

The seal of the United States Department of Agriculture is centered in the background. It features a central figure of a farmer with a plow, surrounded by a wreath of wheat and cotton. The outer ring of the seal contains the text "DEPARTMENT OF AGRICULTURE" at the top and "UNITED STATES" at the bottom. Below the central figure, there are two banners with the motto "AGRICULTURE" and "COMMERCE", and a smaller banner at the bottom that reads "FOUNDATION OF MANUFACTURE".

# *AGRICULTURE FINANCIAL STANDARDS MANUAL*

*Office of the Chief Financial Officer  
Credit, Travel, and Accounting Policy Division  
Revised May 2004*



**United States  
Department of  
Agriculture**

Office of the Chief  
Financial Officer


1400 Independence  
Avenue, SW

Washington, DC  
20250

MAY 12 2004

**Transmittal Letter No. 003**

**TO:** All Agencies, Staff Offices and Working Capital Fund Activity  
Directors

**FROM:** Matthew Faulkner   
Acting Director  
Credit, Travel and Accounting Policy Division

**SUBJECT:** Agriculture Financial Standards Manual

This transmittal letter revises the Agriculture Financial Standards Manual. A summary of the changes is attached and are effective May 2004.

Address all inquiries to Charleta Dixon of my staff at (202) 720-4976.

Attachment

### Summary of Changes

Section	Date	Item Changed	Change
Authoritative Sources FASAB, SFFAC, SFFAS, and OMB Circulars	Nov 03	Added	<b>SFFAC 4, Intended Target Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government</b>
“	“	Added	<b>SFFAS 23, Eliminating the Category National Defense Property, Plant, and Equipment (not applicable to USDA operations)</b>
“	“	Added	<b>SFFAS 24, Selected Standards For The Consolidated Report of the United States Government</b>
“	“	Added	<b>SFFAS 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment</b>
“	“	OMB Circular A-125, Prompt Payment	<b>Rescinded and replaced by Prompt Pay regulations at 5 CFR Part 1315</b>
Internal Use Software Definition of Software	“	Added numerals 1-3 to the definition of software	<b>(1) off-the-shelf from vendors, (2) developed by contractors or (3) developed internally.</b>
Internal Use Software Capitalized Cost	“	Deleted <i>Preliminary Design Phase and the</i> from Capitalized Cost description	<b>Now reads ... full cost incurred during the Software Development Phase</b>
Internal Use Software Capitalization Threshold	“	Added	<b>Effective FY 2001 ... with an estimated service life of 2 years or more.</b>
Internal Use Software Amortization/Useful Life	“	Deleted <i>The Office of the CIO should have responsibility for determining the estimated useful life of the software.</i>	<b>Program offices should coordinate with the OCIO regarding the estimated useful life of software.</b>
Internal Use Software Amortization/Useful Life	“	Deleted <i>Amortization of internal use software will not begin until the Software Development Phase is completed.</i>	<b>Amortization of internal use software begins after the Software Development Stage is completed. Upon completion, these costs will be transferred from USSGL account 1832, “Internal-Use Software in Development, to USSGL account, 1830, “Internal-Use Software.”</b>
Internal Use Software Models/Components	“	Deleted <i>In terms of amortization</i>	
Internal Use Software Enhancements	“	Deleted <i>If ... are ... they ...</i>	<b>Costs incurred which extend the functionality and the useful life of internal use software should be capitalized.</b>
Internal Use Software	“	Deleted <i>The amortization of these costs shall not exceed 5 years.</i>	

<b>Section</b>	<b>Date</b>	<b>Item Changed</b>	<b>Change</b>
USDA Directives	Mar-04	DR2200-002, Capitalization/Depreciation Real/Personal Property	<b>DR2200-002, Property, Plant and Equipment</b>
Internal Use Software	May-04	Added	<b>Title: Recognition, Measurement, and Disclosure</b>
Internal Use Software	“	<i>Added titles and discussion of the following topics</i>	<b>Data Conversion Costs Cutoff for Capitalization Integrated Software Bundled Products and Services</b>
Internal Use Software	“	<i>Deleted Training. Initial training should be capitalized. All recurring training must be expensed as incurred. Training costs should include personnel labor costs, facilities, and supplies and materials. Each of the costs are in separate cost pools and therefore, need to be appropriately coded in order to capture the costs as capitalized cost or expense.</i>	<b>Training. Training costs must be recognized as expense as incurred. Even though these may be costs which are associated with the internal development or acquisition of software for internal use, under GAAP those costs relate to the period in which incurred.</b>
Internal Use Software	“	Deleted <i>Capitalizing</i> before License Fees	<b>Now reads License Fees</b>
Internal Use Software	“	Deleted <i>Capitalizable</i> before Costs vs. Executory Costs	<b>Now reads Costs vs. Executory Costs</b>

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## CHAPTER 1 - OVERVIEW

### *Purpose and Scope*

The Chief Financial Officers Act of 1990 requires the Department of Agriculture (USDA) Chief Financial Officer (CFO) to issue a manual providing a comprehensive text of applicable financial policies and accounting standards for USDA. This manual fulfills that requirement and is intended to be the official presentation and interpretation of the financial management-related laws, regulations, and policies issued by authoritative bodies to ensure consistent application in recording and reporting transactions throughout the Department. This manual was developed to provide mission areas/entities with a single, definitive source for department-wide standards for financial policies, accounting standards, and requirements for general-purpose financial reports.

The principal authoritative sources used in preparing this manual are listed in this overview. Providing these references demonstrates the comprehensive and authoritative nature of the manual.

All USDA mission areas/agencies are required to comply with the standards addressed in this manual. Each mission area or entity, however, may define supplementary directives and standards to satisfy their unique needs, as long as they are consistent with department-wide standards. Accounting events, which must be executed prior to updates to this manual or not covered here, should be enacted in accordance with authoritative guidance provided herein. This manual serves to support the following objectives:

- Standardize USDA financial data and provide for intra-entity data interchange.
- Streamline processes for recording financial events and reporting financial information.
- Enable agencies to apply common standards while providing flexibility to satisfy unique needs.
- Promote uniform accounting processes to aid entities in implementing the Department's Foundation Financial Information System (FFIS).
- Increase the reliability and consistency of financial information in USDA.

### *Organizational Summary of USDA and the Office of the Chief Financial Officer (OCFO)*

USDA is divided into eleven offices as well as twenty agencies, including the Office of Chief Financial Officer and Office of Budget and Program Analysis. An organizational chart summarizing the offices of USDA can be found at:

<http://www.usda.gov/agencies/agchart.htm>.

## Roles and Responsibilities

The roles and responsibilities of the Chief Financial Officer, the Office of the Chief Financial Officer, USDA program entities, and the Office of Budget and Program Analysis are defined in this section.

**Chief Financial Officer (CFO).** The Secretary of the Department of Agriculture has delegated to the CFO responsibility for a variety of duties authorized or required by the Chief Financial Officers Act of 1990 (CFO Act) and many other laws or regulations. The CFO Act provided for the establishment of a Departmental CFO whose primary mission is effective financial management. The CFO's authority and functions under the CFO Act require him or her to:

- Oversee all financial management activities relating to the programs and operations of the Department.
- Develop and maintain an integrated departmental accounting and financial management system, including financial reporting and internal controls.
- Develop and/or review the Departmental plan to implement a 5-year financial management systems plan.
- Approve and manage Departmental financial management systems design or enhancement projects.
- Implement entity asset management systems, including systems for cash management, credit management, debt collection, and property and the management and control of inventory.

In addition, the CFO must monitor the financial execution of the Department's budget in relation to actual expenditures; prepare and submit timely performance reports to the Secretary; and review, on a biennial basis, the fees, royalties, and other charges imposed by the Department for services and things of value it provides and make recommendations for revising these charges to reflect costs incurred in providing the services and things of value.

**Office of the Chief Financial Officer (OCFO).** The mission of OCFO is to shape an environment in which USDA officials have and use high quality financial and performance information to make and implement effective policy, management, stewardship, and program decisions. To discharge its delegated and statutory responsibilities, the OCFO maintains a headquarters staff and a staff at the National Finance Center (NFC) in New Orleans, Louisiana.

OCFO prepares the consolidated financial statements, monitors department-wide audit findings and resolutions, administers the debt-collection processes and policies, works with credit agencies to implement credit reform initiatives, directs the Department's strategic planning process and establishes Department-wide skill level standards for the financial management



personnel. OCFO's NFC provides payroll and accounting services to USDA as well as other Federal entities. It also operates financial and administrative systems for USDA and serves as the record keeper for the Federal Government's Thrift Savings Plan, a retirement fund similar to a 401(k) Plan.

The primary goals for OCFO are the following:

- Promote sound financial management through leadership, policy, and oversight
- Create an infrastructure to carry out financial management policies
- Operate a financial center that produces timely and reliable information.  
Specific OCFO operational activities in support of these responsibilities include:
  - Providing guidance to the Under/Assistant Secretaries in their financial organizations, including establishing qualifications for USDA mission area and entity CFO's and participating in the selection and performance appraisals of the CFO's
  - Participating in the general management of USDA as the key financial advisor to the Secretary and the sub-cabinet
  - Coordinating the implementation of the Government Performance and Results Act
  - Developing and issuing department-wide financial management policies and accounting standards
  - Preparing annual audited consolidated financial statements
  - Developing a Department-wide financial information classification structure consistent with the U.S. Government Standard General Ledger
  - Implementing a single, integrated financial management system with common data elements, common transaction processing, consistent internal controls, and efficient transaction entry, as required by Office of Management and Budget Circular A-127, "Financial Management Systems."

**Office of Budget and Program Analysis (OBPA).** OBPA plays a critical role in budget formulation, budget execution, and funds control. OBPA's responsibilities include:

- Providing budget assistance and advice to the Secretary and Under/Assistant Secretaries
- Participating in general management of USDA as the key budget advisor to the Secretary and the sub-cabinet
- Developing and issuing USDA budget policy and guidance

- Reviewing and submitting apportionments, reapportionments, and allotments
- Coordinating and managing the budget formulation process
- Coordinating and managing the budget reprogramming process.

**Mission Area and Entity CFO's.** Each mission area/entity has a CFO who manages the financial management activities of the organization. The responsibilities of the entity CFO's include, but are not limited to:

- Formulating financial management policies consistent with Federal and Departmental policy and standards, and ensuring that such policies are implemented and followed
- Recording financial transactions in an accurate and timely fashion
- Preparing and certifying all required components of the annual financial statements
- Preparing and issuing all other external and internal accounting reports
- Distributing and controlling funds and resources for the purpose intended and within legal and management limitations
- Maintaining the integrity of all financial data in the financial management system.

### ***Directions on using the USDA AFSM Guidance Network***

**Who?** Intended users for this manual include any and all USDA employees seeking guidance from a single definitive source on department-wide standards for financial policies, accounting standards, and requirements for general purpose financial reports.

**What?** This manual is organized into 6 chapters as shown below. A brief description of the contents of each chapter follows:

1. **Chapter 1, Overview** - defines the purpose and scope of the manual, applicability, and roles and responsibilities; briefly describes the contents of the chapters and appendices; provides a list of authoritative sources, including information on internal and external financial policies and accounting standards that are the primary authoritative bases for USDA's policies and standards.
2. **Chapter 2, Budget Execution and Funds Control** - describes the relationship between budget execution and funds control; provides an understanding of the various types of budgetary resources; discusses the various aspects of funds control; defines the types of information that should be provided by internal reports; and describes the accounting classification code structure.

3. **Chapter 3, Managerial Cost Accounting** - describes the purposes of using cost information; explains managerial cost accounting concepts, standards, and requirements, including cost accumulation and distribution; and defines cost accounting terms and methodologies, including FFIS project cost accounting and cost allocation mechanisms.
4. **Chapter 4, Assets, Liabilities and Net Position** - defines the standards for managing, accounting for and reporting assets (cash, fund balance with treasury, receivables, property, plant and equipment and inventory), liabilities (exchange and non-exchange liabilities, government-related liabilities, and government-acknowledged liabilities) and net position (unexpended appropriations, revenues, expenses and cumulative results of operations); describes the structure and characteristics of the USDA general ledger and chart of accounts; discusses standards for recording and posting transactions in the general ledger; and indicates standards for performing periodic activities, including monthly and annual activities.
5. **Chapter 5, USDA Specific Policies and Procedures** – This section is reserved for the reader/user to file specific Office of the Chief Financial Officer (OCFO) policies and guidelines that are issued as memorandums, guides, and bulletins. Many of these documents may also be found on the USDA OCFO website at [www.usda.gov/ocfo/acctpol](http://www.usda.gov/ocfo/acctpol) and at [www.nfc.usda.gov/pubs/na-pubsmain.html](http://www.nfc.usda.gov/pubs/na-pubsmain.html).

Where? *The table of contents for this manual provides explicit detail as to where within the Manual various topics are discussed. In addition, each chapter contains its own descriptive outline with links to applicable standards, related subject matter and associated organizations. Links are also provided throughout the contents of the manual in order to allow the user to effectively locate additional detail and/or information related to the topic at hand.*

When? Unless otherwise stated, the chapters and appendices of this manual are effective upon final issuance by the OCFO.

**Modifications and Interpretations of this Manual.** This Manual is intended to be a source of financial policies and accounting standards for USDA. It contains official presentations and interpretations of federal legislation, regulations, and policies, which apply to USDA. However, inevitably instances will arise where amendments or additions to the Manual will become necessary because of the issuance of new laws or regulations, novel or unusual situations, areas of controversy, audit findings, or other circumstances.

Those individuals needing clarification or who encounter unusual situations not covered in the Manual may request in writing a written opinion or interpretation of the topic in question from the USDA CFO. The USDA CFO will consult as necessary with the policy and standard-issuing bodies referenced in this Manual and/or with working groups comprising USDA entity experts to devise an appropriate amendment or addition to this Manual, which will then apply equally to all USDA entities.

### *Authoritative Sources*

This section lists and describes the principal of federal laws, regulations, standards, policies, and other authoritative sources that are presented and interpreted in this Manual and with which USDA entities must comply when recording and reporting financial information for general

purpose financial reports, i.e., those reports which are prepared from entity general ledgers in accordance with generally accepted federal accounting standards. The issuances promulgated by these organizations establish government-wide standards that must be followed by all executive agencies. They serve as the framework for USDA's business functions and financial information systems.

The following list includes federal policies and standards from eight sources:

- Legislation
- Financial Accounting Standards Board (FASB)
- Office of Management and Budget
- Department of the Treasury (Treasury)
- Joint Financial Management Improvement Program (JFMIP)
- General Accounting Office (GAO)
- General Services Administration (GSA)
- Departmental Directives
- Management Accountability and Control regulations.

### **Hierarchy of Accounting Standards**

The hierarchy of accounting standards for annual financial statements is included in the OMB Bulletin 01-09, "Form and Content of Agency Financial Statements." Government corporations may follow a slightly different hierarchy, if they are required by regulations or through long practice to follow generally accepted accounting principles (GAAP) as they apply in the private sector and if there is no current applicable federal accounting standard.

In April 2000, the American Institute of Public Accountants (AICPA) established the following hierarchy of accounting principles for Federal governmental entities:

- (A) Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations plus AICPA and FASB pronouncements if made applicable to Federal governmental entities by a FASAB Statement of Interpretation;
- (B) FASAB Technical Bulletins and the following pronouncements if specifically made applicable to Federal governmental entities by the AICPA and cleared by the FASAB: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position;
- (C) AICPA Accounting Standards Executive Committee (ACSEC) Practice Bulletins if specifically made applicable to Federal governmental entities and cleared by the FASAB and Technical Releases of the Accounting and Auditing Policy Committee of the FASAB;
- (D) Implementation guides published by the FASAB staff and practices that are widely recognized and prevalent in the Federal government.

An entity will be considered in substantial compliance with financial accounting standards if the entity can prepare reliable, audited financial statements in accordance with applicable accounting standards and has no material weaknesses in related internal controls. Substantial compliance does not require all transactions at the point of original entry to be in full compliance with

financial accounting standards, but does require that financial information used in the preparation of financial statements, based on such transactions, is adequately supported by detailed financial records (automated or manual).

Indicators that entities have achieved substantial compliance in meeting these standards include:

- (1) An unqualified opinion on the agency's financial statements. For a qualified opinion, a review of the underlying reasons for the qualified opinion is needed to determine whether or not the entity is in substantial compliance with this requirement. In limited circumstances, a qualified opinion on the agency's financial statements may indicate substantial compliance with this requirement when it is solely due to reasons other than the agency's ability to prepare auditable financial statements. Further, a disclaimer of opinion may not indicate substantial noncompliance with this requirement when it results from a material uncertainty, such as resolution of litigation.
- (2) No material weaknesses in internal controls that affect the entity's ability to prepare auditable financial statements and related disclosures.
- (3) No noncompliance with laws or regulations, which have a direct and material effect on the financial statements being audited.
- (4) In situations where an entity receives an unqualified opinion but material weaknesses and/or noncompliance with laws and regulations are reported, the nature and extent of the material weaknesses and/or noncompliance should be considered in determining whether the agency is in substantial compliance with the Federal Financial Managers Integrity Act (FFMIA).

## Legislation

Legislation is the foundation for most financial accounting standards in the U.S. Government. A list of the major laws impacting the accounting standards is addressed below.

- *United States Code, Title 31, "Money and Finance"* [http://uscode.house.gov/title\\_31.htm](http://uscode.house.gov/title_31.htm)
- *Accounting and Auditing Act of 1950* <http://www.disa.mil/comptrol/fmfia.html>
- *Federal Manager's Financial Integrity Act of 1982 (FMFIA)*  
<http://www.disa.mil/comptrol/fmfia.html>
- *Debt Collection Improvement Act of 1996* <http://www.fms.treas.gov/debt/dcia.html>
- *Single Audit Act of 1984* <http://www.ignet.gov/single/saamend.html>
- *Chief Financial Officers Act of 1990* [http://www.gao.gov/policy/12\\_19\\_4.pdf](http://www.gao.gov/policy/12_19_4.pdf)
- *Prompt Payment Act of 1990* <http://www.wvnet.edu/procure/prmpmt.pdf>
- *Federal Credit Reform Act of 1990*  
<http://www.fms.treas.gov/ussgl/creditreform/fcratoc.html>
- *Cash Management Improvement Act of 1990* <http://www.fms.treas.gov/cmia/>
- *Government Performance and Results Act of 1993*  
<http://www.whitehouse.gov/omb/mgmt-gpra/gplaw2m.html>
- *Government Management Reform Act of 1994* <http://www.fedsources.gov/pdf/reform.pdf>
- *Federal Financial Management Improvement Act of 1996*
- *Accounting Standardization Act of 1995*
- *Anti-Deficiency Act* <http://www.dol.gov/dol/oasam/public/regs/statutes/antidef.htm>

- *Pay and Allowance System for Civilian Employees*
- *Reports Consolidation Act of 2000*

### **Federal Accounting Standards Advisory Board (FASAB) Statements on Federal Financial Accounting Standards (SFFAS)**

FASAB's purpose is to consider and recommend accounting principles, standards, and requirements to GAO, Treasury, and OMB. The Comptroller General, the Secretary of the Treasury, and the Director of OMB will decide upon new principles, standards, and requirements after considering FASAB's recommendations. FASAB statements can be found at <http://www.fasab.gov>.

Statements on Federal Financial Accounting Concepts, FASAB may issue, and the Comptroller General and the Director of OMB may each publish "Statements of Federal Financial Accounting Concepts" (SFFAC) after a 45-day period of Congressional review. SFFAC differs from SFFAS in that they represent a conceptual logical framework around which the SFFAS may be developed. Both the SFFAS and their application in individual agencies or entities must conform to the concepts and principles delineated in the approved SFFACs. To date, only OMB has issued the approved SFFAC's. The three SFFAC's issued to date are listed below.

- ***SFFAC 1. Objectives of Federal Financial Reporting***
- ***SFFAC 2. Entity and Display***
- ***SFFAC 3. Management's Discussion and Analysis-Concepts***
- ***SFFAC 4. Intended Target Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government.***

Statements on Federal Financial Accounting Standards, The Comptroller General and the Director of OMB may each publish the principles, standards, and requirements after a 45-day period of Congressional review. To date, only OMB has issued the approved standards as official regulations, in the form of "Statements of Federal Financial Accounting Standards" (SFFAS). The SFFAS's issued in final or in final recommendation are listed below.

