Investments Not Held to Maturity
March 8, 2001

Purpose

The intent of this scenario is to provide SGL guidance on how to report investments not held to maturity. The guidance is needed for the few Federal entities that are required to report investments at fair value on their audited financial statements. These entities are limited to those that either (a) are required by law or policy to publish financial statements pursuant to the standards issued by the Financial Accounting Standards Board (FASB)[1] or (b) have an audit finding to report investments not held to maturity at fair value.

For those entities that are required to produce financial statements in accordance with FASB, the scenario does not address how to report investments not held to maturity in on the entity's audited financial statements but does address how to meet the FACTS I reporting requirements.[2]

For those entities that are required to produce financial statements according the FASAB standards, the scenario is used for the FACTS I reporting as well as the entity's audited financial statements. These entities currently use Financial Accounting Standards Board Statement #115 (FAS-115) "Accounting for Certain Investments in Debt and Equity Securities as guidance for valuing securities not held to maturity. This scenario, however, does not incorporate all requirements of FAS-115 because of conflicts between FAS-115 and the FASAB standards as explained below.

Differences between FAS-115 and the FASAB Standards

Federal agencies are required to follow guidance in the FASAB standards. Investments are addressed in FASAB Standard #1 (SFFAS No. 1) "Accounting for Selected Assets and Liabilities" but only investments held to maturity. SFFAS No. 1 does not

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[1] SFFAS No. 8 paragraph 40

[2] "When the 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." SFFAS No. 8 paragraph 40.

address how to value or report securities that will not be held to maturity but does advise agencies to continue their current practices (paragraph 141). The current practice of the Federal agencies that report investments at fair value is to follow the guidance in Financial Accounting Standards Board Statement #115 (FAS-115) “Accounting for Certain Investments in Debt and Equity Securities”.

According to FAS-115, a security not held to maturity can be classified as either trading or available-for-sale. If the security is classified as trading (i. e. bought and held primarily for sale in the near term), the accounting treatment is fair value with unrealized holding gains and losses included in earnings. If the security is classified as available-for-sale, the treatment is fair value, with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders’ equity. Currently, Federal agencies that have trading or available-for-sale securities follow the guidance in FAS-115.

A conflict exists between SFFAS No. 7 and how available-for-sale investments are reported per FAS-115. Although SFFAS No. 7 does not specifically address securities classified as available-for-sale, it does address the use of equity accounts and the treatment of interest on investments. The FASAB Board determined that several equity accounts should be eliminated per SFFAS No. 7, paragraphs 217 – 223[3], but FAS-115 requires that unrealized holding gains and losses be reported as a separate component of equity. Since SFFAS No. 7 takes precedence, an SGL equity account can not be established to meet FAS-115 requirements.

SFFAS No. 7 also addresses the treatment of interest on investments. Interest on investments has the same classification as the predominant source of the invested balances. In most cases the invested balances of trust and special funds derive predominantly from the funds’ earmarked taxes which are non exchange transactions with the public. Therefore, in such cases, the interest on Treasury securities should not be deducted from gross costs of the trust (or special fund) in determining net cost of operations. The interest received from invested balances of trust funds and special funds is, therefore, normally non exchange revenue.[4]

If the treatment of interest on investments is applied to unrealized gains and losses on investments, the exchange and non exchange classification is significant. An unrealized loss or gain classified as non exchange is reported on the statement of changes in net position and an exchange unrealized gain and loss is reported on the net cost statement. Exchange and non exchange revenues

[3] Paragraphs 82 and 100 of Statement of Federal Financial Accounting Concepts no. 2 (SFFAC 2) also support the position that unexpended appropriations and cumulative results of operations are the only equity accounts currently available.
[4] SFFAS No. 7 paragraphs 306 and 307

are not addressed in FAS-115, instead, the major classifications are trading and available-for-sale. The treatment of trading and available-for-sale is not parallel to that of exchange and non exchange revenue. Once again, SFFAS No. 7 takes precedence.

The following diagram illustrates the differences between FAS-115 and SFFAS No. 7.

FAS-115	**FAS-115 Accounting treatment**	**SFFAS No. 7**	**USSGL Interpretation**
Trading securities	Fair value with unrealized holding gains and losses included in earnings	If the predominant source is exchange revenue, classify interest as exchange. If predominant source is non exchange, classify interest as non exchange.	Gains and losses are treated the same as interest: -If exchange, the gain and loss will flow through the net cost statement. -If non exchange, the gain and loss will flow through the statement of changes in net position
Available-for-sale securities	Fair value with unrealized holding gains and losses excluded from earnings and reported as separate component of equity	If the predominant source is exchange revenue, classify interest as exchange. If predominant source is non exchange, classify interest as non exchange. Equity accounts eliminated per paragraphs 217 – 223.	Gains and losses are treated the same as interest: -If exchange, the gain and loss will flow through the net cost statement. -If non exchange, the gain and loss will flow through the statement of changes in net position Based on paragraphs 217 - 223, a new equity account will <u>not</u> be established.

