119
SFFAS5¶39-42	L40.120-.123
SFFAS5¶43	L20.100&.101

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS5¶44-46	L20.103-105
SFFAS5¶47-55	F10.100-.108
SFFAS5¶ Figure 2	F10.4000
SFFAS5¶56-96	P20.100-.140
SFFAS5¶97-104	I40.100-.107
SFFAS5¶105, as amended by SFFAS25¶	I40.108
SFFAS5¶106	I40.111
SFFAS5¶107-110	I40.4000-.4003
SFFAS5¶ Table 9	I40.4004
SFFAS5¶111-113	I40.4005-.4007
SFFAS5¶114	I40.109
SFFAS5¶115-121	I40.112-.118
SFFAS5¶122-193 Appendix A	Basis for Conclusions
SFFAS5¶ Appendix B Illustration	F10 & P20 as Non-authoritative Illustrations; Editorial Deletion[a]
SFFAS5¶ Appendix C Glossary	Glossaries by Subject Area Section
SFFAS6¶1-15	Background
SFFAS6¶16	Effective Date
SFFAS6¶17-18	G20.100-.101; L10.103-.104
SFFAS6¶19	G20.102
SFFAS6¶20	L20.100.
SFFAS6¶20 Fn 22	L20.102
SFFAS6¶21 as amended by SFFAS23¶9	G20.103; L10.105
SFFAS6¶22	G20.104; L10.106
SFFAS6¶23	G20.105; L10.102
SFFAS6¶24-26	G20.106-.108; L10.107-.109
SFFAS6¶27-28	Rescinded by SFFAS10
SFFAS6¶29	G20.109; L10.110; L20.106
SFFAS6¶30-32	G20.110-.112; L10.111-.113
SFFAS6¶33	G20.113; L10.114; S30.115
SFFAS6¶34	G20.116; L10.115
SFFAS6¶35 as amended by SFFAS23¶9	G20.117
SFFAS6¶36-42	G20.118-.124
SFFAS6¶43	G20.125; P40.106
SFFAS6¶44-45	G20.126-.127

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS6¶46-56	Rescinded by SFFAS23
SFFAS6¶57-58	H20.100-.101
SFFAS6¶59-63	Superseded by SFFAS16
SFFAS6¶64	H20.108
SFFAS6¶65	H20.104; P40.108
SFFAS6¶66	L10.100; S60.100
SFFAS6¶67	L10.101; S60.100; Editorial Deletion
SFFAS6¶68	G20.107; S60.103
SFFAS6¶69	S60.111
SFFAS6¶70-73	S60.107-.110
SFFAS6¶74	Editorial Deletion
SFFAS6¶75-76	P40.108-.109; S60.114-.115
SFFAS6¶77-78	D20.100-.101
SFFAS6¶79	Superseded by SFFAS14
SFFAS6¶80 as amended by SFFAS14¶6	D20.102
SFFAS6¶81-82	D20.103-.104
SFFAS6¶83 as amended by SFFAS14¶8	D20.105
SFFAS6¶84 as amended by SFFAS 14¶9	D20.106
SFFAS6¶85-103	C40.100-.118
SFFAS6¶104-105	C40.119-.120; P40.104-.105
SFFAS6¶106	C40.121; P40.112
SFFAS6¶107-111	C40.122-.126
SFFAS6¶112-199 Appendix A	Basis for Conclusions
SFFAS6¶200-232 Appendix B Illustrations	Editorial Deletion
SFFAS6¶233 as amended by SFFAS14 Appendix C Illustration	D20.4000
SFFAS6¶234-240 Appendix D Illustration	C40.4000-.4007
SFFAS6¶ Appendix E Glossary	See Glossaries by Subject Area
SFFAS7¶1-26	Discussion and Background
SFFAS7¶27-29	Not used in Original Pronouncement
SFFAS7¶30-31	R40.100-.101
SFFAS7¶32	Editorial Deletion
SFFAS7¶33-52	R40.102-.121
SFFAS7¶53	R10.101-.102 & .118; R40.122
SFFAS7¶54-56	R10.119-.121; R40.123.-.125