- ***SFFAS 1. Accounting for Selected Assets and Liabilities***
- ***SFFAS 2. Accounting for Direct Loans and Loan Guarantees***
- ***SFFAS 3. Accounting for Inventory and Related Property***
- ***SFFAS 4. Managerial Cost Accounting Concepts and Standards for the Federal Government***
- ***SFFAS 5. Accounting for Liabilities of the Federal Government***
- ***SFFAS 6. Accounting for Property, Plant, and Equipment***
- ***SFFAS 7. Accounting for Revenue and Other Financing Sources***
- ***SFFAS 8. Supplementary Stewardship Reporting***
- ***SFFAS 9. Deferral of SFFAS 4-Managerial Cost Accounting***
- ***SFFAS 10. Accounting for Internal Use Software (amends SFFAS 6)***
- ***SFFAS 11. Amendments to Accounting for PP&E Definitions (amends SFFASs 6 and 10). This Statement clarifies definitions for National Defense and Space Exploration assets and is not applicable for USDA.***
- ***SFFAS 12. Recognition of Contingent Liabilities from Litigation (amends SFFAS 5)***

- **SFFAS 13. Deferral of Paragraph 65.2-Material Revenue-Related Transactions (amends SFFAS 7). This statement outlines requirements for entities involved in tax and duties collections, and is not applicable to USDA operations.**
- **SFFAS 14. Amendments to Deferred Maintenance (amends SFFASs 6 and 8)**
- **SFFAS 15. Management's Discussion and Analysis Standards**
- **SFFAS 16. Amendments to Accounting for PP&E: Multi-Use Heritage Assets (amends SFFASs 6 and 8)**
- **SFFAS 17. Accounting for Social Insurance (not applicable to USDA operations)**
- **SFFAS 18. Amendments to Accounting Standards for Direct Loans and Loan Guarantees (amends SFFAS 2)**
- **SFFAS 19. Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees (amends SFFAS 2)**
- **SFFAS 20. Elimination of Certain Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs and Others (amends SFFAS 7) (not applicable to USDA operations)**
- **SFFAS 21. Reporting and Corrections of Errors and Changes in Accounting Principles**
- **SFFAS 22. Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations**
- **SFFAS 23. Eliminating the Category National Defense Property, Plant, and Equipment (not applicable to USDA operations)**
- **SFFAS 24. Selected Standards For The Consolidated Report of the United States Government**
- **SFFAS 25. Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment**

**Accounting and Auditing Policy Committee of the Federal Financial Accounting Standards Board Technical Releases.** *The FASAB will author technical releases based on issues presented for their consideration and further discussion. To date, there have been five (5) technical releases as follows:*

- Technical Release 1: Legal Representation Letters
- Technical Release 2: Environmental Liabilities
- Technical Release 3: Preparing and Auditing Estimates for Direct Loans and Loan Guarantees
- Technical Release 4: Reporting on Non-valued Seized and Forfeited Property
- Technical Release 5: Implementation Guidance on Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software

### **Office of Management and Budget's (OMB's) Bulletins and Circulars**

*This section provides a list of key OMB directives that contribute to the basis for the general Government-wide standards used for finance and accounting activities. The full bulletins and circulars can be found at <http://www.whitehouse.gov/omb/circulars/>.*

- **OMB Bulletin 01-09. Form and Content of Agency Financial Statements**
- **OMB Bulletin 01-02. Audit Requirements for Federal Financial Statements**
- **OMB Circular A-11. Preparation and Submission of Budget Estimates**



- **OMB Circular A-25. User Charges**
- **OMB Circular A-34. Instructions for Budget Execution**
- **OMB Circular A-123. Management Accountability and Control**
- **OMB Circular A-125. Rescinded and replaced by Prompt Pay regulations at 5 CFR Part 1315**
- **OMB Circular A-127. Financial Management Systems**
- **OMB Circular A-129. Policies for Federal Credit Programs and Non-tax Receivables**
- **OMB Circular A-134. Financial Accounting Principles & Standards**

## Department of the Treasury

*The list below provides a summary of key Treasury directives that contain government-wide policies and procedures covering certain aspects of financial and accounting activities. Treasury prescribes the financial management activities of notably transactions involving receipt of appropriations, maintenance of fund balances, depositing and accounting for receipts, and disbursing funds. Treasury also prescribes certain reporting requirements by obtaining from each agency such summary-level account information as may be necessary for carrying out its central banking, accounting, and financial reporting responsibilities.*

**Treasury Financial Manual (TFM).** This manual is Treasury's principal directives manual for financial accounting and reporting of all receipts and disbursements of the Federal government. The manual can be found at <http://www.fms.treas.gov/tfm/>.

Credit Reform Case Studies are found at  
<http://www.fms.treas.gov/ussgl/creditreform/casestud.html>

**Report on Receivables Due from the Public.** The quarterly “Report on Receivables Due from the Public” contains three sections: Receivables, Debt Collection Management Information, and Footnotes. Agency programs are required to submit separate reports for direct loans, defaulted guaranteed loans, and non-credit receivables (that is, receivables generated from activities other than direct or defaulted guaranteed loans). This can be found at <http://www.fms.treas.gov/debt/trorworkbk.html>.

*Joint Financial Management Improvement Program (JFMIP)*  
<http://www.jfmip.gov/jfmip/>

Legislation codified at 31 U.S.C. 3511(d) (1982) requires that the Comptroller General, the Secretary of the Treasury, and the President conduct a continuous program to improve accounting and financial reporting in the government. This program, known as the Joint Financial Management Improvement Program (JFMIP), is conducted jointly by the General Accounting Office, the Department of the Treasury, the Office of Management and Budget, and the Office of Personnel Management with participation by the other federal agencies and private sector companies. Government-wide financial management problems, as well as those concerning individual agencies, are considered under the joint program.

JFMIP is a joint cooperative working with each other and operating agencies to improve financial management practices throughout the Government. Improving federal financial



management involves establishing uniform requirements for financial information, financial systems, reporting, and financial organization. To accomplish this objective, JFMIP has created a series of financial management system requirement documents called the Federal Financial Management Systems Requirements (FFMSR).

The following list contains FFMSR's that contribute to the basis for the general government-wide standards used for finance and accounting activities.

- Grant Financial System Requirements
- Property Management Systems Requirements
- Core Financial System Requirements
- Human Resources & Payroll Systems Requirements
- Travel System Requirements
- Direct Loans System Requirements
- Guaranteed Loans System Requirements
- Inventory System Requirements
- Seized Property and Forfeited Assets System Requirements
- System Requirements for Managerial Cost Accounting
- Revenue System Requirements
- Acquisition Financial Systems Interface Requirements
- Benefits Systems Requirements

#### *USDA Directives*

<http://www.usda.gov/ocio/directives/DR>

*USDA Directives cover the regulations and directives that are issued by the Office of the Chief Financial Officer (OCFO) and the Office of Budget and Program Analysis (OBPA). The following provides a short list of Departmental directives that impact USDA financial activities.*

- **DR 110-2, Management Controls**
- **DR 2120-1, Cash Management**
- **DR 2120-2, Capitalization and Depreciation of Real and Personal Property**
- **DR 2100-1, Financial Management Systems**
- **DR1043-040, Working Capital Fund Activities**
- **DR1110-002, Management Accountability and Control**
- **DR1610-002, Management and Payment of USDA (SLUC) Space Costs**
- **DR1720-001, Audit Follow-up and Final Actions**
- **DR2100-001, Financial Management Systems**
- **DR2100-002, Taxpayers Identification Numbers**
- **DR2110-001, Accounting Systems Approval**
- **DR2120-001, Cash Management**
- **DR2130-001, Management of Accounts Receivable**
- **DR2130-002, Reporting on Accounts and Loans from the Public**
- **DR2130-003, Debt Collection**
- **DR2130-004, IRS Reporting Requirements on Indebtedness**
- **DR2130-005, Debt Collection**
- **DR2130-006, Debt Collection - Uncollectible Claims**
- **DR2170-001, Performance of Commercial Activities**
- **DR2200-002, Property, Plant and Equipment**

- **DR2230-001, Management Controls On Unliquidated Obligations**
- **DR2250-001, Imprest Fund Authorities and Requirements**
- **DR2270-001, Irregularities Affecting Accounts of Officers**
- **DR2300-001, Agriculture Traveler's Charge Card Program**
- **DR2300-002, Advance of Funds for Official Travel**
- **DR2300-003, Authorized Telephone Calls on Official Travel**
- **DR2510-002, Claims Against U.S. Which Must Be Submitted to GAO**
- **DR2520-001, Interest Rate on Delinquent Debts**
- **DR2600-001, Taxation of Fringe Benefits**
- **DR2600-002, Distribution of Salary Checks**
- **DR3040-001, Records Disposition**

## **Records Management**

The Secretary of Agriculture (in accordance with 44 USC 2904, 3102, and 3301) is required to establish and maintain a records disposition program to ensure efficient, prompt, and orderly reduction in the quantity of records and to provide for the proper maintenance of records designated as permanent by the National Archives and Records Administration (NARA) (36 CFR 1228.10).

USDA's Departmental Regulation 3080-001 (DR 3080-01) establishes records management policy. Annually, each agency will receive a schedule, Files Eligible for Cleanup, which outlines the record retention requirements for all records, including administrative records. Files should be forwarded to NARA for storage or disposed of in accordance with this schedule and the policies outlined in DR 3080-001. The File Cleanup schedule is attached as an addendum. Please note that the Office of Primary Interest (OPI) is the Office of the Chief Information Officer (OCIO).

Administrative records such as source documentation for obligations and disbursements are generally maintained by the agency for only one to two years before being sent for storage where they are maintained for six years and three months.

Questions regarding Records Management can be addressed to Dr. Bette Fuggitt, Records Manager for USDA.

## **Management Accountability and Control**

Management accountability is the expectation that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law. Management controls are tools that help program and financial managers achieve results and safeguard the integrity of programs and data. These controls should be integrated into program and financial systems established by agency management to direct and guide its operations.

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## CHAPTER 2 - BUDGET EXECUTION

### ***Introduction***

*The process for budget execution begins with Congressional action and the subsequent administrative actions to make funds available to USDA entities for specific governmental purposes. Throughout their life, these funds are distributed, monitored, tracked, reported, controlled, and regulated to ensure that funds are used for appropriate purposes, that all obligations are made in accordance with legislated time limits, and that no obligations exceed authorized amounts. At the end of the fund's life, entities close out their accounts and ensure that they have made effective use of any remaining available funds and have not exceeded their total authorized funding.*

*This chapter provides both an explanation of the budget process and USDA standards and policies for this process.*

### **General Budget Process**

The annual budget process for USDA begins in early May when agency budget officers begin preparing agency estimates for the fiscal year after next. Once budget priorities are determined by a team made up of Deputy Administrators, the Administrator, the Assistant Secretary and the Deputy Secretary, the agency's Budget Division establishes Agency Budget Estimates. These estimates are transmitted to the Office of Budget and Program Analysis (OBPA) in mid-July.

Agencies present their budget requests to the USDA Deputy Secretary at department-wide hearings in August. By late August, the agency should receive a Department Allowance from OBPA. Once any appeals are resolved, the estimate package is finalized and transmitted to OMB in early September. OMB reviews the submissions and conducts its own hearings on each appropriation.

By early December, agencies receive their Presidential allowance from OMB. Once any appeals are resolved, the budget is printed. The total United States budget is transmitted to Congress in late January. Once the budget is released, agencies debrief management and staff on its details.

Congressional hearings are held in late February or early March by both the House and Senate. Once both houses of Congress are in agreement, an appropriations bill is passed and submitted for the President's signature. It is rare that the process is completed by September 30 as expected in order to enact a budget before the start of the fiscal year; therefore, a continuing resolution (CR), which is discussed later in this chapter, must be enacted allowing continued operations through temporary funding.

In order to achieve the goals established during the budget formulation process, it is critical that execution of the Department's budget is properly carried out. Accordingly, systems and processes have been established to adequately address the principles, processes, procedures, timing, and other information relative to the distribution and control of the Department budget to ensure compliance with public law and Office of Management and Budget (OMB) and Department directives during the budget execution phase.

USDA budget execution policies regarding funds distribution and control, and the associated

requirements, are contained in this chapter. Budget execution and funds control activities determine the process by which USDA funds are spent, monitored, tracked, managed, and regulated. Program and budget officials perform administrative funds control by planning, programming, and utilizing integrated budget and accounting systems to preclude violations of the Anti-Deficiency Act and other regulations. The administrative control of funds shall satisfy the requirements set forth in [OMB Circular No. A-34, Instructions on Budget Execution](#). At a minimum, the following requirements must be met:

- Funds are to be expended solely for the original appropriation purpose except as otherwise provided by law.
- Obligations or expenditures are not authorized or incurred in excess of available funds or in excess of any legal or administrative limitations.
- Only valid obligations are recorded in the accounting records and all obligations incurred are recorded accurately and promptly.
- Outstanding obligations are validated annually.

### **Relationship between the Office of the Chief Financial Officer (OCFO) and the Office of Budget and Program Analysis (OBPA)**

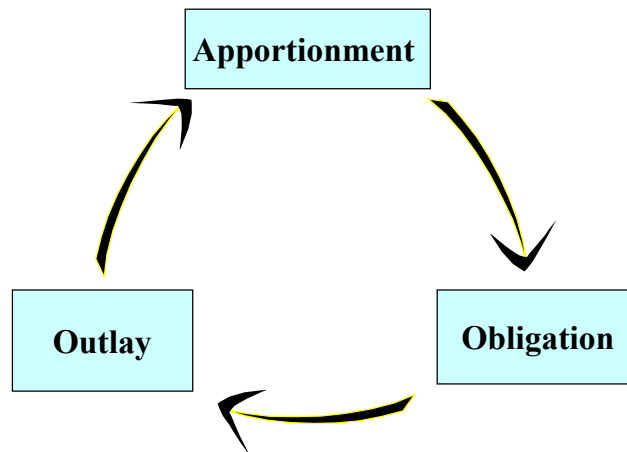
The Department's Office of Budget and Program Analysis (OBPA) was established in June 1981. OBPA is one of several Department level offices that provide centralized leadership, coordination and support for the various administrative and policy functions of the Department, by assisting program agencies in their efforts to improve service to all USDA customers. OBPA aids the Secretary and other Departmental and agency officials, including the Chief Financial Officer, in making informed decisions regarding the Department's programs and resources by providing analyses and information regarding the Department's programs and policies, budget, legislative, and regulatory actions.

OBPA's key responsibilities include:

- coordinating the preparation of the Department's budget estimates, legislative reports, and regulations
- providing direction and administration of the Department's budgetary functions including development, presentation, and administration of the budget
- reviewing program and legislative proposals for program and budget related implications
- analyzing program and resource issues and alternatives
- preparing summaries of pertinent data to aid Departmental policy officials and agency program managers in making informed decisions

### **Budget Execution**

Budget execution provides a basis for making funds available to organizations; establishing entity policy and procedures for budgetary resources; monitoring, tracking and reporting on federal funds; and supporting the establishment of budgetary limitations. The budget execution process encompasses the following cycle:



Prior to the fiscal year, or within 30 days after a spending bill is approved, you must submit an apportionment request to OMB for each account. At the beginning of the fiscal year, or at such other times as necessary, OMB apportions funds – that is, OMB specifies the amount of funds available for use by time period, program, project or activity – from the funds appropriated for that fiscal year. Throughout the year, various programs, projects, and activities use up the available funds by obligating the Federal government to make outlays, immediately or in the future.

The complete cycle of the budget execution process lasts for a minimum of six years, as the actual outlay of funds obligated during the fiscal year can occur during the next five years. During the budget execution process, the authority to incur obligations and spend money generally passes through the following major phases:

- Various types of budgetary resources are made available for use.
- Budgetary resources may be reduced or proposed for reduction, for example, proposed for rescission or deferred.
- OMB apportions the amounts available for obligation by time, project, or activities.
- Amounts available from the apportionment are allotted.
- Amounts available from the apportionment are obligated and distributed.

## Funds Control

Funds Control is the process of preventing overspending. This process requires compliance with the [Anti-Deficiency Act](#), [Appropriations Law](#), and various other budgetary laws. A number of other budget laws (including the Congressional Budget and Impoundment of 1974, the Budget Enforcement Act of 1990 and others) have been enacted to control and help guide the formulation and implementation of federal fiscal policy. These laws, in conjunction with the Constitution of the United States, play an important role in the budget process and set forth the rules and restrictions governing Federal spending.

The Anti-Deficiency Act requires that the Department establish a system of administrative control of funds. The key objectives of the fund control process include:

- Ensuring that funds are used economically and efficiently for the purposes authorized by law.
- Restricting both obligations and expenditures from each appropriation or fund account to the lower of the amount apportioned by OMB or the amount available for obligation and/or expenditure.
- Ensuring that certifying officers do not authorize expenditure of funds, but only certify the availability of funds.
- Identifying those responsible for any obligation or expenditure exceeding the amount available in the appropriation or fund account, the OMB apportionment or reapportionment, the allotment or sub-allotments, any statutory limitations, and any other administrative subdivision of funds made.

Entities should implement specific procedures which entity officials and employees are required to follow whenever they obligate or expend government funds. Processes related to funds control are discussed in the following paragraphs.

**Authorizations.** Designation of individuals selected as authorizing officials by allottees and approved funding program recipients must be in writing. If applicable, it should contain information on dollar limitations of the authorization or on use limitations. The authority may not be redelegated by an authorizing official unless specifically authorized by other USDA authority.

The allottee or approved funding program recipient must provide written notification, which includes the particulars of the authorization, to all personnel who are authorized to approve program release documents. The notification shall stress that only authorized persons will sign program release documents, verbally make commitments, or incur obligations on behalf of the activity. The notification should also include a stern warning that disciplinary action will be taken for any violations of the prohibition. Renotification must be made at least annually or when authorizations and accounting classifications or senior officials change.



**Major Players.** Funds control responsibility rests with each USDA agency. Many players are involved in the funds control process, including:

- Foundation Financial Information System (FFIS) – issues financial reports.
- Funds Officers - responsible for reviewing status of funds reports. Before personnel actions may be taken or procurement authorized, funds officers must verify availability by signing off on the commitment or obligation document. Any obligations appearing on the status of funds report should be reviewed by the funds officer to ensure that only the allowance holder's authorized obligations have been recorded.
- Administrator - presents agency budgets to the Department, OMB and Congress; makes funding decisions within the Agency; and approves operating plans for Agency allowance holder.
- Budget Division – responsibilities include:
  - developing budgetary requests relating to appropriations and apportionments for submission to the Department, OMB and Congress
  - issuing allotments and allowances for administrative funds and establishes related accounting codes
  - preparing special analyses and projections for use by the Administrator and other top Agency officials
  - assisting the Administrator and Deputy Administrator for Financial Management in monitoring the financial performance of all allowance holders
  - providing guidance, materials, training, and assistance to allowance holders, funds officers, and other Agency personnel
  - reviewing any undistributed charges and assigns the appropriate accounting code
  - monitoring prior year obligations and liquidation of obligations
  - using the proof of payments reports to verify that only correct disbursements were made for purchase orders
  - providing specific policy guidelines for travel payments and serves as liaison with the official USDA travel agent
- Allowance Holders - includes the Administrator, Staff Directors, Deputy Administrators, and Regional Administrators; their responsibilities include:
  - authorizing the obligation and expenditure of funds in accordance with legislative intent and within the amount of the allowance
  - subdividing allowances to a lower organizational level, if desired
  - assigning specific responsibility for maintaining funds control in their organization.
- National Finance Center - processes documents received from the Agency, including those for obligations, payments, billings, and collections and maintains accurate accounting records based on these documents.

- Other Organizations - Responsibility for issuing obligation documents has been delegated to other organizations in some cases. These cases include printing, procurement, motor pools, telecommunications, and personnel. Specifically:
  - Office of the Chief Information Officer's Information Resources Management Division, and Office of Communication's Public and Media Outreach Center.
  - Departmental Administration offices Procurement staff and regional procurement staffs for procurement activities.
  - Departmental Administration Office of Human Resources and regional Personnel staffs for hiring, promotions, cash awards, lump sum leave payments, training, and security clearances.