Conclusion

For those Federal entities that are required to produce financial statements in accordance with the FASAB standards, this scenario is to be used in preparing the entity's audited financial statements and the FACTS I submission. A new equity account will not be established. Non exchange gains and losses will through the statement of changes in net position while exchange gains and losses will flow through the net cost statement. An allowance account is being proposed to capture the accumulated unrealized gains and losses and separate accounts for unrealized gains and losses on investments are proposed.

For those Federal entities that are required to produce financial statements in accordance with FASB, the following scenario will be used in preparing the FACTS I submission. Please note for entities subject to FASB reporting, differences may exist between the entity's audited financial statements and the FACTS I submission.

1. Trial balances prior to investment purchases. The revenue is classified as exchange.	Budgetary 4114 Appropriated Trust or Special Fund Receipts 4510 Apportionments Proprietary 1010 Fund Balance with Treasury 5900 Other Revenue	 $60,000,000 $60,000,000	 $60,000,000 $60,000,000
2. During the year, a Treasury note (non-marketable, market based) is purchased. The par value is $9,000,000 and the discount is $1,500,000. TC B128	Budgetary None Proprietary 1610 Investments in U.S. Securities Issued by Public Debt 1611 Discount on U.S. Securities Issued by Public Debt 1010 Fund Balance with Treasury	 $ 9,000,000	 $ 1,500,000 $ 7,500,000
3. At yearend the discount on the note is amortized. SFFAS No. 1 requires agencies to use the interest method (paragraph 71). TC 510	Budgetary No entry Proprietary 1613 Amortization of Discount and Premium on U.S. Treasury Securities Issued by Public Debt 5310 Interest Revenue	 $ 250,000	 $ 250,000

4. At yearend it is determined that the Treasury note is available for sale. If Financial Accounting Standards Board Statement no. 115 (FAS-115) is followed, available for sale securities are valued at market with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity. The market value adjustment is the difference between the amortized cost and the current market value. The current market value is $7,850,000 and the amortized cost is $7,750,000 (par $9,000,0000 – discount $1,500,000 + amortization $ 250,000). New TC is needed	Budgetary No entry Proprietary **1618 Market Adjustment - Investments $ 100,000** **7180 Unrealized Gains – Investments $100,000**
5. During the year a second treasury note is purchased. The par value is $20,000,000 and the discount is $3,000,000.	Budgetary None Proprietary 1610 Investments in U.S. Securities Issued by Public Debt $ 20,000,000 1611 Discount on U.S. Securities Issued by Public Debt $ 3,000,000 1010 Fund Balance with Treasury $ 17,000,000
6. At yearend the discount on the second Treasury note is amortized. SFFAS No. 1 requires agencies to use the interest method (paragraph 71). TC 510	Budgetary No entry Proprietary 1613 Amortization of Discount and Premium on U.S. Treasury Securities Issued by Public Debt $ 60 ,000 5310 Interest Revenue $ 60,000

7. At year-end the second Treasury note is classified as a trading security. If FAS-115 is followed, trading securities are valued at market with unrealized holding gains and losses included in earnings. The market value adjustment is the difference between the amortized cost and the current market value. The current market value is $17,040,000 and the amortized cost is $17,060,000 (par $20,000,000 – discount $3,000,000 + amortization $ 60,000). New TC is needed	Budgetary No entry Proprietary **7280 Unrealized Losses – Investments $ 20,000** **1618 Market Adjustment – Investments $ 20,000**
8. Pre closing adjusted trial balance	Budgetary 4114 Appropriated Trust or Special Fund Receipts $60,000,000 4510 Apportionments $60,000,000 Proprietary 1010 Fund Balance with Treasury $ 35,500,000 1610 Investments in U.S. Securities Issued by Public Debt $ 29,000,000 1611Discount on U.S. Securities Issued by Public Debt $ 4,500,000 1613 Amortization of Discount and Premium on U.S. Treasury Securities Issued by Public Debt $ 310,000 **1618 Market Adjustment - Investments $ 80,000** 5310 Interest Revenue $ 310,000 5900 Other Revenue $ 60,000,000 **7180 Unrealized Gains – Investments $ 100,000** **7280 Unrealized Losses – Investments $ 20,000** $ 64,910,000 $ 64,910,000