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS7¶57-64	R40.126-133
SFFAS7¶65 as amended by SFFAS20¶6	R40.134
SFFAS7¶66-75	R40.135-.144
SFFAS7¶76	Superceded by SFFAS14
SFFAS7¶77-79	B60.100-.102
SFFAS7¶80 as amended by SFFAS22¶6	B60.103
SFFAS7¶81-82	B60.104-.105
SFFAS7¶83-87	R40.145-.149
SFFAS7¶88	B60.106; SFFAC2 Amendments
SFFAS7¶89-102	SFFAC2 Amendments
SFFAS7¶103-153 Appendix A	Basis for Conclusions
SFFAS7¶154-160 Appendix A	I80.114-.120
SFFAS7¶161-227 Appendix A	Basis for Conclusions
SFFAS7¶228-229 Appendix A	I80.104-.105
SFFAS7¶230-234 Appendix A	Basis for Conclusions
SFFAS7¶235-238 Appendix B	R40.150-.153
SFFAS7¶239 Appendix B	T30.100
SFFAS7¶240-256 Appendix B	R40.154-.170
SFFAS7¶257 Appendix B	I80.124; R40.171
SFFAS7¶258-263 Appendix B	R40.172-177
SFFAS7¶264 Appendix B	R40.178; S30.111, .119 & .121
SFFAS7¶265 Appendix B	R40.179; S30.122
SFFAS7¶266 Appendix B	R40.180; S30.123
SFFAS7¶267-269 Appendix B	R40.181-183; S30.125-.127
SFFAS7¶270-283 Appendix B	R40.184-.197
SFFAS7¶284 Appendix B	C40.127; I40.110; R40.198
SFFAS7¶285-291 Appendix B	R40.199-.205
SFFAS7¶292 Appendix B	I40.110; R40.206
SFFAS7¶293-294 Appendix B	R40.207-.208
SFFAS7¶295-299 Appendix B	G20.139-.143; R40.209-.213
SFFAS7¶300 Appendix B	L60.158; R40.214
SFFAS7¶301 Appendix B	R40.215
SFFAS7¶302 Appendix B	L60.159; R40.216
SFFAS7¶303-305 Appendix B	R40.217-.219
SFFAS7¶306-308 Appendix B	I80.121-.123; R40.220-.222

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS7¶309-310 Appendix B	R40.223-.224
SFFAS7¶311-312 Appendix B	I80.125-.126; R40.225-.226
SFFAS7¶313-321 Appendix B	R40.227-.235
SFFAS7¶322-325 Appendix B	I80.127-.130; R40.236-239
SFFAS7¶326-328 Appendix B	R40.240-.242
SFFAS7¶329-330 Appendix B	I80.131-.132; R40.243-.244
SFFAS7¶331-350 Appendix B	R40.245-.264
SFFAS7¶351-361Appendix B	T30.101-.112
SFFAS7¶362-369 Appendix B	L60.160-.166; T30.113-.119
SFFAS7¶370 Appendix B	T30.120
SFFAS7 Appendix C Glossary	R40 Glossary
SFFAS7 Index of Transactions	Editorial Deletion
SFFAS7 List of Abbreviations	Editorial Deletion
SFFAS8¶1-3	S70.100-.102
SFFAS8¶4	Editorial Deletion
SFFAS8¶5-10	S70.103-.108
SFFAS8¶11 as amended by SFFAS23	S70.109
SFFAS8¶12-13	S70.110-.111
SFFAS8¶14-16	Rescinded by SFFAS25¶5
SFFAS8¶17 as amended by SFFAS23 & SFFAS25¶6-7	S70.112
SFFAS8¶18-22	S70.113-.117
SFFAS8¶23 as amended by SFFAS25¶5	S70.118
SFFAS8¶24-31	S70.119-.126
SFFAS8¶32-33	Discussion
SFFAS8¶34-35	S70.127-.128
SFFAS8¶36-37	Background Information
SFFAS8¶38 as amended by SFFAS25¶6	S70.131
SFFAS8¶39	Discussion
SFFAS8¶40	H20.114 Fn 6
SFFAS8¶41	Background
SFFAS8¶42	Effective Date(s)
SFFAS8¶43-45	H20.100-.102
SFFAS8¶46	H20.105
SFFAS8¶47 as amended by SFFAS16¶8	H20.106
SFFAS8¶48-49	Rescinded by SFFAS16