## *Authoritative Sources*

### **OMB Circulars**

OMB's predominant mission is to assist in overseeing the preparation of the Federal budget and to supervise its administration in Executive Branch agencies. OMB evaluates the effectiveness of agency programs, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities. OMB ensures that agency reports, rules, testimony, and proposed legislation are consistent with the President's budget and with Administration policies. In performing these tasks, it has published large amounts of guidance, in the form of bulletins and circulars on budget related issues. Some specific circulars that apply to this chapter include:

*OMB Circular No. A-11, Preparation and Submission of Budget Estimates*  
<http://www.whitehouse.gov/omb/circulars/a11/01toc.html>

This Circular provides detailed instructions and guidance on the preparation and submission of budget requests and related material. The instructions in this Circular apply to all Government agencies, unless specifically exempted by OMB.

In accordance with this Circular, budget proposals should result from a comprehensive system that integrates analysis, planning, evaluation, and budgeting, and budget estimates should reflect:

- (a) The judgment of the agency (department) head regarding the scope, content, performance, and quality of programs and activities; and
- (b) Adequate support for accomplishment of approved plans for management improvement in the areas of management integrity and controls, credit and cash management, financial systems, and financial reporting.

This Circular is revised annually to include changes for preparing estimates for the budget year and legislative updates (e.g. Federal Credit Reform Act and GPRA requirements).

*OMB Circular No. A-34, Instructions for Budget Execution*  
<http://www.whitehouse.gov/omb/circulars/a034/toc00.html>

This Circular provides instructions for: handling budget execution; monitoring federal outlays; obtaining exemptions from the GAO access to records; reporting requirements for unvouchered expenditures; closing accounts; and monitoring federal employment.

*Anti-Deficiency Act*

<http://www.dol.gov/dol/oasam/public/regs/statutes/antidef.htm>

The Anti-Deficiency Act was enacted to prevent the obligation of government funds that are not available. Compliance with the Anti-Deficiency Act is determined at the point in time that the obligation occurs. Violations of the Anti-Deficiency Act occur when an officer or employee of the government:

- makes or authorizes an obligation or disbursement under any appropriation or fund in excess of the amount available
- involves the Government in a contract or other obligation for the payment of money for any purpose in advance of appropriations made available for such purpose, unless such contract or obligation is authorized by law
- accepts voluntary service for the United States or employs personal services in excess of that authorized by law, except in cases of an emergency involving the safety of human life or the protection of property
- authorizes or creates an obligation or makes a disbursement in excess of an apportionment or reappropriation
- authorizes or makes an allotment, authorizes or creates an obligation, or makes a disbursement in excess of the amount permitted by regulation or instructions issued by heads of Departmental entities pursuant to a regulation. Statutory limitations are subject to this provision.

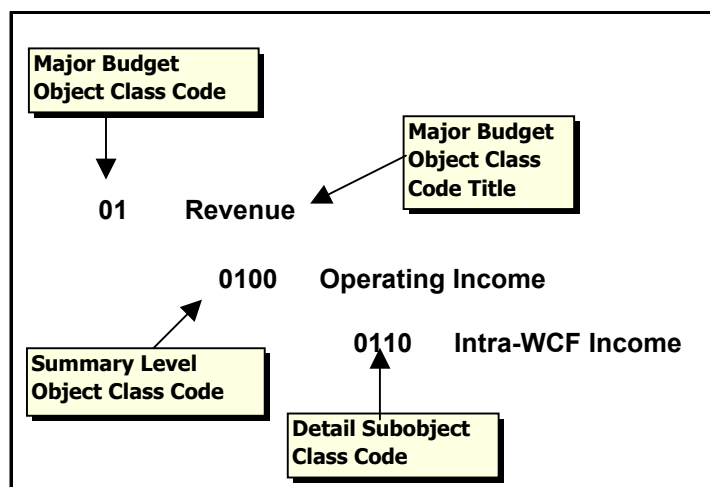
USDA provides guidance on the reporting of violations of the Anti-Deficiency Act. In accordance with OMB Circular No. A-34 and the USDA Budget Manual, the head of the entity or office shall promptly submit to the Department, through OBPA, a letter addressed to the President for signature of the Secretary when an officer or employee of the United States commits any of the above violations.

**The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 666)**, defines the legal basis for the issuance of appropriation warrants by the Secretary of the Treasury, who is responsible for the system of central accounting and financial reporting for the Government as a whole.

*USDA National Finance Center's (NFC's) Procedures on Budget Object Classification Codes (BOCC's)*

<http://dab.nfc.usda.gov/pubs/na-pubsmain.html>

Budget object classification codes are used by the Federal Government to record its financial transactions according to the nature of services provided or received when obligations are first incurred. The Office of Management and Budget (OMB) Circular No. A-11 (Section 83) establishes the major object class codes and titles for use by all Federal agencies. In addition to these codes and titles, the NFC's procedures identify summary level object class codes and detail sub-object class codes they assign.



The manual containing the NFC's procedures, which can be found in its entirety at <http://dab.nfc.usda.gov/pubs/na-pubsmain.html> provides a reference list of budget object classification codes to be used by Agencies and Departments serviced by NFC. These codes are used when obligations are first incurred to record financial transactions according to the nature of services provided or received. The manual includes an introduction that describes how budget object classification codes are used, provides an interpretive schematic that identifies the levels of coding, and informs the reader how to obtain technical support. It also contains a reference list of budget object classification codes to be used by Agencies and Departments serviced by NFC. NFC also issues short written notices called bulletins to keep readers informed about new or changed information related to this publication.

For questions about budget object classification codes, contact the Requirements and Development Coordination Branch at (504) 255-5544. For questions about the NFC's Procedures on Budget Object Classification Codes manual, contact the Credit, Travel, and Accounting Policy Division at (202) 720-8992.

*SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*

<http://www.fasab.gov/pdf/ssfas-7.pdf>

**This statement amended Statement of Federal Financial Accounting Concepts No. 2, Entity and Display. The statement clarifies the classification of exchange revenue, which occurs when one party sacrifices value to receive a valuable good or service. The statement determines how an entity should account for inflows of resources from revenue and other financing sources in its general-purpose financial statements.**

*SFFAS No. 7 Implementation Guide*

<http://www.fasab.gov/pdf/impguid7.pdf>

**This guide presents examples to illustrate the requirements outlined in SFFAS No. 7. The hyperlink is included here for ease of reference, although the guide is not an authoritative source.**

*SFFAS No. 22, Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations*

<http://www.fasab.gov/pdf/sffas-22.pdf>

**This statement, an amendment to SFFAS No. 7, deletes the requirement to report increases and decreases in receivables from the public related to exchange revenue as nonbudgetary resources.**

**Budget Object Classes**

USDA's BOC's can be found online at <http://dab.nfc.usda.gov/pubs/na-pubsmain.html>. The structure of the codes is based on requirements included in [OMB Circular No. A-11](#), “Planning, Budgeting, and Acquisition of Fixed Assets,” Section 35, “Object Classification (MAX Schedule O).”

The major object class and major object class extension are assigned by OMB as follows:

Budget Object Classification	
Code	Standard Title
11.1 - 11.9	Personnel Compensation
12.1 & 12.2	Personnel Benefits
13.0	Benefits for Former Personnel
21.0	Travel and Transportation of Persons
22.0	Transportation of Things
23.1-23.3	Rent, Communications, and Utilities
24.0	Printing and Reproduction
25.1 - 25.8	Other Contractual Services
26.0	Supplies and Materials
31.0 - 33.0	Acquisition of Assets
41.0 - 44.0	Grants and Fixed Charges
91.0 - 99.9	Other

## ***Appropriations***

Congress reviews the President's budget request during the summer months. Typically, the House and Senate mark up the budget separately and discuss a compromise during Conference. Once a budget agreement has been reached, Congress passes an appropriation act for the coming fiscal year, which provides legal authority for entities to incur obligations and to make payments from the Treasury for specified purposes. If agreement cannot be reached, Congress may either pass a Continuing Resolution, which is discussed later in this section) or, in rare cases, close down government operations.

Appropriations law is the body of law that governs the availability and use of federal funds. It ensures that funding is used properly in terms of the purpose, time, and amounts, of obligations and expenditures, and that appropriated funds are used for the purpose for which Congress intended. Appropriations law focus is on the decisions and opinions of the Comptroller General; a comprehensive overview of appropriations law is contained in a series of volumes issued by the General Accounting Office entitled "Appropriations Law"(informally called the "Red Book"). The Red Book volumes may be obtained at [www.gao.gov](http://www.gao.gov).

Appropriation is one form of budgetary authority, which is a general term referring to various forms of authority provided by law to enter into obligations which will result in immediate or future outlays of government funds. There are four basic types of budget authority that Congress utilizes to finance federal programs and activities, including:

- Appropriations – provisions of law that make funds available for obligation and expenditure
- Contract Authority – the making of funds available for obligation but not for expenditure
- Borrowing Authority – 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
- Reimbursable Authority
- Offsetting receipts and collections.

Appropriations are the most common form of budget authority and are explained further below. The other forms of budget authority are also discussed briefly later in this chapter.

### **Types of Appropriations**

*Appropriations are identified on financial documents by account symbols which are assigned by the Treasury Department based on the number and types of appropriations an agency receives and other types of funds it may control. An appropriation account symbol is a group of numbers, or a combination of letters and numbers, which identifies the agency responsible for the account, the period of availability of the appropriation, and the specific fund classification. The following classifications are used to define types of appropriations.*

**Classification Based on Duration**

- *One-year appropriation* – available for obligation only during a specific fiscal year; this is the most common type of appropriation, also known as a “fiscal year” or “annual” appropriation.
- *Multiple-year appropriation* - available for obligation for a definite period of time in excess of one fiscal year
- *No-year appropriation* – available for obligation for an indefinite period; a no-year appropriation is usually identified by appropriation language such as “to remain available until expended.”

**Classification Based on Presence or Absence of Monetary Limit**

- *Definite appropriation* – a specific amount of money; a definite appropriation includes authority stated as “not to exceed” a specified figure.
- *Indefinite appropriation* – an unspecified amount of money; an indefinite appropriation may appropriate all or part of the receipts from certain sources, the specific amount of which is determinable only at some future date, or it may appropriate “such sums as may be necessary” for a given purpose.

**Classification Based on Permanency**

- *Current appropriation* – made by Congress in, or immediately prior to, the fiscal year or years during which it is available for obligation.
- *Permanent appropriation* – a ‘standing’ appropriation, once made is always available for specified purposes and does not require repeated action by Congress to authorize its use.

**Classification Based on Availability for New Obligations**

- *Unexpired appropriation* – available for incurring and recording new obligations.
- *Expired appropriation* – no longer available to incur new obligations, although it may still be available for the recording and/or payment (liquidation) of obligations properly incurred before the period of availability expired.

**Transfers of Funds**

Appropriation acts and other laws often provide for the transfer of funds between departments or between appropriations within USDA. This occurs when programs cross organizational lines or can be more efficiently and economically conducted through cooperative effort. A transfer involves the shifting of funds between appropriations. For example, if an agency receives one appropriation for Operations and Maintenance and another for Capital expenditures, a shifting of funds from either to the other is a transfer.

Transfer is prohibited without statutory authority. This rule applies to transfers from one agency to another, transfers between two accounts within the same agency and transfers to an interagency or interagency working fund. An unauthorized transfer would violate 31 U.S.C. § 1301 (a), which prohibits the use of appropriations for other than intended purposes. It would also constitute an unauthorized augmentation of the receiving appropriation, and could, if the transfer led to over obligating the receiving appropriation, result in an Anti-Deficiency Act violation.

Some agencies have limited transfer authority either in permanent legislation or in appropriation act provisions. Such authority will commonly set a percentage limit on the amount that may be transferred from a given appropriation and/or the amount by which the receiving appropriation may be increased.

### **Reprogramming**

On occasion, it is necessary for an agency to change the amount of funding provided for a program in an appropriation. Reprogramming shifts funds within an appropriation account in order to restate the intended purpose of the funds. The reallocation of funds is limited to activities within the same appropriation account and cannot violate the appropriations language, including any stipulations for the fiscal year involved. A reallocation of funds to a different account or a reallocation that would result in a violation of an earmark in appropriations language cannot be handled as a reprogramming; instead, it is a transfer, as discussed above.

The authority to reprogram is inherent in the agency's responsibility to manage its funds; no statutory authority is necessary. There is no general statutory provision either authorizing or prohibiting reprogramming, which usually develops from informal agreements between various agencies and their congressional oversight committees. These informal arrangements do not have the force or effect of law.

### **Rescissions**

Although it rarely occurs, Congress has the authority to enact a Rescission Bill that cancels the availability of budgetary resources previously provided by law before the authority would otherwise lapse. The Impoundment Control Act specifies that, whenever the President determines that all or part of any budget authority will not be required to carry out the full objectives or scope of programs for which it is provided, the President will propose to the Congress that the funds be rescinded. Likewise, if all or part of any budget authority limited to a fiscal year (e.g., annual appropriations or budget authority for the last year of multiple-year accounts) is to be reserved for the entire fiscal year, a rescission will be proposed. Budget authority also may be proposed for rescission for other reasons. Generally, amounts proposed for rescission will be withheld during the time the proposals are being considered by the Congress. This may be accomplished through OMB apportionment action and through agency withholding action.



All funds proposed for rescission, including those withheld, must be reported to the Congress in special messages. Positive action in the form of an enacted law must be completed to rescind funds. If both houses of the Congress have not completed action on a rescission proposed by the President within 45 calendar days of continuous session, any funds being withheld must be made available for obligation.

## Sequesters

*The sequester process was originally established in the Gramm-Rudman-Hollings law (the Balanced Budget and Emergency Deficit Control Act) in 1985, as amended by the Budget Enforcement Act. If OMB determines that legislation for a given year will not meet the deficit target or discretionary spending limits, then the President must issue an order to sequester (reduce or cancel) budget authority. A sequester reduces budget authority across the board equally for all discretionary programs. Mandatory programs are reduced by certain "special rules" included in the Gramm-Rudman-Hollings law.*

## Continuing Resolution

Continuing resolutions (also known as "CRs") are joint resolutions that provide continuing appropriations for a fiscal year. If an appropriation is not enacted by the beginning of the fiscal year, Congress can pass a continuing resolution to prevent a government shutdown due to lack of funds. The continuing authority (after it is signed by the President or after Congress overrides a Presidential veto) is usually temporary in nature and specifies a maximum amount or rate at which obligations may be incurred. This rate is usually the lowest amount in either the prior year's budget, the President's budget request, or an appropriation bill passed by either or both Houses of Congress.

Amounts made available for obligation do not remain available after a continuing resolution expires. CRs make amounts available for obligation only until a time specified by the CR or until the enactment of regular fiscal year appropriations, whichever is sooner. A CR normally provides temporary funding as a stop-gap measure, but could be set to last any period of time, as specified by the CR (one day, a few days, a few weeks, or a month). The normal appropriations process will eventually produce appropriation acts to replace or terminate the CR.

Normally, a CR makes amounts available subject to the same terms and conditions that are specified in the enacted appropriations acts for the prior fiscal year. The CR may also establish additional terms and conditions. However, agencies are not usually permitted to start new projects or activities or to terminate existing projects or activities.

## Treasury Warrant

Once Congress enacts an appropriation, the entity requests that the funds be made available from Treasury. Treasury issues a warrant (FMS Form 6200) that establishes, by federal account symbol, the individual amounts appropriated by Congress, which an entity can use to liquidate (disburse) amounts obligated against the account or fund. The warrant is received in the Office of Financial Systems and a copy is forwarded to the Budget Execution Branch to verify that:

- The Treasury warrant and the OMB apportionment provided by the same legislation are reconcilable.

- The appropriation symbol and the title are the same on both.
- The legislation citation is the same on both.

When appropriation legislation is passed, Treasury will prepare a warrant to cover full amount of budget authority provided by the appropriation. The warrant establishes the agency's Fund Balance with Treasury account.

### **Other Budgetary Resources**

The most common types of budgetary resources used for budget execution are: appropriations; continuing resolutions; non-expenditure transfers; estimated reimbursements and other income including user charges. Appropriations and continuing resolutions have already been discussed. An explanation of non-expenditure transfers, estimated reimbursements and user charges follows.

**Non-expenditure Transfers.** Non-expenditure transfers (SF-1151) occur when all or part of the budgetary resources in a USDA account are transferred to another government account. In a non-expenditure transfer, budgetary resources are shifted from one purpose to another, but such transfers do not represent payments for goods and services received or to be received as in the case of an expenditure (reimbursable) transfer. Non-expenditure transfers include the following types:

- Transfers without benefit to a transferring account;
- Transfers for establishment of transfer appropriation accounts, for the benefit of the advancing account;
- Borrowing from Treasury under loan authorization capital transfers; and
- Borrowing from other funds.

**Estimated Reimbursements and Other Income.** USDA has several entities and programs (e.g., GIPSA, APHIS, FSIS, and AMS), which incur revenues and related expenses throughout the year. Apportionments can include anticipated amounts of reimbursements and other income even if the amounts are not available for obligation. Special attention must be given to apportionments that include anticipated reimbursements and other income since budget execution and funds control standards apply for these types of activities as well.

- Expenditures in excess of resources available are prohibited. Inclusion of the anticipated reimbursable amounts in the apportionment in no way authorizes an entity to obligate or make expenditures in excess of the budgetary resources available for obligation from such sources at the time the obligation or expenditure is made. Because of this limitation, entities that receive approved apportionments containing estimated reimbursements and other income must maintain constant and careful oversight to ensure that these reimbursements and revenues are earned as planned.
- In the case of estimated reimbursements and other income, budgetary resources available for obligation can include:

- (a) Entitlement to reimbursement and other income based on goods and services furnished and as authorized by law;
  - (b) The amounts of orders received from within the Government that represent valid obligations of the ordering account, to the extent that the reimbursements therefore will be placed in the current account when collected; and
  - (c) The amount of unfilled customer orders from the public for which advance payment has been received by the Government.
- Obligations are to be limited at all times to the smaller of the apportionment or the budgetary resources available. If there is an anticipated shortfall in revenues or reimbursements earned, obligations will be restricted to the budgetary resources available for obligation. The OCFO and OBPA should be notified of any anticipated shortfall to determine the impact on the allottee as well as on total USDA funding.

**User Charges.** A user charge, as described below, will be assessed against each identifiable recipient for special benefits derived from Federal activities beyond those received by the general public. When the imposition of user charges is prohibited or restricted by existing law, agencies will review activities periodically and recommend legislative changes when appropriate. In general, legislation should seek to remove restraints on user charges and permit their establishment under the guidelines provided in OMB Circular No. A-25.

Agencies are responsible for the initiation and adoption of user charge schedules consistent with the policies in Section 6 of OMB Circular No. A-25. Each agency shall:

- Identify the services and activities covered in the OMB circular;
- Determine the extent of the special benefits provided;
- Apply the principles specified in determining full cost or market price, as appropriate (SFFAS # 4);
- Apply the guidance in Section 7 of the OMB Circular either to institute charges through the promulgation of regulations or submit legislation as appropriate;
- Review the user charges for agency programs biennially, to include: (1) assurance that existing charges are adjusted to reflect unanticipated changes in costs or market values; and (2) a review of all other agency programs to determine whether fees should be assessed for Government services or the user of Government goods or services. Agencies should discuss the results of the biennial review of user fees and any resultant proposals in the Chief Financial Officers Annual Report required by the Chief Financial Officers Act of 1990;
- Ensure that the requirements of OMB Circular No. A-123 (Internal Control Systems) and appropriate audit standards are applied to collection;
- Maintain readily accessible records of:

- services or activities covered by this Circular.
  - extent of special benefits provided.
  - exceptions to the general policy of this Circular.
  - information used to establish charges and the specific method(s) used to determine them.
  - collections from each user charge imposed.
- Maintain adequate records of the information used to establish charges and provide them upon request to OMB for the evaluation of the schedules and provide data on user charges to OMB in accordance with the requirements in Circular No. A-11.

**Contract Authority.** Contract authority is a form of budget authority that permits contracts or other obligations to be entered into in advance of an appropriation or in excess of amounts otherwise available in a revolving fund. It is to be distinguished from the inherent authority to enter into contracts possessed by every government agency but which is dependent upon the availability of funds.

Contract authority itself is not an appropriation; it provides the authority to enter into binding contracts but not the funds to make payments under those contracts. Therefore, contract authority must be funded by a subsequent appropriation referred to as a ‘liquidating appropriation’ or by the use of a supplemental appropriation.