9. Closing entries	<u>Budgetary</u>		
	4201 Total Actual Resources Collected	$60,000,000	
	4114 Appropriated Trust or Special Fund Receipts		$60,000,000
	<u>Proprietary</u>		
	5310 Interest Revenue	$ 310,000	
	5900 Other Revenue	$60,000,000	
	7180 Unrealized Gains – Investments	**$ 100,000**	
	3310 Cumulative Results of Operations		$60,410,000
	3310 Cumulative Results of Operations	$ 20,000	
	7280 Unrealized Losses - Investments		**$ 20,000**
10. Post closing trial balance	<u>Budgetary</u>		
	4201 Total Actual Resources Collected	$60,000,000	
	4510 Apportionments		$60,000,000
	<u>Proprietary</u>		
	1010 Fund Balance with Treasury	$ 35,500,000	
	1610 Investments in U.S. Securities Issued by Public Debt		$ 29,000,000
	1611 (.911) Discount in U.S. Securities Issued by Public Debt		$ 4,500,000
	1613 Amortization of Discount and Premium on U.S. Treasury Securities Issued by Public Debt	$ 310,000	
	1618 Market Adjustment - Investments	**$ 80,000**	
	3310 Cumulative Results of Operations	.	$ 60,390,000
		$ 64,890,000	$ 64,890,000

11. Balance Sheet	Assets 1010 \$ 35,500,000 Investments 1610 \$ 29,000,000 1611 \$ (4,500,000) 1613 \$ 310,000 **1618** **\$ 80,000**) \$ 24,890,000 Total assets \$ 60,390,000 Net position 3310 \$60,390,000 \$60,390,000
12. Net Cost Statement In this illustration the unrealized loss and gain flow through the net cost statement because the predominant source of funds is exchange revenue. The unrealized loss and gain may also flow through the statement of changes in net position if the predominant source of funds is non exchange revenue. Note, if agencies are reporting available for sale securities per FAS-115, the unrealized gain or loss is a separate component of equity. This scenario, however, does not accommodate an equity account for unrealized gains and losses.	Costs **7180** **\$ (100,000)** **7280** **\$ 20,000** Less earned revenues 5310 \$ (,310,000) 5900 \$(60,000,000) Net Cost \$(60,390,000)

13. Statement of Changes in Net Position	1. Net cost	$(60,390,000)
	2G. Financing Sources-Other	NA
	3. Net results of operations (Calc 2-1)	$ 60,390,000
	4. Prior period adjustments	NA
	5. Net change in cum. Results of operations (Calc 3+/-4)	$ 60,390,000
	6. Increase (decrease) in unexpended appropriations	NA
	7. Change in net position (Calc 5+/-6)	$ 60,390,000
	8. Net position, beginning of period	NA
	9. Net position, end of period (Calc 7+8)	$ 60,390,000

14. FMS 2108	Col. 1	Col. 2	Col. 5	Col. 6	Col.11
	20X5227	$35,500,000	$35,500,000 SGL 1010		$60,000,000 SGL 4510
	20X5227.971	$29,000,000		$29,000,000 SGL 1610	
	20X5227.911	$ (4,500,000)		$(4,500,000) SGL 1611	
	TOTALS		$35,500,000 +	$24,500,000 =	$60,000,000

15. SF 133	1A. Appropriations	4114E	$60,000,000
	7		$60,000,000
	9.	4510	$60,000,000
	11.		$60,000,000

16. Statement of Budgetary Resources	1A. Appropriations 4114E $60,000,000 5. Total budgetary resources $60,000,000 7A. Unobligated balances available 4510E $60,000,000 9. Total status of budgetary resources $60,000,000
17. Statement of Financing	1H.LessTrust or special fund receipts related to exchange revenue in the entity's budget 5900 $(60,000,000) 3A. Depreciation and amortization 1613 subtract net debit balance (310,000) 3C. Revaluation of assets and liabilities **7180** **(100,000**) **7280** **20,000** 5. Net cost $(60,390,000)

Account Title: Market Adjustment - Investments
Account Number: 1618
Normal Balance: Either

Definition: The accumulated unrealized gain or loss on investments other than investments in zero coupon bonds. Unrealized gain or loss is due to adjustments for fair value

Justification: This account will provide a mechanism for agencies to report investments at market value on the balance sheet. Currently, a limited number of agencies are required to report investments at market value. These agencies are limited to those that prepare commercial GAAP based financial statements or those that have an audit finding to report investments at market value

Account Title: Unrealized Gains - Investments
Account Number: 7180
Normal Balance: Credit

Definition: The unrealized gains on investments resulting from adjustment of investments to fair value

Justification: Same as above

Account Title: Unrealized Losses - Investments
Account Number: 7280
Normal Balance: Debit

Definition: The unrealized losses on investments resulting from adjustment of investments to fair value.

Justification: Same as above