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS8¶50 as amended by SFFAS14¶10-11 & SFFAS16¶18	H20.113
SFFAS8¶51	Background
SFFAS8¶52-70	Rescinded by SFFAS23
SFFAS8¶71-79	S60.100-.108
SFFAS8¶80	S60.110
SFFAS8¶81 as amended by SFFAS14¶10-11	S60.112
SFFAS8¶82	S60.113
SFFAS8¶83-88	N60.100-105
SFFAS8¶89-95	H60.100-.106
SFFAS8¶96-101	R20.100-.105
SFFAS8¶102-108	Recinded by SFFAS25¶5
SFFAS8¶109-135	Basis for Conclusions
SFFAS8 Appendix B Sample Reports	Non-authoritative Guidance by Subject Area
SFFAS8 Appendix B Sample Reports: Illustration of Current Services Assessments	Rescinded by SFFAS25¶5
SFFAS8 Appendix C Glossary	See Glossaries by Subject Area
SFFAS9¶1-4	Introduction & Background
SFFAS9¶5	M20 fn1
SFFAS9¶6-17	Basis for Conclusions
SFFAS10¶1-6	Introduction & Background
SFFAS10¶7	Effective Date
SFFAS10¶8-36	S50.100-.128
SFFAS10¶37-84 Appendix A	Basis for Conclusions
SFFAS10 Appendix B Glossary	S50 Glossary
SFFAS11	Rescinded by SFFAS23
SFFAS12¶1-8	Background
SFFAS12¶9	Effective Date
SFFAS12¶10	L40.114
SFFAS12¶11	L40.117 & .119
SFFAS12¶12-18 Appendix A	Basis for Conclusions
SFFAS12 Appendix B	Editorial Deletion
SFFAS12 Appendix C	Editorial Deletion
SFFAS13¶1-3	Background
SFFAS13¶4	R40 Fn 1

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS13¶5	Effective Date
SFFAS13¶6-10	Basis for Conclusions
SFFAS14¶1-3	Introduction
SFFAS14¶4	Effective Date
SFFAS14¶5	Deletes SFFAS6¶79
SFFAS14¶6	D20.102
SFFAS14¶7-8	D20.105
SFFAS14¶9	D20.106
SFFAS14¶10-11	H20.113; S60.112
SFFAS14¶12-14 Appendix A	Basis for Conclusions
SFFAS14 Appendix B	Editorial Deletion
SFFAS15¶1-7	M10.100-.106
SFFAS15¶8	Effective Date
SFFAS15¶9-22 Appendix A	Basis for Conclusions
SFFAS16¶1-2	Introduction
SFFAS16¶3	Effective Date
SFFAS16¶4-5	Introduction
SFFAS16¶6	H20.109
SFFAS16¶7	Editorial Deletion
SFFAS16¶8	H20.106
SFFAS16¶9	G20.114; H20.110
SFFAS16¶10	H20.107
SFFAS16¶11	G20.115; H20.111
SFFAS16¶12	Background
SFFAS16¶13	Editorial Deletion
SFFAS16¶14	H20.103; P40.107
SFFAS16¶15	G20.138; H20.112; P40.111
SFFAS16¶16	Background
SFFAS16¶17	Editorial Deletion
SFFAS16¶18	G20.128; H20.113
SFFAS16¶19-31	Basis for Conclusions
SFFAS16 Appendix B	Editorial Deletion
SFFAS16 Appendix C Glossary	H20 Glossary
SFFAS17¶1-12	Introduction & Background
SFFAS17¶13	Effective Date