**Borrowing Authority.** Borrowing authority permits entities to incur and liquidate obligations and make payments to liquidate the obligations out of borrowed funds. Usually the funds are borrowed from the Treasury Department (from the sale of public debt securities), but may also be borrowed from the public (through the sale of agency debt securities) and the Federal Financing Bank. Borrowing from the Treasury, as known as “public debt financing” is the most common form of borrowing authority.

Borrowing authority may be definite or indefinite. Definite borrowing authority provides a specific amount of authority that cannot be exceeded. Authority is recorded at the beginning of the program and carried forward until the authority is either (1) rescinded or completely consumed, or (2) the program is terminated, whichever comes first. This type of authority is normally accounted for through a no-year account. The authority does not expire but remaining authority must be reapportioned each year.

Indefinite borrowing authority is unlimited (although there may be a legislative cap on total borrowing authority at any given time). Authority is recorded as needed to fund obligations during the life of the program. Indefinite authority is also usually accounted for through a no-year account and the authority is reduced to the amount needed for obligations for the current year. Indefinite authority does not carry over except for unpaid obligations.

**Other Fund Types.** Besides reimbursable agreements, the Department has other funds that receive income for USDA operations. The Department's Working Capital Fund (WCF) is set up with authorizing legislation and does not receive appropriations. The WCF develops its budget estimates based on customer demand for its products. The legislation establishing a working capital fund at USDA is found at 7 USC 2235 (July 12, 1943).

Revolving funds are designed to operate according to commercial business practices, in order to improve operations. They are intended to have more freedom than appropriated activities. Rates are established with the intent of recapturing the costs of selling products and services to the Fund's customers. Revolving fund activities are not concerned with the fiscal period since they are no-year appropriations and may carry forward unobligated balances. There are fewer administrative limitations from appropriation language. The fund also has flexibility with regard to spending funds. Some categories of expenses supported by the WCF include:

- Personnel compensation and benefits
- Contract services and supplies
- Travel (people)
- Transportation (things)
- Rent
- Communications and Utilities
- Printing and Reproduction
- Maintenance and Repair
- Fees
- Supplies and Materials
- Distributed Overhead

The Fund falls under the responsibility of the Chief Financial Officer's operation; however, the CFO relies on a WCF Executive Committee that represents each of the program mission areas in the Department. Annually the Committee reviews and makes recommendations to WCF and activity management on activity center budget estimates and program proposals.

Appropriations usually are provided to start, increase the size, or replace significant losses of a public enterprise or working capital fund. Also, existing resources in other accounts may be transferred to a working capital fund as capitalized assets to serve these same purposes in lieu of an appropriation.

Revenues are generated in USDA revolving funds from customers buying goods or services. The funds collected from customers are used to pay for the acquisition of resources needed to operate the working capital fund. In working capital funds that are apportioned by the OMB, the ability to incur obligations is limited to the amount of authority approved for obligation during the budget review as amended by unanticipated events during execution. The SF-132, discussed later in this chapter, is required to be submitted to the OMB for approval of the amount of obligation authority needed for the operation of the working capital fund for a fiscal period, usually a full fiscal year.

*The apportionment of anticipated reimbursements as obligational authority does not authorize a working capital fund to obligate in excess of the orders received from within the Federal Government and advances received for orders outside the Federal Government. Orders from state, local, and foreign governments are considered to be orders from the public. Other assets, whether of a working capital nature such as inventories of stock or of a fixed asset nature, are not considered as a budgetary resource. Such assets, therefore, do not enter into the determination of unobligated balances. However, claims against budgetary resources, such as accounts payable and undelivered orders, are obligations of a working capital fund and must be subtracted from unobligated balances when incurred. Obligations for the procurement of inventories, as well as for the acquisition of other working capital fund assets, must be recognized, recorded, and reported along with other obligations.*

The amount of contract authority apportioned or the available balance of contract authority may be less than the total budgetary resources available in a working capital fund. The difference, which cannot be obligated unless it is apportioned, may be characterized as either an unapportioned balance of a revolving fund or a restrictive withholding. The concept of an unapportioned balance is one of preserving a portion of the fund's capital so it may continue to revolve or represents those resources not scheduled for obligation within a fiscal year.

The incurring of obligations or authorizing the incurrence of obligations in excess of apportioned budgetary resources must be reported as an apparent violation of the Anti-Deficiency Act. This reporting requirement applies whether or not a working capital fund has unapportioned budgetary resources or non-budgetary assets greater than the amount of the deficiency.

### ***Apportionments***

An apportionment is a plan approved by OMB to spend resources provided by law. The law providing the resources may be a permanent law (mandatory appropriations), one of the 13 annual appropriations acts, a supplemental appropriations act, or a continuing resolution. Apportionments are requested for the following types of appropriated obligational authority:

- Budget authority;
- Unobligated balances;
- Reimbursements and other income;
- Recoveries of prior year obligations; and
- Restorations and write-offs.

The apportionment process is utilized to centralize the Administration approval of agency spending plans to:

- Prevent agencies from obligating funds in a manner that would require deficiency or supplemental appropriations. Note: In certain specified instances, OMB may approve apportionments and reapportionments that indicate the necessity for a deficiency or supplemental appropriation. However, these instances must be reported to Congress.
- Achieve the most effective and economical use of amounts made available.

The entity budget office must prepare and submit a request for apportionment or reapportionment, using the SF-132, Apportionment and Reapportionment Schedule, ([detailed instructions and sample SF-132](#)), to the appropriate OBPA Budget Officer for review, approval, and submission to the Office of Management and Budget (OMB). The request must be signed by an officer duly authorized by the head of the agency. The apportionment request reflects the appropriation and can include collections of user fees, anticipated reimbursements, and other forms of revenue. Types of apportionments include:

- Category A. Apportionment by fiscal quarter.
- Category B. Apportionment by time periods other than by quarters; for activities, projects, objects; or for a combination thereof.

Initial apportionment requests must be submitted by August 21 if any part of the budgetary resources for an account is *not* determined by current action of the Congress (such as permanent appropriations, public enterprise and other revolving funds subject to apportionment, reimbursements and other income and balances of prior year budget authority). However, if all or any part of the budgetary resources for an account are determined by current action of Congress, initial apportionment requests are due by August 21, or within 10 calendar days after the approval of the appropriation or substantive acts providing new budget authority, whichever is later.

Once OMB approves the SF-132, it is returned to OBPA, who then distributes copies as required within OCFO and notifies cognizant program organizations of the action by OMB. OMB also provides a copy to Treasury to initiate the Treasury Appropriation Warrant process. The Treasury Warrant is the official document issued by the Secretary of the Treasury that establishes the amount of money authorized to be withdrawn from the Treasury for payments of obligations. The Treasury Appropriation Warrant may also be issued to reduce the amount of monies authorized to be withdrawn from the accounts maintained by Treasury. These credit warrants are issued to reduce accounts in accordance with enacted rescissions and appropriation offsets. The apportionment provides budget authorization, allowing the entity to incur obligations and expenditures in accordance with any provisions contained in the apportionment schedule. Apportionments are recognized in the 45XX general ledger account series.

OMB divides the appropriation into amounts available for obligation usually by specific time periods (Category A), and sometimes by activities, projects, or objects (Category B). The amounts apportioned by OMB as indicated on the SF-132 are legal limitations on funds availability and, as such, represent ceilings on the amount that may be obligated. For example, if OMB incorporates a program identification into the apportionment schedule, the amount identified is a legal limitation on the use of funds for that program.

Reapportionments are requested when changes need to be made to the previously approved apportionment. Reapportionments may be required for any of the following:

- New obligational authority when unobligated carryover for the same appropriation was previously apportioned.
- Supplemental appropriations.
- Appropriation transfers.
- Release of deferrals or denial of proposed rescissions.

For no-year and multi-year appropriations, unobligated carryover must be apportioned on an annual basis since apportionments only cover 1 year. In no case will an apportionment cover a period longer than 1 fiscal year. However, unobligated balances apportioned for periods less than 1 fiscal year remain available for obligation through the end of the fiscal year. For example, the unobligated balance of funds apportioned for the first quarter are available for obligation in subsequent quarters of the same fiscal year without reapportionment.

*For further details on apportionments, see OMB Circular No. A-34.*

## ***Allotments***

### **Advice of Allotment**

After OMB apportions the funds, the USDA Office of Budget and Program Analysis (OBPA) provides each entity head with an advice of allotment. The allotment process is the principal means whereby responsibility is fixed for the conduct of program activities within the funds available.



UNITED STATES DEPARTMENT OF  
ADVICE OF ALLOTMENT

1 DOC. REF. NO:	98-K400-001
2 DATE ENTERED:	11/20/97
3 COPIES TO:	720A, 720B

4 TO:  
5 APPROPRIATION SYMBOL, TITLE, AND FISCAL YEAR:

6 FUND	7 PROGRAM CLASS	8 TITLE	9 PREVIOUS	10 INCREASE/ DECREASE	11 PRESENT
3300	337	Agriculture	0	2,215,000	2,215,000
	338	Irrigation Drainage	0	444,000	444,000
	339	Forestry	0	7,346,000	7,346,000
	340	Water Resources	0	4,600,000	4,600,000
	341	Unresolved Hunting & Fishing	0	2,214,000	2,214,000
		12 TOTAL	0	16,819,000	16,819,000

13 AUTHORITY: These funds are made available pursuant to P.L. 105-83, Department of Interior and Related Agencies Appropriations Act, 1998, signed November 14, 1997.

14 STATE PURPOSE OF FUNDS: The funds will support non-recurring natural resource projects in the field.

CONDITIONS: THESE FUNDS ARE SUBJECT TO THE CONDITIONS AND RESTRICTIONS CONTAINED IN 26 IAM.

15 TOTAL ALLOTTED FOR FY 1998 :			19 FY 1998 RESOURCES AVAILABLE
16 FUND	17 PROGRAM CLASS	18 TITLE	
3300	337	Agriculture	2,215,000
	338	Irrigation Drainage	444,000
	339	Forestry	7,346,000
	340	Water Resources	4,600,000
	341	Unresolved Hunting & Fishing	2,214,000
		TOTAL	16,819,000

20 APPROVED BY: Deputy Commissioner \_\_\_\_\_ DATE: \_\_\_\_\_  
 21 RECEIVED BY: Director, Office of \_\_\_\_\_ DATE: \_\_\_\_\_

(RETURN A SIGNED COPY TO THE DIVISION OF BUDGET)

## Distribution of Allotments

When apportionments are received, allotments should be distributed by major object class as required in the budget formulation process. If budgetary resources are not subject to OMB apportionment (e.g. certain trust funds) and statutory authority making funds available for obligation exists, the authority for entity employees to allot funds and to incur obligations within the budgetary authority is delegated to the entity head or other authorized entity official. Allotments are recognized in the 46XX general ledger account series.

## Funds Control Required At the Allotment Level

Entities must carry out their operating responsibilities within the provisions of the allotment from the Secretary of Agriculture and within the provisions or limitations reflected in the apportionment. An over-obligation or over-expenditure of an allotment is a violation of the Anti-Deficiency Act. Therefore, absolute funds control is required for commitments (if the entity controls funds by commitments), obligations, and expenditures at the allotment level. The USDA Budget Officer is responsible for making, with the Secretary of Agriculture's approval, allotments to entities in amounts not in excess of funds made available to the Secretary through the appropriation and apportionment process.

## Establishing Changing Allotments

The procedures for establishing and changing allotments and are as follows:

- Allotments should be made using the formal “Advice of Allotment” document;
- Procedures should identify names and position titles of those authorized to issue and reduce allotments; and
- Documentation should include available amount; funding source (e.g., appropriations, reimbursements); time period of availability; and justification for allotment changes.

## Absolute and Advisory Control

Several levels of budget limitations exist for federal funds to ensure entities stay within their available funding amounts. The two types of controls that govern these levels of budget execution and funds control include:

1. **Absolute (or mandatory) Controls** - restrict obligations and/or expenditures to specific funds availability thresholds and are a result of legal limitations. The higher areas of the budget level structure, such as an appropriation, apportionment, and advice of allotment, fall under absolute control.
2. **Advisory Controls** - are optional and are established at Departmental or entity discretion. The lower budget levels under advisory control are allocations, allowances and operating plans. These levels will be discussed later in the Budget Execution section.

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## ***Allocations***

After funds are made available to an entity through Congressional action (after the legislation is signed by the President or after Congress overrides a Presidential veto) and the subsequent administrative actions described below, the process of budget execution begins. USDA entities may choose to allocate their funds, i.e., distribute the advice of allotment to lower levels within their respective organizations, to better manage or control funding by using the organizational components of the accounting classification code structure. This allows the entity to obtain detailed data that can be summarized for upper level management and that is needed to meet internal and external reporting requirements.

**Operating Plans.** Sometimes called a Budget Execution Plan, an operating plan is developed by entity groups having responsibility for administrative and program resources. Although it can be developed at a higher budget level, the plan is usually created at the lowest level of the allocation. The plan is useful in making effective use of limited funds and provides a benchmark against which to compare cumulative obligations and year-end projections.

The operating plan should be developed in advance of the apportionment process, on the basis of anticipated and actual funding levels and can be revised later to reflect the approved budget and then periodically for management of resources. An operating plan is optional, and developed by managers to manage their resources for salaries, awards, rent, and other items. Object classes (major and sub-object classes) are used at this level to identify the types of activities on which funds are being spent.

**Budget Level Structure.** Once the advice of allotment is received from OBPA, an entity implements its own controls to manage the funds. The head of each entity to which allotments are made available is responsible for limiting obligations or expenditures to amounts permitted by appropriations, apportionments and allotments. Toward that goal, each entity has its own budget level structure.

**Allocation Options.** A budget level structure is how an entity distributes and organizes its budgetary resources internally. The entity head can maintain total control over the funding and not further divide the funds beyond the appropriation level. However, most entities have a structure in which the funds are further divided. The entity head may authorize his/her senior level subordinates to incur obligations within a specified amount for better control or to better utilize resources.

**Minimum Reporting Requirements.** For the purposes of budget formulation and execution, the Department's system for accounting and internal control shall provide information on actual obligations, outlays, and budgetary resources. The USDA chart of account balances is the principal source of information and establishes controls consistent with financial plans.

## ***Commitments***

A commitment is a reservation of a specific amount of available funds that provides for a later issuance of an obligation. Not all activities require the issuance of a commitment prior to the incurrance of an obligation. Funds control requires certification of funds availability prior to the occurrence of commitments or obligations. Commitment of funds is established to enhance the funds control process by earmarking funds prior to the preparation and processing of the official obligation document. However, commitments are optional and are not required for all obligations or disbursements. Commitments are recognized in the 47XX general ledger account series.

If an entity does not use commitments, funds control requires certification of funds availability prior to the occurrence of obligations. No amount shall be reported as an obligation unless supported by documentary evidence of transactions authorized by law. OMB Circular No. A-34, Section II, provides details about the application of the concept of obligations to various types of transactions such as personal services and benefits; travel and transportation; rent; communications; and utilities; printing and reproduction; lands and structures; grants; etc.

## ***Obligations***

An obligation represents the amounts of orders placed, contracts awarded, services received, and similar transactions during a given period that will require payment during the same or a future period. An obligated balance equals the cumulative amount of budget authority that has been obligated but not yet outlayed, also known as unpaid obligations net of accounts receivable and unfilled customers orders. Budgetary resources must be available before obligations can be incurred legally. It is legally binding on the part of the government to make payment once the goods or services are provided. Obligations are recognized in the 48XX general ledger account series.

It is sound financial policy for an entity to obligate funds whenever it orders goods or services. Although entities may face practical difficulties obligating services such as travel or goods such as supplies in advance of performance or delivery, up-front obligation avoids the possibility (at the end of a quarter or fiscal year) that available funds are exhausted before an after-the-fact obligation can be made.

**Delivered vs. Undelivered Order.** Undelivered orders are the amount of goods and services ordered by an account but not yet received, i.e., the amount of orders for goods and services outstanding for which the liability has not yet accrued. This amount includes any orders for goods or services for which delivery or performance has not yet occurred. Small items of prepaid expense (such as subscriptions to periodicals) may be omitted from the reports on undelivered orders. Delivered orders are those orders received and for which a liability should be accrued.

***Expended Authority***

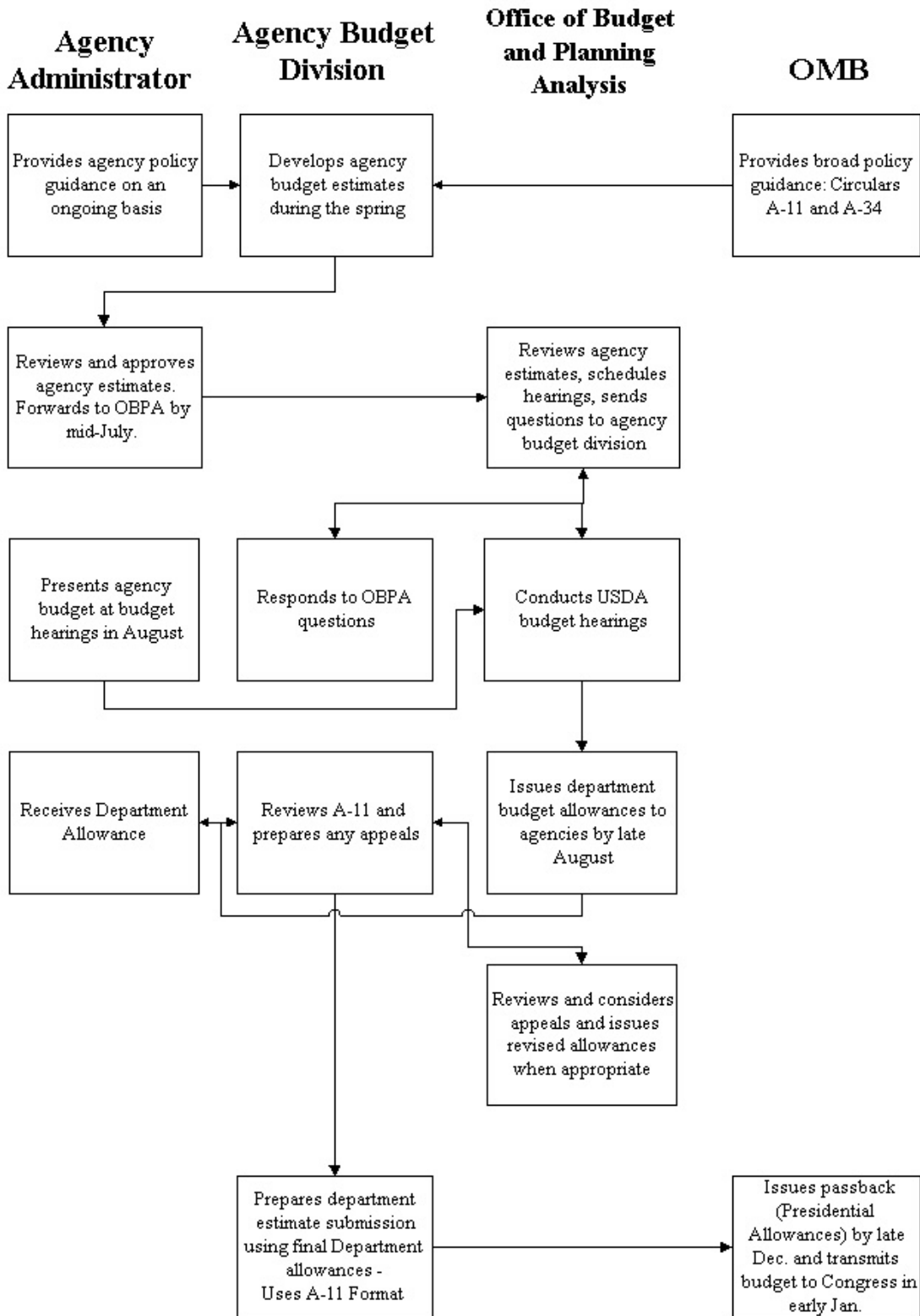
As an entity obligates funds, remaining budget authority is reduced (with the exception of uncapped indefinite borrowing authority). In some cases (as when goods or services are not delivered or provided or are not accepted by the entity), obligations can be reduced or canceled; this action has the effect of increasing remaining budget authority. Expended Authority is recognized in the 49XX general ledger account series.