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS17¶14-23	S40.100-.109
SFFAS17¶24	S40.110; S70.129
SFFAS17¶25-33	S40.112-.119
SFFAS17¶34-109 Appendix A	Basis for Conclusions
SFFAS17¶110-181 Appendix B	S40.4000-.4072
SFFAS17¶ Appendix C	Background
SFFAS17¶ Appendix D Glossary	S40 Glossary
SFFAS18¶1-7	Introduction & Background
SFFAS18¶8	Effective Date
SFFAS18¶9	L60.112
SFFAS18¶10	L60.113
SFFAS18¶11	L60.114
SFFAS18¶12-53 Appendix A	Basis for Conclusions
SFFAS18¶ Appendix B Illustration	L60.4189
SFFAS18¶ Appendix C	Editorial Deletion
SFFAS18¶ Appendix D Glossary	L60 Glossary
SFFAS19¶1-4	Introduction & Background
SFFAS19¶5	Effective Date
SFFAS19¶6	L60.103; fns 2 & 3
SFFAS19¶7	L60.110, .111, .128, .132, .139, .141
SFFAS19¶8	L60.106 & .107
SFFAS19¶9-23 Appendix A	Basis for Conclusions
SFFAS19 Appendix B	Editorial Deletion
SFFAS20¶1-4	Introduction & Background
SFFAS20¶5	Effective Date
SFFAS20¶6	R40.134
SFFAS20¶7	Discussion
SFFAS20¶8-29 Appendix A	Basis for Conclusions
SFFAS20 Appendix B	Editorial Deletion
SFFAS21¶1-7	Introduction
SFFAS21¶8	Effective Date
SFFAS21¶9	Discussion
SFFAS21¶10-13	P40.100-.103
SFFAS21¶14-25 Appendix A	Basis for Conclusions
SFFAS22¶1-4	Introduction

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
SFFAS22¶5	Effective Date
SFFAS22¶6	B60.103; SFFAC2 Amendments
SFFAS22¶7-12 Appendix A	Basis for Conclusions
SFFAS22 Appendix B	Editorial Deletion
SFFAS23¶1-6	Background & Discussion
SFFAS23¶7	Effective Date
SFFAS23¶8	Discussion
SFFAS23¶9	G20.103 & .117; L10.105
SFFAS23¶10-18	G20.129-.137
SFFAS23¶19-51 Appendix A	Basis for Conclusions
SFFAS24¶1-6	Introduction
SFFAS24¶7	Effective Date
SFFAS24¶8-14	C60.100-.106
SFFAS24¶15-41 Appendix A	Basis for Conclusions
SFFAS24¶ Appendix B Illustration	C60.4000
SFFAS24¶ Appendix C Illustration	C60.4001
SFFAS24¶ Appendix D Illustration	C60.4002
SFFAS24¶ Appendix E Illustration	C60.4003
SFFAS24¶ Appendix F Glossary	C60 Glossary
SFFAS25¶1-3	Introduction & Background
SFFAS25¶4	I40.108
SFFAS25¶5	Rescinds SFFAS8¶14-16; & ¶102-108
SFFAS25¶6-7	S40¶.111&.114; S70.130
SFFAS25¶8-63	Basis for Conclusions
Interpretations:	
I1¶1-4	R40.1000-.1003
I1¶5	Effective Date
I1¶6-14 Appendix	Basis for Conclusions
I2¶1-2	Introduction
I2¶3-5	L40.1000-.1002; M20.1000-.1002
I2¶7-9 Appendix a	Basis for Conclusions
I2 Appendix B	L40.4000-.4003; M20.4000-.4003
I3¶1-2	Introduction
I3¶3-4	P20.1000-.1001

(Continued From Previous Page)

Original Pronouncement Reference	Current Text Reference(s)
I3¶5	Discussion
I3¶6	Effective Date
I3¶7-9 Appendix A	Basis for Conclusions
I4¶1-8	Introduction
I4¶9-15	P20.1100-.1105
I4¶16	Discussion
I4¶17	Effective Date
I4¶18-19	Basis for Conclusions
I5¶1-2	R40.1100-.1101
I5¶3	Effective Date
I5¶4-6	Basis for Conclusions
I6¶1-8	Introduction & Discussion
I6¶9-15	M20.1100-.1106
I6¶16	Discussion
I6¶17	Effective Date
I6¶18-47 Appendix A	Basis for Conclusions
I16 Appendix B Illustration	M20.4004
Technical Bulletins:	
TB2000-1	Volume 2 Introduction
TB2002-1	L40.2000-.2002; M20.2000-.2002
TB2002-2	R40.2000-.2004
TB2003-01	Editorial deletion[b]
Technical Releases:	
TR1	L40.3000-.3008
TR2	C40.3000-.3020
TR3	Superseded by TR-3 Revised & TR6
TR3-Revised	L60.3000-.3047
TR4	S30.3000-.3013
TR5	S50.3000-.3014
TR6	L60.3048-.3096

[a] Text of a non-specific nature that was not used in Volume 2.
[b] TB2003-1 applied only to one agency's FY 2003 reporting.