*Unexpended balances of budget authority are budgetary resources that have not been outlayed and/or spent. They include unobligated balances and obligated balances.*

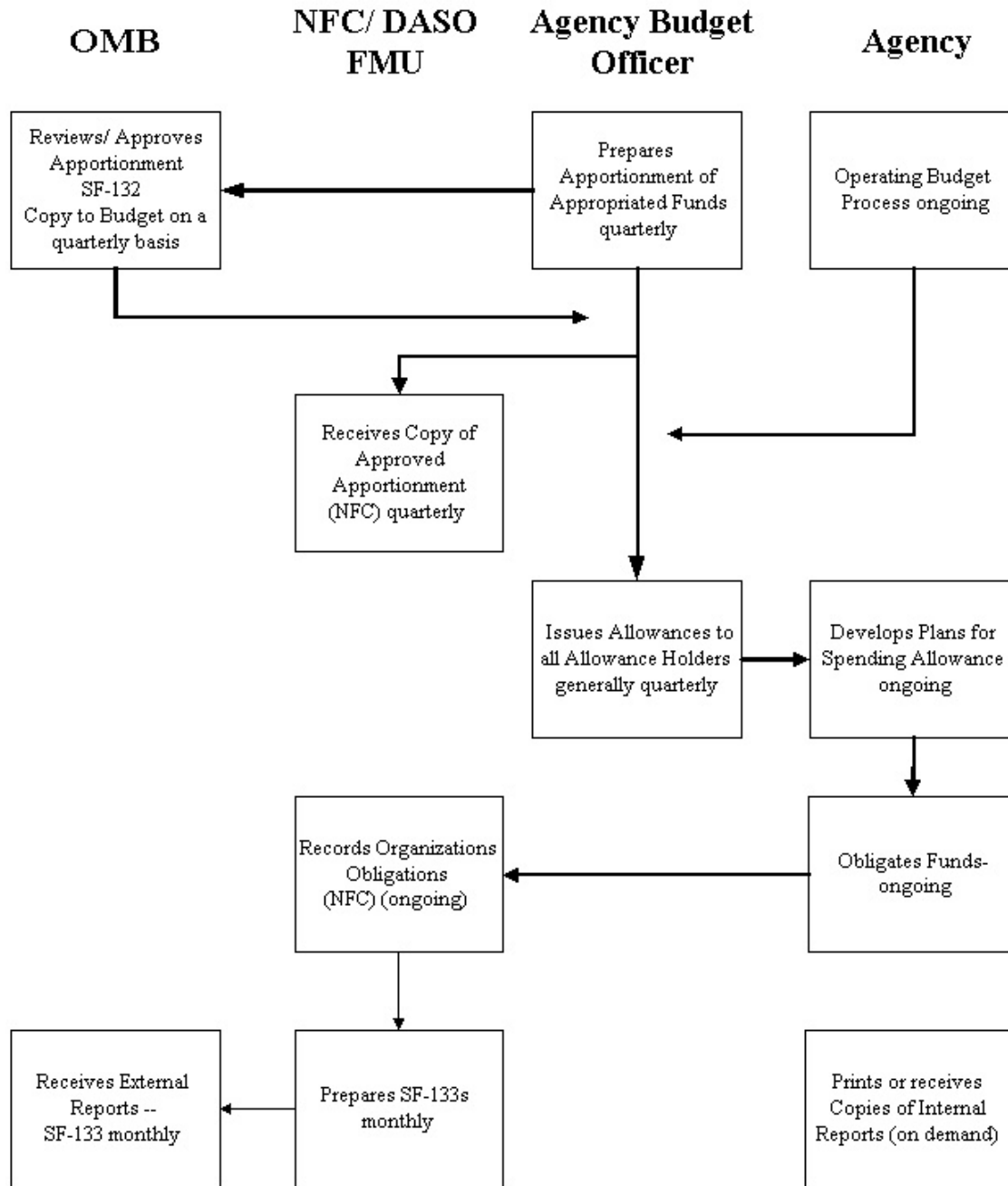
***Addendum***

The following flowcharts illustrate the budget formulation and execution processes.

## USDA Budget Formulation



# Budget Execution



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## CHAPTER 3 – MANAGERIAL COST ACCOUNTING

### *Introduction*

Financial reporting provides information on the financial position and operating results of an entity. Federal accounting systems frequently do not provide internal operating cost reports for managers to determine the effectiveness of their operations.

Financial Accounting Standards Advisory Board (FASAB) Accounting Standard No. 4, Managerial Cost Accounting Standards for the Federal Government (hereinafter referred to as SFFAS No. 4), was written to address this issue. SFFAS No. 4 establishes internal costing standards to accurately measure and manage the cost of Federal programs, grants or other endeavors.

SFFAS No. 4 describes the relationship between cost accounting, financial reporting, and budgeting. The standard sets forth the basic objectives of managerial cost accounting, which are:

- (1) Accumulation and reporting of activity costs on a regular basis for management information purposes,
- (2) Establishment of responsibility segments to match costs with outputs,
- (3) Determination of the full cost of government goods and services,
- (4) Recognition of costs of goods and services provided among Federal entities, and
- (5) Use of appropriate costing methodologies to accumulate and assign costs to outputs.

SFFAS No. 4 addresses the following requirements:

- **Requirement for cost accounting** - Costs may be accumulated through *either*:
  - Cost accounting systems
  - 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. Full cost of an output produced by a responsibility segment is the sum of:
  - Costs of resources consumed by the segment that directly or indirectly contribute to the output
  - 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 received from other entities. The entity providing the goods and 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.

Inter-entity costs are addressed in more detail below.

- **Costing methodology** - Costs of resources consumed by responsibility segments should be accumulated by type 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.

Cost assignments must use the following methods listed in order of preference:

- (a) Directly tracing costs wherever feasible and economically practicable
- (b) Assigning costs on a cause-and-effect basis
- (c) Allocating costs on a reasonable and consistent basis

SFFAS No. 4 has three general objectives:

1. Provide program managers with relevant and reliable information relating costs to outputs and activities to assist them in making managerial decisions. This will result in improving operational economy, effectiveness, and efficiency.
2. Provide relevant and reliable cost information to assist Congress and executives in making decisions about allocating Federal resources, authorizing, and modifying programs, and evaluating program performance.
3. Ensure consistency between costs reported in general purpose financial reports and costs reported to program managers. This includes standardizing terminology for managerial cost accounting to improve communication among Federal organizations and users of cost information.

These accounting standards need not be applied to items that are qualitatively and quantitatively immaterial. The managerial accounting standards of this Statement were effective for fiscal periods beginning after September 30, 1997.

## **Purposes of Using Cost Information**

In managing USDA programs, cost information is essential in the following five areas:

1. Budgeting and Cost Control
2. Performance Measurement
3. Determination of Reimbursements and Setting Fees and Prices
4. Program Evaluations
5. Making Economic Choice Decisions

Each of these areas is discussed below.

### **Budgeting and Cost Control**

Information on the costs of program activities is used to estimate future costs in preparing and reviewing budgets. Once budgets are approved and executed, cost information serves as a feedback to budgets. By using cost information, USDA managers can control and reduce costs, and find and avoid waste. With appropriate cost information, USDA managers can:

- Compare costs with known or assumed benefits of activities, identify value-added and non-value-added activities, and make decisions to reduce resources devoted to activities that are not cost-effective
- Compare and determine reasons for variances between actual and budgeted costs
- Compare cost changes over time and identify causes
- Identify and reduce excess capacity costs
- Compare costs of similar activities and find causes for any cost differences

### **Performance Measurement**

Measuring performance is a means of improving program results. One of the stated purposes of the Government Performance and Results Act (GPRA) of 1993 is to improve the confidence of the American people in the capability of the Federal government by systematically holding Federal agencies accountable for achieving program results.

Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness. Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show “cost-effectiveness.” Thus, the service efforts and accomplishments of a USDA entity can be evaluated with:

- 
- Measures of service efforts that include the costs of resources used to provide the services
  - Measures of accomplishments that are outputs (the quantity of services provided) and outcomes (the results of those services)
  - Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness

Performance measurement requires both financial and non-financial measures. Cost is a necessary element for performance measurement, but it is not the only element.

### **Determining Reimbursements and Setting Fees and Prices**

Cost information is important in setting fees and reimbursements. Costing and pricing, however, are two different concepts. Setting prices is a policy matter, sometimes governed by regulations or statutory provisions and other times by managerial or public policies. Thus, the price of a good or service does not necessarily equal the cost of the good or service determined under a particular set of cost principles.

USDA has many mandated pricing policies. You should be familiar with all legislative and regulatory pricing related to your agency's programs. Milk price supports, import and export restrictions, and domestic and international food programs are some of the policies, which are used to establish prices that will in turn be compared to actual costs for the year.

As examples, the Agricultural Marketing Service and the Animal and Plant Health Inspection Service set fees, respectively, for grading products and inspections based upon full cost, while the Farm Service Agency's administrative processing fee related to catastrophic insurance is legislatively mandated.

Cost is an important consideration in setting USDA prices, and information about the full cost of providing goods and services should always be made available to management. With certain exceptions, the Office of Management and Budget (OMB) established in Circular A-25 that:

- User charges must be sufficient to recover the full cost of those goods and services that the Government provides in its sovereign capacity to a particular group of individuals as a special benefit.
- User charges for goods and services that the Government provides under business-like conditions need not be limited to the recovery of full cost and may yield net revenue.

Cost information is also important in calculating reimbursements for goods and services provided by one Government agency to another. Even if fees or reimbursements do not recover the full cost due to economic or policy constraints, management needs to be aware of the difference between cost and price, and the resulting subsidy. With this information, program managers can properly inform Congress, Federal executives, and the public about the costs of providing goods and services.

### **Program Evaluations**

The cost of Federal resources by program is an important factor in making policy decisions related to program authorization, modification, and discontinuation. These decisions are usually subject to policy constraints and often require the consideration of economic and social costs and benefits affecting different sectors of the economy and society. Information on program costs can be used as a basis for cost-benefit considerations.

### **Economic Choice Decisions**

Agencies and programs often face choices, such as whether to do a project in-house or contract it out, to accept or reject a proposal, or to continue or drop a product or service. Making these decisions requires cost comparisons among available alternatives.

### ***Managerial Cost Accounting Concepts***

Managerial cost accounting should be an integral 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 should be an essential element of proper financial planning, control, and evaluation for any activity or organization that uses resources having monetary value. It is a basic part of the financial management system in that it supports and provides data to the budgetary and financial accounting functions and, by itself, provides useful information for both internal and external users.

Managerial cost accounting is the accumulation, measurement, analysis, interpretation, and reporting of cost information useful to both internal and external users. It serves budgetary and financial accounting by providing additional information. It also provides this information directly to management.

### **Common Data Source**

The information flow within a financial management system begins with a basic information pool, or common data source. This data source consists of all financial and programmatic information used by the budgetary, cost, and financial accounting processes. It includes all

financial and much non-financial, such as environmental, data that is necessary for budgeting and for financial reporting. The common data source also includes decision and evaluation information developed as a result of prior reporting and feedback. Other types of data may be included based on the needs of the ultimate users of the information.

The common data source may include many different kinds of data and is far more than the information about financial transactions found in the standard general ledger, although that is a significant part of the data source. Few entities maintain all of their managerial cost data in any one location or system. Furthermore, the term "data source" is not meant to imply only computerized sources of information.

The National Finance Center (NFC) may maintain financial data in its systems on behalf of an agency; however, the agency is still responsible for the accuracy of the data maintained on its behalf.

Budgetary, financial, and managerial cost accounting draw information as needed from the common data source. The data is then processed to attain specific objectives.

### **Relationship to Financial Accounting**

Financial and managerial cost accounting are closely related or integrated. The close relationship exists because cost information generally originates with transactions recorded for financial accounting purposes.

Inventory valuation is an example of this fundamental relationship, but managerial cost accounting serves financial accounting in other ways. Cost accounting should assist financial accounting in determining the results of operations during a fiscal period by providing relevant data that is accumulated to produce operating expenses. This data includes the allocation of capitalized costs to periods of time and units of usage.

Cost information pertaining to financial accounting involves costs from past transactions and their assignment to fiscal periods and particular outputs. This use of cost information has been closely aligned with external reporting.

### **Relationship to Budgetary Accounting**

Managerial cost accounting should also provide budgetary accounting with cost information. However, budgetary accounting is not as closely aligned with cost accounting. This is because costs are recorded, accumulated, and allocated on an accrual basis in cost accounting but on a cash or obligation basis in budgetary accounting.

Still, cost accounting does provide cost information to budgetary accounting for use in preparing annual and long-term budgets. Managerial cost accounting also helps in making budget decisions, such as those related to future capital expenditures and purchase-or-lease determinations.

It is important to note that the FASAB's authority does not extend to recommending budgetary concepts or standards. However, FASAB is committed to providing relevant and reliable cost accounting information that supports budget planning, formulation, and execution.

### **Cost Information for Management Purposes**

Cost information is used for different purposes that can generally be classified into five types:

- Cost reduction and control,
- Decisions to contract out or make other changes in the method of production,
- Determinations of reimbursement and fee or price setting,
- Performance measurement, and
- Program authorization, modification, and discontinuation decisions.

Managers can use cost estimates, cost studies, and cost-finding techniques for things such as comparing actual with anticipated costs, and non-financial as well as financial data should be considered. For instance, cost accounting tracks units of input used, including the amount of labor in terms of employees or employee-hours, and units of output produced.

While cost accounting is concerned with past and future costs, one of its most important features is the use of present costs to assist management. Accounting data may be assigned, allocated, or associated with units of activity or production, segments of organizations, and so on within the same time period. These kinds of intra-period allocations are developed most extensively in the branch of accounting called cost accounting. Neither the Financial Accounting Standards Board (FASB) nor the Government Accounting Standards Board (GASB) has devoted much attention to cost accounting but FASAB, because of its unique mission, must do so.

### **Reporting Relationships**

Federal financial reporting encompasses general and special-purpose reports to meet the needs of users. Information produced by managerial cost accounting appears in, or influences, both types of reports.

Managerial cost accounting results in internal reports as well as external reports. Most often, these are special-purpose reports designed for internal users, typically line and program managers.

One of the most important aspects of cost accounting is that of performance reporting. Measuring and reporting actual performance against established goals is essential in assessing governmental accountability. Cost information is necessary in establishing strategic goals, measuring service efforts and accomplishments, and relating efforts to accomplishments.

### **Basis of Accounting and Recognition/Measurement Methods**

Costs may be measured and reported in many ways. A particular cost measurement has meaning only when considering its purpose.

When managerial cost accounting is used to supply information for use in financial accounting and reporting that information should be consistent with the basis of accounting, and recognition and measurement standards, required by Federal accounting principles. Traditionally, this has meant the use of accrual accounting and historical cost measurement, particularly in the general-purpose reports.

When managerial cost accounting is used to supply information for the preparation and review of budgets, cost data should be consistent with the basis of accounting, and recognition and measurement, used in financial reporting but may be adjusted to meet the budgetary information needs.

Special-purpose cost studies and analyses are sometimes performed for decision-making. In those studies and analyses, management may need to develop cost data beyond that currently reported in general-purpose financial reports. For example, in making planning decisions, management may develop replacement costs and capital costs. However, the basis and methods used shall be appropriate for the circumstances and consistent with the intended purposes.

### **Reconciliation of Information**

Different bases of accounting will produce different costs for the same item, activity, or entity. This can confuse users of cost information. Therefore, the significant reports that address the same cost subject but use different accounting bases or different recognition and measurement methods shall be reconcilable and fully explain those bases and methods. The intent is not to require or perform unnecessary reconciliations but to assure the reader of the consistency of the information being reported. Regardless of the type of report in which cost information is presented, it should ultimately be traceable back to the original common data source.

To be reconcilable, the amount of the differences in the information reported should be ascertainable and the reasons for the differences should be explainable. In some situations, informational differences may be clearly understandable without further explanation. However, other cases may require a narrative statement concerning the differences. In complicated situations, a schedule or table may be required to fully explain the differences.

Financial reporting has long recognized the necessity for reconciliation between information reported on different accounting bases. Reconciliation's have been required in federal financial reports to show and explain significant differences between budget reports and financial statements prepared in accordance with generally accepted accounting principles.

### **Need for Consistent Cost Accounting on A Regular Basis**

To perform managerial cost accounting on a "regular basis" means that entities should establish procedures to accumulate and report costs consistently, continuously, and routinely for management information purposes. Consistent and regular cost accounting is needed to help the user determine (a) the costs of providing specific activities and programs and (b) the composition of, and changes in, those costs.

The requirement for managerial cost accounting on a consistent and regular basis supports recent legislative actions. The Chief Financial Officers (CFOs) 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, GPRA requires that each agency establish performance indicators for each program and measure or assess relevant outcomes, outputs, and service levels as a basis for comparing actual results with established goals. Costs must then be allocated according to goals in the Statement of Net Cost, discussed further in the Operations section of this manual.

The managerial cost accounting processes consist of collecting data from the common data sources, processing that data, and reporting cost and output information in general-purpose and special-purpose reports. Appropriate procedures and practices shall 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 cost-finding techniques and other cost studies and analyses.

A cost accounting “system” is an organized grouping of methods and activities designed to consistently produce reliable cost information.

### **Basic Cost Accounting Processes**

*Regardless of whether a reporting entity uses a cost accounting system or cost-finding technique, the methods and procedures followed shall be designed to perform at least a certain minimum level of cost accounting and provide the basic amount of cost information necessary to accomplish the many objectives associated with controlling, decision-making, planning, and reporting. The more important of these minimum criteria for cost accounting include:*

- **Responsibility Segments** - Responsibility segments identified by management shall collect cost information, and outputs shall be defined for each responsibility segment.
- **Full Costing** - Each reporting entity shall measure the full cost of outputs so 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.
- **Costing Methodology** - The costing methodology used (e.g., activity-based, job-order, process, or standard costing) shall be appropriate for management's needs and the operating environment.
- **Performance Measurement** - Cost accounting shall help provide (a) the information needed to determine and report on service accomplishments and efforts and (b) the information to help meet the requirements of GPRA or interface with systems that provide 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 shall 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.

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- Standard General Ledger - Managerial cost accounting shall 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 shall be reliable and useful in making evaluations and decisions. At the same time, unnecessary precision and refinement of data shall be avoided.
  - Special Situations - The managerial cost accounting processes shall be designed to accommodate any of management's special cost information needs that may arise due to unusual or special circumstances. If such cost information is needed on a regular basis, appropriate procedures to provide it shall be developed.
  - Documentation - All significant managerial cost accounting activities, procedures, and processes shall be documented by a guidebook, handbook, or manual of applicable accounting operations. This document shall contain examples of forms and other documents to be used, list the cost accounts and subsidiary accounts related to the standard general ledger, provide instructions for practices and procedures to be followed, and outline applicable activities.

### **Complexity of Cost Accounting Processes**

While each entity's managerial cost accounting shall 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 shall determine the appropriate detail for its cost accounting processes and procedures based on factors such as 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.
- Any specific information needs of management.

Some entities may find that they can purchase a basic “off-the-shelf” cost accounting process, program, or system or adapt one from another federal agency. All entities shall consider using the same or compatible cost accounting processes throughout their component units to facilitate the comparison and consolidation of cost information.

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## Cost Analyses, Findings, and Studies

**A cost accounting system is a continuous and systematic cost accounting process that is designed to accumulate and assign costs to a variety of objects as desired by management.** However, a sophisticated system is not always needed to perform detailed cost accumulation and assignment.

Cost information can sometimes be developed, and savings achieved, more appropriately through cost finding and/or the use of cost studies. Cost finding is a method of determining the cost of producing goods and services by sampling and/or analyses. Cost-finding techniques may be useful for computing costs in cases where the information is not needed on a recurring basis.

### Defining Responsibility Segments

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. In addition, responsibility segments usually possess the following characteristics:

- Their managers report to the entity's top management directly.
- Their resources and results of operations can be clearly distinguished from those of other segments of the entity.

Reporting entities shall use FFIS, when feasible and cost beneficial, or a reporting entity or a segment-based system to provide managerial cost information for each segment.

Managerial cost accounting shall:

- Define and accumulate outputs; and, if feasible, quantify each type of output in units.
- Accumulate costs and quantitative units of resources consumed in producing the outputs.
- Assign costs to outputs, and calculate the cost per unit of each type of output.

Some reporting entities may have only one responsibility segment if they perform only one mission or provide only one type of service. Other reporting entities may have several responsibility segments. Furthermore, a sub-organization of the Federal government may be a reporting entity in itself and, at the same time, be a responsibility segment of a higher-level reporting entity to which it belongs.

*For example, the FNCS mission area is a reporting entity because it meets the reporting entity criteria. As such, it shall establish responsibility segments for itself. At the same time, the FNCS mission area is regarded as a responsibility segment of the U.S. Department of Agriculture, of which it is a component.*

## **Purposes of Segmentation**

A basic purpose of dividing an entity into segments is to determine and report the costs of products and services 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 will serve financial reporting for the entity but will not serve costing purposes. In order to determine the cost of each type of product and service, it is necessary to divide an entity into segments such that each segment is responsible for certain types of products and/or services. 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 costing methodology that is best suited to its operations.

Another important purpose of segmentation is to facilitate cost control and management. Cost information provided for each segment helps managers to examine the costs of activities performed, and specific resources consumed, in each segment. Managers can analyze cost variances in both dollars and units of resources consumed against budgets and 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.

For entities that consist of components engaging in diverse lines of activities, it is desirable to provide financial reports that display information for each significant component and for the entity as a whole. Some entities may find costs accumulated by segments useful in support of financial reporting by components.

For internal management, segmentation can 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, outcomes, and outputs related to each segment can be used to measure its performance against the goals. The results of the segment performance measurement can support external reporting on performance measures for the entire reporting entity or its major programs.

## **Structuring Responsibility Segments**

Managers of a reporting entity shall define and structure their responsibility segments. The designation of responsibility segments shall be based on the following factors:

- The entity's organization structure
- Its lines of responsibilities and missions
- Its outputs (goods and/or services it delivers)
- Its budget accounts and funding authorities

However, the predominant factor is the reporting entity's organizational structure and its existing responsibility components.

USDA allocates cost among eight program mission areas that provide goods and services. Those mission areas are: (a) Farm and Foreign Agricultural Services; (b) Food, Nutrition, and Consumer Service; (c) Food Safety; (d) Marketing and Regulatory Programs; (e) Natural Resources and Environment; (f) Research, Education, and Economics; (g) Rural Development, and h) Other Services. Each mission area is designated as a separate responsibility segment within the USDA reporting entity.

Since responsibility segments are major parts of an entity, some segments may carry more than one program. In USDA, the FNCS mission area is an example with its Food Stamp Program, National School Lunch Program, etc. Two or more segments may jointly manage some programs. Thus, each segment must accumulate costs for each type of output produced for those various programs. To accomplish this, a network of cost centers shall be established within a segment to accumulate costs. The manager of each cost center shall be provided with information to control and manage costs within his or her area of responsibility. Depending on costing methods and operational patterns, cost centers may be structured along different dimensions such as activities, operating processes, or organizational units.

### ***Full Cost***

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 contributes 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.

“Output” 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.

### **Direct Costs**

Direct costs are costs that can be specifically identified with an output. All direct costs shall be included in the full cost of outputs. Typical direct costs in the production of an output include the costs of:

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- Equipment, facilities, office space, and utilities that are used exclusively to produce the output.
  - Goods and services received from other segments and/or entities that are used to produce the output.
  - Salaries and other benefits for employees who work directly on the output.
  - Materials and supplies used in the work.

### **Indirect Costs**

Indirect costs are the costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable to any of the outputs. Typical examples of indirect costs include the costs of employee health and recreation facilities, general administrative services, general research and technical support, rent, security, and operating and maintaining buildings, equipment, and utilities. There are two levels of indirect costs:

- 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.
- Costs of support services that a responsibility segment receives from other segments and entities. The support costs should first be directly traced or assigned to various segments that receive the support services. They should then be assigned to outputs.

A reporting entity and its responsibility segments may incur administrative support and general management costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization's costs and shall be reported on the entity's financial statements (such as the Statement of Net Cost) as costs of the responsibility segments not assigned to programs.

### ***Certain Cost Elements***

#### **Employee Benefits**

Costs of employee benefits include:

- Health and life insurance benefits for current employees covered in part by the Federal government's contribution to health and life insurance premiums.
- Pension benefits for employees, and their survivors and dependents, covered by defined pension plans such as the Civil Service Retirement System and Federal Employees Retirement System (CSRS) and the Federal Employees Retirement Plan (FERS).

- Health and life insurance benefits for retired employees, and their survivors and dependents, covered in part by the Federal government's contribution to health and life insurance premiums and referred to as “other retirement benefits” (ORB).
- Other post-employment benefits (OPEB) for terminated and inactive employees including severance payments, training and counseling, continued health care, and unemployment and workers compensation.

Employee benefit programs are covered by trust funds that are administered by governmental entities such as the Office of Personnel Management (OPM). Contributions to the trust funds come from three sources: current and retired employees, employing agencies, and direct appropriations. The management expenses of the trust funds are paid with the funds' receipts.

USDA entities shall 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. USDA entities shall recognize those expenses regardless of whether the benefits are funded by them or by direct appropriations to the trust funds. This principle shall also be applied to health and life insurance benefits for current employees. The costs of employee benefits incurred by responsibility segments shall be traced directly or assigned to outputs.

OPEB costs include health care, counseling and training, severance payments, and workers compensation benefits paid to former or inactive employees. OPEB costs are often incurred as a result of events such as reductions in force or on-the-job injuries of employees. OPEB costs shall 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 the events occurring on or before the accounting date.

Since the recognition of OPEB costs is linked to the occurrence of an OPEB event rather than the production of an output, in many instances, assigning OPEB costs recognized for a period to output of that period will distort the cost of the output. In special-purpose cost findings or studies, 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.

### **Public Assistance and Social Insurance Programs**

These are the costs of resources transferred from the Federal government to individuals and state and local governments, generally referred to as “transfer payments.” The following are some typical public assistance and insurance programs funded by USDA:

- Grants, such as aid to state and local governments;
- Subsidies, such as agricultural commodity price-support and stabilization programs;
- Credit and insurance, such as the housing loan and crop insurance programs; and
- Welfare payments, such as food stamps and the Old Age, Survivors, and Disability Insurance Program (OASDI).

The full cost of such a program includes (a) the cost of operating the program and (b) the cost of the Federal resources that have been, or will be, transferred to individuals and State and local governments. These two types of cost shall be recognized on a basis of accounting as prescribed

in these USDA accounting standards and identified separately so each can be used for different analytic purposes.

The costs resulting from transfer payments are determined by the level of credit subsidies, entitlement benefits, grants, and loss payments made under guarantee and insurance agreements. They are also determined by the number of eligible persons who receive the transfer payments. This type of cost information is useful for making policy decisions about levels of subsidies and 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.

Program operating costs, on the other hand, are costs of managing the program and delivering the payments. They include the cost of equipment, office space, personnel, and supplies. The costs are related to activities such as answering inquiries, screening benefit recipients for eligibility, keeping their accounts, and making payments and collections. Information on this type of cost is useful in measuring the efficiency of program operations.

### **Costs Related to Property, Plant, and Equipment Depreciation Expense**

General property, plant, and equipment (PP&E) are used in the production of goods and services, and its consumption is recognized as depreciation expense. The depreciation expense incurred by a responsibility segment shall be included in the full cost of the goods and services that the segment produces.

The cost of acquiring or constructing heritage assets shall be charged to expense at the time the acquisition or construction cost is incurred. Since the recognition of this expense is linked to property acquisition rather than the production of goods and services, the expense shall not be included in the full cost of goods and services. However, the cost is part of the cost of the responsibility segment that acquires the property and should be identified, if possible, with the acquiring program.

### **Nonproduction Costs**

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 nonproduction costs were discussed earlier: (a) OPEB costs that are recognized as expenses when an OPEB event occurs and (b) certain property acquisition costs that are recognized as an expense at the time of acquisition.

Other nonproduction 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 services produced in that period would distort production costs. In special-purpose cost studies, management may have reasons to determine historical output costs by distributing some of these costs to outputs over a number of past periods. Such distribution may be appropriate when (a) experience shows that the costs are recurring in a regular pattern and (b) a nexus can be established between the costs and the production of outputs that may have benefited from those costs.

### ***Inter-entity Costs***



A receiving entity's full cost shall include 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 and services either through billing or other advice.

The recognition of inter-entity costs that are not fully reimbursed shall be limited to material items that (a) are significant to the receiving entity, (b) form an integral or necessary part of the receiving entity's output, and (c) 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 shall not be recognized unless such services form a vital and integral part of the operations, or output of the receiving entity.

Knowledge of inter-entity costs is helpful to top-level management in assessing and controlling the operating environment. Such knowledge is also helpful to other users in evaluating overall program costs and performance and in making decisions about resource allocations and changes in programs.

### **Inter-entity Activities**

Within the Federal government, some reporting entities rely on other Federal entities to help them achieve their missions. This often involves support services, but may include the provision of goods. Sometimes these arrangements are stipulated in law, but others are established by mutual agreement between the entities involved. The relationships can be classified into two types depending upon the funding methods.

- Provision of Goods and Services with Reimbursement - One entity agrees to provide goods or services to another with reimbursement at an agreed-upon price. The reimbursement price has sometimes not been enough to recover full costs, but an agreement has usually been established voluntarily through an interagency agreement. Revolving funds are normally included in this group because they are usually established to recover costs through the sale of their outputs to other Government entities. Revolving funds are usually meant to be self-sustaining through their sales, without receiving additional appropriated funds.
- Provision of Goods and Services without Reimbursement - One entity provides goods or services to another entity free of charge. The agreement may be legally mandated, voluntary, or inherently established in the mission of the providing entity. Goods and services provided without reimbursement include those specifically negotiated between entities as well as services provided due to Government policy, where the receiving entity has no or little discretion in the situation (such as certain retirement expenses funded through OPM).

Under the franchise fund concept, entities are allowed to sell their outputs on a competitive basis and have the authority to purchase goods and/or services from any Federal or private provider. This is seen as a way to improve Government efficiency through competition since inefficient Government providers will be forced to improve or stop providing their goods or services. This could result in consolidating support services in fewer governmental entities. Underlying this

concept is the requirement that all costs shall be recognized in developing the price at which goods and services are sold to other entities.

### **Accounting and Implementation Guidance**

If an entity provides goods and services to another entity, regardless of whether full reimbursement is received, the providing entity shall continue to recognize in its accounting records the full cost of those goods and services. The full cost of the goods and services provided shall be reported to the receiving entity by the providing entity.

The receiving entity shall recognize in its accounting records the full cost of the goods and 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 and services shall be available from the providing entity. However, if such cost information is not provided, or is only partially provided, a reasonable estimate shall be used by the receiving entity. The estimate shall be of the cost of the goods and services received (the estimate shall be based on the market value of the goods and services received if an estimate of the cost cannot be made). To the extent that reimbursement is less than full cost, the receiving entity shall recognize the difference as a financing source. Inter-entity assets, expenses, and financing sources shall be eliminated for any consolidated financial statements covering both entities. This applies to both budgetary and proprietary accounts. As of this writing, the Statement of Budgetary Resources continues to be prepared on a combined basis, which nullifies the need to prepare budgetary elimination entries.

The cost recognized by USDA receiving entities shall be the reimbursable agreement amount, where reimbursable agreements exist, or the actual or estimated full cost of non-reimbursed or under-reimbursed goods and services received when those goods and services are (a) significant to them, (b) form an integral or necessary part of their output, and (c) can be identified or matched to them with reasonable precision.

### **Recognition Criteria**

*Ideally, all inter-entity costs should be recognized. This is especially important when those costs constitute inputs to Government goods and services provided to non-Federal entities for a fee or user charge. The fees and user charges should recover the full cost of those goods and services. 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, shall be made in accordance with the implementation guidance issued by OMB.*

The situation is often different with goods and services transferred within the Federal government, which in its entirety is an economic entity. Therefore, it is reasonable to expect some flow of goods and 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 and under-reimbursed goods and 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 - 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, materiality shall be considered in terms of the importance of the inter-entity transaction to the receiving entity. The importance of the transaction and its recognition shall be judged in light of the following factors:

- Significance to the Entity - The cost of the good or service is large enough that management should be aware of the cost when making decisions.
- Directness of Relationship to the Entity's Operations - The good or service provided is an integral part of 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 and General Support - Some entities provide broad and 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 shall not be recognized as an expense (or asset) by the receiving entities when there is no reimbursement of those 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 is OMB, which establishes policy and provides general guidance to all parts of the executive branch of Government. The costs of OMB shall not be spread over all reporting entities because the services provided are (1) broad and general in scope, (2) not specifically or directly tied to the receiving entity's outputs, and (3) provided to almost all reporting entities in the executive branch.

On the other hand, under certain circumstances some services provided shall 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 the

Treasury and legal activities performed by the Department of Justice. For example, when the issuance of checks is integral to the operations of an entity, the receiving entity shall include the 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 shall not recognize that cost.

The decision as to whether the cost of non-reimbursed or under-reimbursed goods and services shall be recognized requires the use of judgment. Ultimately, inclusion or exclusion of the cost shall 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.

**USDA shall recognize as imputed inter-departmental costs:**

- (1) Pension and other retirement benefit costs funded through OPM, and
- (2) Court judgments and settlement claims negotiated by the U.S. Department of Justice and paid by the Treasury Judgment Fund.

For guidance on the accounting entries needed for recording imputed costs, refer to the Department of Treasury, Financial Management Service web site for the latest Treasury Financial Manual release of the United States Government Standard General Ledger at <http://www.fms.treas.gov/ussgl/index.html>.

## ***Costing Methodology***

### **Cost Accumulation**

Cost accumulation is the process of collecting cost data in an organized way. The accumulation of costs by responsibility segment does not mean that each responsibility segment must have its own accounting system. The reporting entity may use a centralized accounting system, but that system shall be capable of identifying costs within a responsibility segment.

The accumulated costs shall be classified by type of resource, such as capital, employees, materials, rent, utilities, etc. When appropriate and cost effective, information on quantitative units related to various cost categories shall 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.

The Joint Financial Management Improvement Program (JFMIP) has created a series of financial management system requirement documents called the Federal Financial Management Systems Requirements (FFMSR). Included in these documents is *System Requirements for Managerial Cost Accounting*, available at <http://www.jfmip.gov/jfmip/>.

## **Cost Assignment**

The term “cost assignment” refers to the process of identifying accumulated costs with reporting periods and cost objects. The purpose of assigning a cost to a time period is to recognize that cost as either an expense or asset for each reporting period. Balance sheet or heritage asset, stewardship land, or an expense for the reporting period. This section addresses cost assignment to cost objects. The word “assignment” as used in this document includes various methods of attributing costs, such as direct tracing, cause-and-effect, and cost allocation.

## **Cost Objects**

The term “cost object” refers to an activity or item whose cost is to be measured. A cost object can be an activity or organizational division, or a customer, product, program, service, or task. 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 products or services 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.

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 shall be assigned to the segments that receive the products and services. This is referred to as intra-entity cost assignments. Also, in accordance with the inter-entity cost standard discussed in the preceding section, an entity shall recognize inter-entity costs for goods and services received from other Federal entities. The inter-entity costs shall be assigned to the responsibility segments that use the inter-entity products and services.

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.

Cost assignments may be performed in cost findings and studies or may be performed within a system on a regular basis. In principle, costs shall be assigned to outputs in one of the methods listed below in the order of preference: (a) Directly tracing costs whenever economically feasible; (b) Assigning costs on a cause-and-effect basis; and (c) Allocating costs on a reasonable and consistent basis.

These principles apply to all levels of cost assignment including: (1) assigning inter-entity costs to segments, (2) assigning the cost 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.

### **Tracing Costs Directly to Outputs**

The direct tracing of costs applies to the cost of resources that are used directly in the production of an output. Examples of such resources include employees who worked directly on the output, equipment and facilities used exclusively in the production of the output, goods and services received from other entities that are used directly in the production of the output, and materials that are used in production.

The method of direct tracing of costs usually relies on the counting, observation, and/or recording of the consumption of resource units, such as staff hours or days that are spent on a project or assignment. Direct tracing also applies to specific resources that are dedicated to particular outputs.

Direct tracing of costs 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 (computer disks, papers, pens, etc.) to various activities or outputs. The cost of doing so usually outweighs the benefit of the increased accuracy in assigning the resources.

### **Assigning Costs on a Cause-and-Effect Basis**

For costs that are not traced directly to outputs, it is preferable that they be assigned 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 may be established as links between resource costs and outputs. The links reflect a cause-and-effect relationship. Costs that have a similar cause-and-effect relationship to outputs can be grouped into cost pools.

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 the 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.

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, programming adjustments, or software design and installation. In the second step, the costs of these activities are further assigned to other departments based on their consumption of the technical services.

Sometimes, an intermediate product, rather than an activity, can be used as a link between the costs and outputs. For example, a hospital laboratory's costs can first be assigned to various medical tests it runs. The costs of the tests can then be assigned to the operating units of the hospital that ordered the tests.

## Allocating Costs

It might not be economically feasible to trace costs directly or assign them on a cause-and-effect basis. Examples include depreciation, general management and support costs, maintenance, rent, security, and utilities associated with facilities that are commonly used by various segments.

Costs can be allocated to segments and outputs on a prorated basis, which involves two steps. The first step involves allocating the costs of support services to segments, and the second step involves allocating those costs to the outputs of each segment. The cost allocations are usually based on a relevant common denominator such as the amount of direct cost incurred, number of employees, or square footage of office space.

Suppose the total cost of a personnel department for a fiscal year is \$500,000 and the cost is allocated to two segments based on the number of employees in each. 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 cost. The allocation is shown below.

### The Allocation of Personnel Department Costs

Segment	Employees	Percent	Allocated Amount
A	300	60	\$300,000
B	200	40	\$200,000
Total	500	100	\$500,000

For cost allocation purposes, indirect costs shall be grouped into pools, and each cost pool shall be subject to one allocation base. Costs grouped into a pool shall have similar characteristics, and the allocation base shall be used consistently to allow cost comparison from one period to another.

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. To assist cost analyses and cost findings, cost accounting should segregate costs that are assigned or traced to outputs from costs that are allocated to outputs.

### Assigning Common Costs

Some resources may be shared by two or more activities at the same time, or at different times, during a fiscal year. For example, a building may be used to process two or more types of goods or services.

Costs that can be traced to each of the activities or outputs shall be assigned to them directly. To determine the full cost of each of the activities or outputs that share resources, indirect common costs shall be assigned. 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. Common costs shall be assigned to activities either on a cause-and-effect basis, if feasible, or through reasonable allocations.

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 preformed only if they will not interfere with the primary activity. Management can then determine two types of costs: (1) the costs that are necessary for the primary activity and are unavoidable even without the secondary activities, and (2) the costs that are caused by the secondary activities and are incremental to the costs of the primary activity. This type of cost information can be produced through cost finding, and help management in making resource allocation and capacity utilization decisions.

### **Cost-Benefit Considerations**

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 produces information of little value to the users.

As a general rule, directly tracing costs directly and assigning costs on a cause-and-effect basis are more expensive than cost allocations because they require detailed analyses and record keeping for costs and activities. However, they are preferable because they produce more reliable cost information than cost allocations.

### **Selecting a Costing Methodology**

A particular type of costing methodology is not required. USDA entities are engaged in a broad range of diverse operations. Reporting entities and responsibility segments are expected to identify a preferred costing methodology for their operations and apply their chosen method on a consistent basis. This does not preclude necessary improvements and refinements to any costing methodology, as long as the effect of any justifiable change is documented and explained. On the contrary, improvements are encouraged.

Four costing methodologies are briefly described below for agency consideration. Activity-based costing has gained broad acceptance by manufacturing and service industries as an effective managerial tool. These costing methodologies are not mutually exclusive. For example, both activity-based costing and standard costing can be applied to job-order or process costing systems.

### **Activity-Based Costing**

Activity-based costing (ABC) focuses on the activities of a production cycle, based on the premises that (a) activities are required to produce an output and (b) those activities consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage process. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs.

Implementing an ABC system requires four major steps: (a) identify activities performed in a responsibility segment to produce outputs, (b) assign or map resources to the activities, (c)



identify outputs for which the activities are performed, and (d) assign activity costs to the outputs. Each of these steps is explained below.

- 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 batch-level, unit-level, facility-sustaining, and product-sustaining activities. Management may combine related small activities into larger activities to avoid excessive costing efforts.
- Assign Resource Costs to Activities - This step assigns resource costs to the activities identified in the first step. The resource costs include direct and indirect costs that are usually recorded in general ledger accounts. Depending on cost-benefit and feasibility considerations, resource costs may be assigned to activities in three ways: (a) direct tracing; (b) estimation based on interviews, statistical sampling, or surveys; or (c) allocation.
- 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 customers, products, or services. Omitting any output will result in overcharging costs to other outputs.
- 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 the individual output's 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).

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.

The direct loan operations involve the “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 time than others. Under ABC, the costs of loan officers would first be assigned to their portfolio review and workout activities that are performed. Then the activity costs would be assigned to the groups of loans for which the activities are performed.

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 product or service costs. Experience in the private sector shows that by

providing accurate cost measures, ABC has helped improve product costing, profit planning, and strategic pricing.

ABC encourages management to evaluate the cost-effectiveness and efficiency 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 also 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) which activities fail to add value to products and services (non-value-added activities). ABC can be integrated with cycle-time and value-added analyses.

### **Job-Order Costing**

Job-order costing is a costing methodology that accumulates and assigns costs to discrete jobs. The word “jobs” refers to assignments, products, projects, or a group of similar outputs. Each job has a number or code to accumulate costs, and resources spent are identified with that job code. Costs are traced to individual jobs to the extent economically feasible, and costs that cannot be traced directly are assigned to jobs either on a cause-and-effect or allocation basis.

Job-order costing is appropriate for responsibility segments that produce special-order products or perform assignments and projects that differ in complexity, duration, or input requirements. Typical situations in the Federal government where job-order costing is appropriate are audit assignments, legal cases, research projects, and repair work for vehicles.

### **Process Costing**

Process costing is a method that accumulates costs by individual processing divisions (organizational 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 product. The output of a processing division becomes either the input of the next processing division or a part of the end product.

Each division accumulates costs, assigns the costs to its outputs, and calculates the unit cost of its output. For each period, each a division shall prepare a cost and production report that shows the completed units, costs, and work-in-process. When a certain number of completed units are transferred from one division to the next, the cost of those units is also transferred and eventually incorporated into the cost of the end product. Thus, the cost flow follows the physical flow of production. The unit cost of the end product is the sum of the unit costs of all the divisions.

Process costing is appropriate for the 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. In USDA, process costing might be used in conjunction with the delivery of a large volume of similar goods or services. An example would be making entitlement benefit payments, which involves a series of consecutive processes for reviewing applications to establish their eligibility, computing the amount of benefits, and issuing checks.

## Standard Costing

Standard costs are expected, or carefully predetermined, costs that can be applied to activities, products, or services on a per unit basis. Standard costing has been defined as follows:

*“A set of standards outlines how a task should be accomplished in nonfinancial terms and how much it should cost. As work is being done, the actual costs incurred are compared with the standard costs to reveal variances. This feedback helps identify better ways of adhering to or altering standards and accomplishing objectives.” SOURCE?*

Standards need to be reviewed and updated to assure that they encourage improvements in efficiency and are within an attainable range.

Standard costing helps a manager control costs, formulate budgets, and measure performance. It can be used in conjunction with ABC, job-order costing, and process costing. Standard costing can be applied to specific activities or outputs. 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 which standard costing is appropriate are operations that produce products or services on a consistently repetitive basis.

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## CHAPTER 4-ASSETS, LIABILITIES AND NET EQUITY

### *Assets*

#### **Introduction**

This section establishes accounting standards to measure and recognize assets in general purpose financial reports, which are issued for both internal and external users. Assets are tangible or intangible items owned by the Federal Government, which have probable economic benefits that can be obtained or controlled by a Federal Government entity. The assets of Federal agencies are classified as assets for use by entity and assets not for use by entity. Both assets for use and not for use by entity are further divided into two sub-sections: Federal and non-Federal assets. These terms are defined below. The nature of the assets described below shall determine which of the four categories the assets should be classified within. Many of these assets have amounts that fall into more than one category and should be classified accordingly.

#### **Assets for Use by Entity**

Assets for Use by Entity are those assets for which the reporting entity has the authority to use in its operations. The authority to use funds in an entity's operations means that entity management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations, e.g., repay loans from Treasury. Within this classification, there are two categories of assets, Federal and non-Federal.

**Federal.** These assets arise from transactions among Federal entities. These assets are claims of a Federal entity against other Federal entities. Brief descriptions of the assets included in this category follow.

**Fund Balance with Treasury.** The aggregate amount of the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. This account includes clearing account balances and the dollar equivalent of foreign currency account balances, and is reported based upon the account balances in the general ledger. Foreign currency account balances reported on the balance sheet shall be translated into U.S. dollars at exchange rates determined by the Treasury and effective at the financial reporting date.

**Investments.** Investments in Federal securities includes; non-marketable par value Treasury securities, market-based Treasury securities, marketable Treasury securities, and securities issued by other Federal entities. Investments are normally reported at acquisition cost or amortized acquisition cost (less an allowance for losses, if any).

**Accounts Receivable, Net.** Federal entity claims for payment from other Federal entities. Include interest receivable (interest income earned but not received as of the reporting date) as a component of accounts receivable. Gross receivables shall be reduced to net realizable value by an allowance for doubtful accounts.

**Other Assets.** Advances and prepayments, which were previously reported as separate line items, should be reported in Other Assets.

**Non-Federal.** These assets arise from transactions of the Federal Government or an entity of the

Federal Government with non-Federal entities. The term “non-Federal entities” encompasses domestic and foreign persons and organizations outside the U.S. Government. Brief descriptions of the assets included in this category follow.

**Investments.** See definition under Assets for Use by Entity, Federal.

**Accounts Receivable, Net.** Federal entity claims for payment from other non-Federal entities. Include interest receivable (interest income earned but not received as of the reporting date) as a component of accounts receivable. Gross receivables shall be reduced to net realizable value by an allowance for doubtful accounts.

**Credit Program Receivables and Related Foreclosed Property, Net.** The net value of assets related to pre-1992 and post-1991 direct loans receivable and acquired defaulted guaranteed loans receivable. Credit program receivables are considered an entity asset if the entity has the authority to determine the use of the funds collected or if the entity is legally obligated to use the funds to meet entity obligations, e. g., loans payable to Treasury. This line includes:

- **Loans and Credits Receivable, Gross.** This item represents the gross value of loan or credit receivables and any miscellaneous credit program receivables related to pre-1992 and post-1991 credit program activity.
- **Interest Receivable, Gross.** This item represents the gross value of interest receivable on pre-1992 and post-1991 performing loan and credit activity that is less than 90 days delinquent.
- **Foreclosed Property, Gross.** Include any asset (other than cash) received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan.
- **Related Allowances on Credit Program Receivables.** This item represents both the Allowance for Subsidy on post-1991 credit receivables and the Allowance for Credit Program Receivables on pre-1992 credit receivables. All allowances are reported at net present value.

**Domestic Commodity Loans, Net.** CCC's domestic loans outstanding at fiscal year end. These loans are not subject to the present value reporting requirements mandated by the Credit Reform Act of 1990 and are, therefore, presented separately from such loans.

**Other Foreign Receivables, Net.** Foreign receivables outstanding at fiscal year end. These receivables are not subject to the present value reporting requirements mandated by the Credit Reform Act of 1990; therefore, they are presented separately from such loans.

**Cash and Other Monetary Assets.** Cash resources and all other monetary assets. Cash consists of: (i) coins, paper currency and readily negotiable instruments, such as money orders, checks, and bank drafts on hand or in transit for deposit; (ii) amounts on demand deposit with banks or other financial institutions; (iii) cash held in imprest funds; and, (iv) foreign currencies, which, for accounting purposes, shall be translated into U.S. dollars at the exchange rate on the financial statement date. Monetary assets include gold, special drawing rights, and U.S. Reserves

in the International Monetary Fund. This category is principally for use by the Treasury Department. The amount of cash and other monetary assets that the reporting entity holds and is authorized to spend is entity cash.

### **Inventory and Related Property, Net**

- Inventory - Tangible personal property that is (i) held for sale, including raw materials and work in process, (ii) in the process of production for sale, or (iii) to be consumed in the production of goods for sale or in the provision of services for a fee.
- Operating materials and supplies - Tangible personal property to be consumed in normal operations.
- Stockpile materials - 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.
- Seized property - Monetary instruments, real property, and tangible personal property of others, including illegal drugs, contraband, and counterfeit items seized by authorized law enforcement agencies as a consequence of various laws, in the actual or constructive possession of a custodial agency.

Only seized monetary instruments shall be recognized as seized assets when seized (and a liability shall be reported in an amount equal to the seized asset value). Seized property other than monetary instruments and additional information regarding seized property shall be disclosed.

- Forfeited property - (i) Monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (ii) property acquired by the government to satisfy a tax liability; and (iii) unclaimed and abandoned merchandise.
- Goods held under are price support and stabilization program - These goods are referred to as commodities. Commodities are items of commerce or trade having an exchange value.

**General Property, Plant, and Equipment, Net.** SFFAS No. 6 defines general property, plant and equipment (PP&E) as any PP&E used in providing goods and services and provides guidance for determining the cost of general PP&E acquired by purchase, capital leases, donation, devise, judicial process, exchange, forfeiture, or transfers from other Federal entities. General PP&E 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 a significantly self-sustaining activity which finances its continuing cycle of operations through the collection of revenue (business-type activities), or

- It is used by entities in activities whose costs can be compared to other entities performing similar activities.

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 other PP&E categories (e.g., heritage assets).

Land and land rights acquired for or in connection with general PP&E shall be included in general PP&E.

The expense associated with the use of general PP&E is calculated through the systematic and rational allocation of the cost, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. This expense, known as depreciation, shall be recognized on all general PP&E, except land and land rights of unlimited duration.

Federal mission PP&E, heritage assets, and stewardship land are categories of PP&E not reported on the balance sheet.

### ***Internal Use Software***

**Internally Developed Software.** The costs of software developed by USDA employees are considered internally developed software costs. These direct costs should be included in general PP&E or reported separately if (1) the costs are intended primarily to be recovered through user charges and (2) feasibility has been proven.

Accounting and reporting policies for internal use software complement USDA policies already in existence for complying with SFFAS No. 4, Managerial Cost Accounting Concepts and Standards, and SFFAS No. 6, Accounting for Property, Plant and Equipment.

Some USDA entities, such as the National Finance Center, are in the process of implementing activity-based cost accounting procedures for accounting and reporting of internal use software that are consistent with the Managerial Cost Accounting Standard. Procedures required by the cost accounting standard are fully consistent and support the objectives of SFFAS No. 10. These objectives are to capitalize all of the costs associated with internal use software (direct and indirect) and report these amounts as general property, plant and equipment in the financial statements.

Accounting and reporting of internal use software should be integrated into the overall accounting system and automated to the greatest extent possible.

**Definition of Software.** 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 includes software that is purchased (1) off-the-shelf from vendors, (2) developed by contractors or (3) developed internally.

USDA has all three types of internal-use software.

- ***Software Development Phases.*** Software life-cycle phases include the Preliminary Design Phase, Software Development Phase and Operational Phase.



- **Preliminary Design Phase.** This Phase includes those activities associated with the initial identification of functional requirements, conceptual design, evaluation of technical and acquisition alternatives, and formal executive approval for a project.
- **Software Development Phase.** This Phase includes technical design, coding, installation and testing (to include component, unit, system, integration, usability, quality assurance, customer acceptance, and Government quality assurance and acceptance testing) and initial security accreditation and certification. A project is considered to be in the Software Development Phase if it:
  - Has been assigned resources.
  - Has been formally approved.
  - Is conducting activities as defined by this Phase for ad-hoc requirements resulting from a legislative or executive order.
- **Operational Phase.** A project is considered to be in the Operational Phase if all Software Development Phase activities have been completed.

This Phase includes data conversion, transition to operation activities, security re-accreditation and re-certification, and on-going maintenance and operations of the asset.

**Capitalization Threshold.** Effective FY 2001 and forward, USDA has established a \$100,000 capitalization threshold for internal use software with an estimated service life of 2 years or more. Internal use software projects must be identified separately in the accounting system for the accumulation of direct costs and the allocation of indirect costs.

For bulk purchases of software, USDA should determine 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 be capitalized.

### **Recognition, Measurement, and Disclosure**

- **Capitalized Cost.** For internally developed software, capitalized cost should include the full cost incurred during the Software Development Phase. If at the conclusion of the Preliminary Design Phase, the project is deemed not feasible, the costs accumulated will be expensed. Cost incurred after final acceptance testing has been successfully completed should be expensed.
- Costs to be accumulated for capitalization include but are not limited to:
  - Costs of Commercial- Off-The-Shelf (COTS) software.
  - Costs of modification to software (internal labor and contractor).

- Costs to custom develop software (internal labor and contractor).
- Costs of management and implementation of the software (internal labor and contractor) including installation and testing as described within the software development phase above.
- Other costs directly associated with the development and implementation of the software.

These costs will be accumulated in a separate account until the software is tested and placed in service. Once placed in service, costs will no longer be accumulated in the project account.

- ***Useful Life of Software Based on Hardware.*** 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 by USDA management and is at their discretion. The rationale for this determination should be documented.

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 capitalized and depreciated accordingly. The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.”

- ***Cost Pools and Financial Reporting.*** Internal controls should be established so that transactions are properly coded and costs accumulated and reported in the proper standard general ledger account.

Timing of obligations and expenditures are critical to the financial reporting requirements of internal use software. Internal controls should be established that would ensure the proper cutoff of obligations and expenditures for different phases of the software project’s development.

Financial reporting for each of the phases of a software development project may be simplified by issuing separate task orders for each phase of the project. In most cases, the financial reporting model for a software development project can be structured to match the agency’s budget and accounting documents (i.e. task orders, purchase orders, receiving reports, vouchers etc.).

- ***Data Conversion Costs.*** All data conversion costs incurred for internally developed, contractor-developed, or COTS software should be expensed as incurred, including the cost to develop or obtain software that allows for access or conversion of existing data to the new software. Such cost may include the purging or cleansing of existing data, reconciliation or balancing of data, and the creation of new/additional data.
- ***Cutoff for Capitalization.*** 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.

- **Integrated Software.** 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. The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.
- **Bundled Products and Services.** 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.
- **Training.** Training costs must be recognized as expense as incurred. Even though these may be costs which are associated with the internal development or acquisition of software for internal use, under GAAP those costs relate to the period in which incurred.

**Amortization/Useful Life.** Amortization of internal use software begins after the Software Development Stage is completed. Upon completion, these costs will be transferred from USSGL account 1832, "Internal-Use Software in Development, to USSGL account, 1830, "Internal-Use Software." Software that is capitalized 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. Program offices should coordinate with the OCIO regarding the estimated useful life of software.

- **License Fees.** In making the determination as to whether software license fees should be capitalized, USDA should follow the lease accounting concepts as provided in SFFAS 5, Accounting for Liabilities of the Federal Government, and SFFAS 6, Accounting for Property, Plant and Equipment.
- **Costs vs. Executory Costs.** USDA management should apply their judgment on a case-by-case basis when determining what portions of license fees are capitalizable costs versus executory costs (i.e., maintenance and technical support). This is entirely at their discretion, but the criteria should be fully documented. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts 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. USDA should ensure each license agreement specifically identifies the various costs charged throughout the license lifecycle, e.g., initial license, maintenance, enhancement, etc.

- **Modules/Components.** 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.” Generally, amortization should begin when USDA starts to realize the benefits of the new computer software system.
- **Enhancements.** Costs incurred which extend the functionality and the useful life of internal use software should be capitalized. Costs incurred solely to repair a design flaw or to perform minor upgrades that may extend the useful life without adding capabilities should be expensed.

The cost of minor enhancements resulting from ongoing systems maintenance should be expensed in the period incurred. Additionally, the purchase of enhanced versions of software for a nominal charge should be expensed in the period incurred.

SFFAS 10 states that an “enhancement” occurs when, for example, a new “capability or function is added to existing software.” In applying the provisions of SFFAS 10, “capability is synonymous with functionality.”

- **Impairment.** Impairment should be recognized and measured if software that is operational 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. The Office of the CFO should have oversight responsibility for ensuring the effect of impairment is recognized and measured in the financial records.
- **Disclosures.** The Office of the CFO should have oversight responsibility for ensuring the cost of internal use software is recorded in the WCF’ financial statements as general property, plant and equipment, in accordance with SFFAS 10 and USDA’s capitalization threshold policy.

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 of each major class of software.
- The method of amortization.

**Other Assets.** Advances and prepayments, which were previously reported as separate line items, should be reported in Other Assets.

### Assets Not for Use by Entity

These are assets that are held by an entity but are not available to the entity. An example of assets not for use by entity are income tax receivables, which the IRS collects for the U.S. government but has no authority to spend. Within this classification, there are two categories of assets, Federal and non-Federal.

**Federal.** These assets arise from transactions among Federal entities. These assets are claims of a Federal entity against other Federal entities. Brief descriptions of the assets included in this category follow.

**Fund Balance with Treasury.** The aggregate amount of the entity's accounts with Treasury as reported in the agency's general ledger for which the entity maintains fund balances in deposit, suspense, and clearing accounts that are not available to finance the entity's activities.

**Accounts Receivable, Net.** Federal entity claims for payment from other Federal entities. Include interest receivable, interest income earned but not received as of the reporting date, as a component of accounts receivable. Gross receivables shall be reduced to net realizable value by an allowance for doubtful accounts.

**Other Assets.** Advances and prepayments, which were previously reported as separate line items, should be reported in Other Assets.

**Non-Federal.** These assets arise from transactions of the Federal Government or an entity of the Federal Government with non-Federal entities. The term “non-Federal entities” encompasses domestic and foreign persons and organizations outside the U.S. government. Brief descriptions of the assets included in this category follow.

**Accounts Receivable, Net.** Federal entity claims for payment from other non-Federal entities. Include interest receivable, interest income earned but not received as of the reporting date, as a component of accounts receivable. Gross receivables shall be reduced to net realizable value by an allowance for doubtful accounts.

**Cash and Other Monetary Assets.** See definition under Assets for Use by the Entity, Federal. The cash and other monetary assets that a Federal entity collects and holds on behalf of the U.S. government or other entities is non-entity cash and other monetary assets.

**Other Assets.** Advances and prepayments, which were previously reported as separate line items, should be reported in Other Assets.

### *Authoritative Sources*

The policies and guidelines issued in this section are issued pursuant to the following guidelines:

*SFFAS 1, Accounting for Selected Assets and Liabilities*

<http://www.fasab.gov/pdf/sffas-1.pdf>

SFFAS 1 includes accounting standards for selected assets and liabilities of Federal government and its entities. The standards apply to both governmental and commercial-type functions of the Federal government. The selected assets and liabilities are among the fundamental elements of Federal accounting and financial reporting. The objective is to provide definitive accounting and reporting guidance to Federal agencies in these fundamental areas. Specifically, the recommended standards would assist users of financial statements in:

- assessing the efficiency and effectiveness of the government’s management of its assets and liabilities.
- determining whether the government’s financial position improved or deteriorated over the reporting period.

*SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees and related amendments (SFFAS 18 and SFFAS 19)*

<http://www.fasab.gov/pdf/sffas-2.pdf>

<http://www.fasab.gov/pdf/sffas-18.pdf>

<http://www.fasab.gov/pdf/sffas-19.pdf>

SFFAS 2 provides accounting standards for USDA direct loans and loan guarantees. It requires that direct loans obligated and loan guarantees committed after September 30, 1991, be accounted for on a present value basis. SFFAS 2 discusses the recognition and measurement of direct loans, the liability associated with loan guarantees, the cost of direct loans and loan guarantees, and the collection of loans from debtors. With the exception of loan collection rules,

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. The standard contains the following essential requirements:

- Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.
- For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.
- For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.
- The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).
- When direct loans or loan guarantees are modified, the cost of modification is recognized at an 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.
- When property is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement direct loans or as a compensation for losses that the government sustained under 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.

*SFFAS No. 3, Accounting for Inventory and Related Property*

<http://www.fasab.gov/pdf/sffas-3.pdf>

This Statement covers the accounting standards for several types of tangible property, other than long term fixed assets, held by Federal Government agencies. This statement consists of the accounting standards and disclosure requirements for the following: inventory (i.e., items held for sale); operating materials and supplies; stockpile materials; seized and forfeited property; foreclosed property; and goods held under price support and stabilization programs (including non-recourse loans and purchase agreements).

*SFFAS No. 6, Accounting for Property, Plant, and Equipment*

<http://www.fasab.gov/pdf/sffas-6.pdf>

This Statement provides accounting standards for Federal owned property, plant, and equipment (PP&E), deferred maintenance; and cleanup costs. The Statement identifies and defines categories of PP&E and addresses recognition and measurement of, and disclosure requirements associated with PP&E (as well as land), including accounting for deferred maintenance and cleanup costs.

In drafting accounting standards for PP&E, the FASAB relied on its Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting. Ultimately, all accounting standards taken as a whole will help meet the four reporting objective expressed in the Objectives statement: budgetary integrity, operating performance, stewardship, and systems and control. The focus of these standards is on the two reporting objectives most relevant to PP&E—operating performance and stewardship.

The standards are grouped into the following categories: general PP&E that are used to provide general Government services or goods; Federal mission PP&E that are an integral part of the output of certain unique Federal Government missions; heritage assets that possess significant educational, cultural, or natural characteristics; and stewardship land, i.e., land other than that included in general PP&E.

*SFFAS No. 10, Accounting for Internal Use Software*

<http://www.fasab.gov/pdf/fasab10.pdf>

SFFAS No. 6, Accounting for Property, Plant and Equipment, addresses internally-developed software. However, this standard provided general guidance for commercial off-the-shelf (COTS) software and contractor-developed software and users were uncertain how to apply it.

SFFAS No. 10 requires the capitalization of the cost of internal use software whether it is COTS, contractor-developed, or internally developed. Furthermore, it provides guidance regarding the types of cost elements to capitalize, the timing and threshold capitalization, amortization periods, accounting for impairment, and other guidance.

*SFFAS No. 14, Amendments to Deferred Maintenance Reporting*

<http://www.fasab.gov/pdf/sffas14.pdf>

This statement amends SFFAS 6 and SFFAS 8. It removes the requirement to include deferred maintenance reporting in the Statement of Net Cost. Instead deferred maintenance should be reported as Required Supplementary Information (RSI).

*SFFAS No. 16, Amendments to Accounting for PP&E: Multi-Use Heritage Assets (amends SFFAS No. 6 and SFFAS No. 8)*

<http://www.fasab.gov/pdf/sffas16.pdf>

This statement establishes consistent accounting for all PP&E acquisition, reconstruction and betterment costs. Multi-use heritage assets are those assets that are also used in general business operations, such as historical buildings. With this amendment, any improvements will now be capitalized and depreciated rather than expensed, leading to consistent treatment for all PP&E.



*SFFAS No. 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*

<http://www.fasab.gov/pdf/sffas25.pdf>

This statement changes the classification of information about stewardship responsibilities required by federal accounting standards. It also eliminates the requirement to present certain information about stewardship responsibilities, known as the “Current Services Assessment,” previously required by SFFAS 8.

## ***Cash and Fund Balance with Treasury***

### **Cash**

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

- coins, paper currency and readily negotiable instruments, such as money orders, checks, and bank drafts on hand or in transit for deposit.
- amounts on demand deposit with banks or other financial institutions.
- foreign currencies, which, for accounting purposes, should be translated into U.S. dollars at the exchange rate on the financial statement date.

### **Types of Cash**

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

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.

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

### **Fund Balance with Treasury**

A Federal entity's Fund Balance with 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.

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.

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

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. 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.

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.

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.

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

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.

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.

### **Appropriations, Transfers, Billings and Collections**

**Cash Management Improvement Act of 1990 (CMIA).** This act requires the timely transfer and drawdown of Federal funds. The primary purpose of the CMIA is to effect good cash management in the exchange of funds between USDA and states so that USDA funds are not provided too early before nor delayed too long after the states' need for them. The CMIA discourages states from drawing down USDA funds too far ahead of time by compelling states to pay interest on funds drawn early; the CMIA also provides for Federal interest payments when states advance their own funds and then experience delays in reimbursement by USDA. The CMIA in effect acts as an incentive for the timely transfer of funds and timely execution of grant awards. The interest obligation provides a mutual incentive for states and the Federal Government to see that the transfer of Federal funds coincides as closely as possible with actual payments to program recipients.

The CMIA applies to disbursements for Federal assistance programs administered by the states. It does not apply to vendor payments that are covered under the Prompt Payment Act.

**Cash Management Policies and Quality Control Programs.** Each USDA entity head is responsible for implementing appropriate departmental and Federal cash management policies including the following:

- Assuring timely payments and the automatic payment of interest penalties where required;
- Issuing internal instructions for monitoring the cause of any interest penalties incurred, taking necessary corrective or disciplinary action; reporting accurately each year through the consolidated Prompt Payment Act report to Treasury; and dealing with inquiries;
- Assuring that effective internal control systems are established and maintained to provide reasonable assurance that cash management activities are effectively and efficiently carried out and that internal management controls over receipt of collections and acceptance of goods and services are in place and being observed;
- Establishing a quality control (QC) program to assess performance of payment systems and provide a reliable way to estimate payment performance. Entity QC programs must fulfill the following requirements:
  - QC must be a systematic performance measurement system in place throughout the entity that provides manager information about problems and assists in targeting corrective actions. QC data must be accurate to within established tolerances and should be used to fulfill OMB-mandated annual reporting requirements;

- Data should be gathered as frequently as needed by managers to identify and correct errors. Rapidly changing situations may require frequent data collection;
- Information must be collected through a process at least as thorough as the original payment decision process. QC reviewers must use original documents and repeat the original calculations;
- To the greatest extent practicable, data should be gathered on the basis of a statistically valid sample sufficient to assure the reliability of QC reviews conducted, without unduly burdening entity resources;
- Data must be collected by individuals who are independent from the original payment decision (segregation of duties). Thus, supervisory reviews, while an excellent way to improve processing, are not QC reviews; and
- QC data should be analyzed periodically and remedial action plans implemented to correct any inefficiencies or errors found.
- Publishing lists of designated entity contacts within their payment centers or finance offices to provide contractors assistance in determining the status of their invoices.

**Disbursements.** The Prompt Payment Act of 1982 (PPA) provides for interest on late Federal payments to contractors. The PPA, as amended, also provides that Federal entities must make payments on time and take discounts only when payments are made on or before the discount date.

### ***Accounts Receivable***

Accounts receivable arise from claims to cash or other assets. A receivable should be recognized when a Federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made. Receivables from Federal entities are intragovernmental receivables, and should be reported separately from receivables from non-Federal entities.

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 non-Federal 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. 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. Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity.

## **Allowances**

Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase “more likely than not” means more than a 50 percent chance of loss occurrence. An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value. The allowance for uncollectible amounts should be reestimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct. Losses due to uncollectible amounts should be measured through a systematic, documented methodology that is applied consistently entity-wide. The systematic methodology should be based on analysis of both individual accounts and a group of accounts as a whole.

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 the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

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.

To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics. The groups should reflect the entity's operating environment. For example, accounts receivable can be grouped by: (a) debtor category, (b) reasons that gave rise to the receivables, or (c) geographic regions. Within a group, receivables may be further stratified by risk characteristics. Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables.

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 economic events, current and forecast economic conditions, and inherent risks. Entities 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.

## **Interest Receivable**

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 as well as on other outstanding accounts receivable and government claims against persons and entities. No interest should be recognized on accounts receivable or investments that are determined to be uncollectible unless the interest is actually collected. Payments received from the debtor are required to be applied first to penalty and administrative cost charged, second to interest receivable, and third to outstanding debt principal. 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 still

be disclosed. Interest receivable from Federal entities should be accounted for and reported separately from interest receivable from the public.

### **Advances and Prepayments**

Advances and prepayments 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 of 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. 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. Both advances and prepayments must be recognized on a full accrual basis.

### **Loans Receivable**

Direct loan obligations or loan guarantee commitments made prior to FY 1992 and the resulting direct loans or loan guarantees are reported at net present value or net realizable value.

Direct loan obligations or loan guarantee commitments made after FY 1991 and the resulting direct loans or loan guarantees are governed by the Federal Credit Reform Act. The Act requires agencies to estimate the cost of direct loans and loan guarantees at present value for the budget. Additionally, the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, delinquencies and defaults, fee offsets and other cash flows) associated with direct loans and loan guarantees are recognized as a cost in the year the loan or loan guarantee is disbursed. The net present value of loans or defaulted guaranteed loans receivable at any point in time is the amount of the gross loan or defaulted guaranteed loans receivable less the present value of the subsidy at that time.

## ***Inventory and Related Property***

### **Materiality**

SFFAS No. 3, *Accounting for Inventory and Related Property*, should be applied only to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

The determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user.

In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the Federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, Federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users. This is expressed well in the "Government Auditing Standards" (the "Yellow Book"):

"In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private-sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions." (Ch. 3, par. 33.)

While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the Federal government. Therefore, the accounting and reporting provisions of these standards should be applied to all items that would influence or change the users' judgments of the entity's efficiency and the effectiveness and its compliance with laws and regulations in a material manner.

## **Inventory**

"Inventory" is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.

**Held for Sale.** 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.

Inventory held for sale shall be categorized as (1) inventory held for immediate sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. Sales transactions for inventory held for immediate sale 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.

**Held in Reserve for Future Sale.** Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory

line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

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.

Inventory should be recognized as an asset 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.

**Excess, Obsolete and Unserviceable Inventory Held for Sale.** “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.

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). Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.

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

**Allowance Method.** 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.

**Direct Method.** 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.

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.

**Historical Cost of Inventory Held for Sale.** 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 market value at the time of donation. Inventory acquired through exchange of non-monetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any differences between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as gain or a loss.

**Valuation Methods of Inventory Held for Sale.** 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 reasonable approximate those of one of the above historical cost methods (e.g., a standard cost system).

**Latest Acquisition Costs Method for Inventory Held for Sale.** The latest acquisition cost method provides that the last invoice price (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 non-monetary exchange. The inventory shall be reviewed periodically be at least at the end of each fiscal year. Revaluation results in recognition of unrealized holding gains or (losses) in the ending inventory value. Upon adjustment for unrealized holding gains or losses, the latest acquisition cost method then results in an approximation of historical cost.

**Holding Gains and Losses Resulting from Revaluation of Inventory Held for Sale.** 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.

**Cost of Goods Sold.** The cost of goods sold for the period shall be computed as follows:

Beginning inventory at beginning-of-period latest acquisition cost

LESS: allowance for unrealized holding gains/losses at the beginning-of-the-period

PLUS: actual purchases

EQUALS: Cost of Goods Available for Sale

LESS: ending inventory at end-of-the period latest acquisition cost

PLUS: ending allowance for unrealized holding gains/losses at the end-of-period

EQUALS: Cost of Goods Sold

**Exception to Historical Cost Valuation: Net Realizable Value.** Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine costs, (2) immediate marketability at quoted prices, and (3) unit interchange ability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.

**Disclosure Requirements for Inventory Held for Sale.** The following disclosures of inventory information are required. The basis of stating inventories must be consistently applied and should be disclosed in agencies' financial statements. Disclosure information should 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;
- The difference between the carrying amount of the inventory before identification as excess, obsolete, or unserviceable inventory, and its expected net realizable value;
- Restrictions on the sale of material;
- The decision criteria for identifying the category to which inventory is assigned; and
- Changes in the criteria for identifying the category to which inventory is assigned.

### **Operating Materials and Supplies**

“Operating materials and supplies” consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

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 below.

**Recognition of Expense for Operating Materials and Supplies: Consumption Method.** 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. 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.

**Recognition of Expense for Operating Materials and Supplies: Purchases Method.** 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.

**Definition of End User of Operating Materials and Supplies.** An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall not be considered an end user.

**Valuation of Operating Materials and Supplies Under the Consumption Method.** Operating materials and supplies shall be valued on the basis of historical cost. 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 non-monetary 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.

**Calculation of Historical Cost of Operating Materials and Supplies.** 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).

**Held for Use.** Operating materials and supplies held for use are those materials and supplies readily available for use in the day-to-day normal operations of the reporting entity.

**Held in Reserve for Future Use.** Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote

chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.

The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

**Excess, Obsolete, and Unserviceable.** “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.

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).

Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies. Disclosure requirements should 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;

- The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete, or unserviceable, and their expected net realizable value;
- Restrictions on the use of material;
- Decision criteria for identifying the category to which operating materials and supplies are assigned; and
- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

### **Stockpile Materials**

“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, (2) items that are held for use in the event of an agency's operating emergency or contingency, and (3) materials acquired to support market prices.

**Recognition of Expense for Stockpile Materials.** The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. “Purchase” is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.

**Valuation of Stockpile Materials.** 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).

**Recognition of Loss on Stockpile Materials.** The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss or an expense in the period in which it occurs.

**Held for Sale.** When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be

disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time.

**Disclosure Requirements for Stockpile Materials.** Management shall develop and disclose in the financial statements the following information regarding stockpiled materials:

- 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.

### **Seized and Forfeited Property**

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.

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. The provisions of this statement need not be applied to immaterial items.

**Seized Property.** “Seized property” includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.

Seized property shall be accounted for in the financial records of the entity that is operating as the central fund. 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.

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.

Seized property other than monetary instruments shall be disclosed in the footnotes. The value of the seized property shall be accounted for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated. Seized monetary instruments shall be valued at their market value.

**Valuation of Seized Property.** Seized property shall be valued at its market value when seized or, if market value cannot be readily determined, as soon thereafter as reasonably possible. Market value shall be based on the value of the property assuming an active market exists for the property. If no active market exists for the property in the general area in which it was seized, a value in the principal market nearest the place of seizure shall be used.

**Disclosure Requirements for Seized Property.** Management shall develop and disclose in the financial statements the following information regarding seized property.

- 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; and
- Analysis of change in seizures, including the dollar value and number of seized property that are (1) on hand at the beginning of the year, (2) made during the year, (3) disposed of during the year, and (4) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seizure and method of disposition where material.

**Forfeited Property.** "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. Examples of forfeited property include: 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.

**Recognition of Forfeited Property.** 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. Revenue from

the sale of property shall be recognized when the property is sold. Revenue shall be classified as it arises from sale or from disposition, and this distinction shall be maintained in the entity's accounting reports.

**Valuation of Forfeited Property.** Intangible property, real property and tangible personal property shall be recorded with an offsetting deferred revenue when forfeiture judgment is obtained. When a determination is made that property will not be sold, the property shall be reclassified as forfeited property held for donation or use. The property shall be valued at its fair value at the time of forfeiture. A valuation allowance shall be established for liens or claims from a third-party. This allowance shall be credited for the amount of any expected payments to third-party claimants.

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. Property not held for sale may be: placed into official use; transferred to another Federal government agency, distributed to a state or local law enforcement agency, or distributed to a foreign government.

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.

**Unclaimed and Abandoned Merchandise.** Unclaimed and abandoned merchandise shall be recorded with an offsetting deferred revenue when statutory and/or regulatory requirements for forfeiture have been met. The merchandise shall be valued at its market value. Upon sale of the merchandise, revenue shall be recognized in the amount of the sale proceeds and the merchandise and the deferred revenue are removed from the accounts.

**Disclosure Requirements for Forfeited Property.** Management shall develop and disclose in the financial statements it's the following information regarding forfeited property:

- 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; and
- If available, an estimate of the value of property or funds to be distributed to Federal, state and local agencies in future reporting periods.

**Summary of Accounting Standards for Seized and Forfeited Property**

The following table summarizes the accounting for seized and forfeited property.

SUMMARY OF ACCOUNTING STANDARDS FOR SEIZED AND FORFEITED PROPERTY				
Category of Property	Method of Disposition	Valuation Method	Recognized as Assets	Recognized as Revenue
Monetary instrument	Sale; proceeds credited to entity's fund	Market Value	Upon seizure	Upon obtaining forfeiture judgment
Intangible property, real property, and tangible personal property acquired by forfeiture proceedings	<b>Sale</b>	Market Value	Upon obtaining forfeiture judgment	Upon sale
Intangible property, real property, and tangible personal property acquired by forfeiture proceedings	Transferred, distributed, or held for internal use	Market Value	Upon obtaining forfeiture judgment	Upon obtaining approval to transfer, distribute or use internally
Unclaimed or abandoned merchandise	Sale; proceeds used to reimburse other funds; excess credited to Treasury General Fund	Market value	Upon meeting statutory and/or regulatory requirements	Upon sale of property

**Foreclosed Property**

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.

**Distinction between Pre-1992 Foreclosed Property and Post-1991 Foreclosed Property.** The Federal Credit Reform Act of 1990 distinguishes between “pre-1992 foreclosed property” and “post-1991 foreclosed property.” “Pre-1992 foreclosed property” refers to property associated with direct loans obligated or loan guarantees committed before October 1, 1991. “Post-1991 foreclosed property” refers to property associated with direct loans obligated or loan guarantees committed after September 30, 1991. The distinction is necessary because for budget purposes, the cash flows associated with post-1991 direct loans and loan guarantees, including the cash flows associated with post-1991 foreclosed property, must be measured on a present value basis. However, pre-1992 foreclosed property need not be valued on this basis. Additionally, any programs that are specifically exempt from the use of present value techniques for determining the costs of direct loans and loan guarantees shall rely on the accounting principles provided for pre-1992 foreclosed property.

**Valuation of Foreclosed Property.** Post-1991 foreclosed property is valued at the net present value of the projected future cash flows associated with the property. Pre-1992 foreclosed property is recorded at cost and adjusted to the lower of cost or its net realizable value; any difference is carried in a valuation allowance. Both of these methods are described further below. For either post-1991 or pre-1992 foreclosed property, other valuation methods may be used as an approximation for the above methods if no material differences in valuation will result.

**Determining Net Present Value of Forfeited Property.** 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.

**Selecting a Discount Rate.** 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.

**Periodic Adjustment in Net Present Value.** Following foreclosure, the net present value (measured in a manner consistent with the measurement at the time of foreclosure) shall be adjusted periodically to recognize both changes in the expected future cash flows and for accrual of interest due to the passage of time. Any adjustments to the carrying amounts shall be included in the presentation of “interest income” and the reestimate of “subsidy expense.”

**Net Realizable Value of Forfeited Property.** 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.

**Recognition of Loss.** If the expected net realizable value is less than the cost, a loss has occurred. This loss shall be charged to operations, and a valuation allowance shall be established. If the asset's net realizable value subsequently increases or decreases, this amount shall be credited or charged to results of operations and the valuation allowance adjusted. However, the asset value shall not be adjusted above cost.

**Assets Subject to Claims of Other Parties.** If the property is taken subject to claims of the lender, debtor, or other party, these claims shall be accounted for in a valuation allowance. These claims can be in the form of a lien or a residual interest of the debtor or lender, etc. For post-1991 foreclosed property, these claims shall be recorded at their net present value at the time of foreclosure. The discount rate applied shall be the same rate that applies to the related foreclosed property. For post-1991 foreclosed property, any periodic changes in the net present value of the claim shall be offset by a charge or a credit to "interest income" and the reestimate of "subsidy expense," as appropriate under the standards for direct loans and loan guarantees. For pre-1992 foreclosed property, these claims shall be recorded at the expected amount of the cash required to settle the claims.

**Receipts and Disbursements During the Holding Period for Post-1991 Foreclosed Property.** Any receipts or disbursements associated with acquiring and holding post-1991 foreclosed property shall be charged or credited to foreclosed property. This shall include rental receipts, maintenance and repair expense, advertising costs, and any other elements of the projected cash flows considered in arriving at the net present value.

**Sale of Foreclosed Property.** 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 reestimate of "subsidy expense." For pre-1992 foreclosed property, this difference shall be recognized as a gain or a loss on the sale of foreclosed property.

**Assets Converted from Held-for-sale Assets to Operating Assets.** Assets not sold but placed into operation shall be removed from foreclosed property when such action is taken. If reimbursement for the transfer of assets from one program to another is made, the proceeds from the transfer shall be treated in the same manner as a sale to a third party.

**Disclosure Requirements for Foreclosed Property.** Management shall develop and disclose in the financial statements the following information regarding foreclosed property:

- 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.

### **Goods Held Under Price Support and Stabilization Programs**

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. These functions are generally carried out as part of one of the following activities:

- Price support programs which are designed to provide eligible producers of certain agricultural commodities the opportunity to obtain a specified return on their commodities, regardless of fluctuation on market prices;
- Supply programs undertaken as the need arises to provide commodities for government agencies, foreign governments, relief and rehabilitation agencies, and for domestic consumption;
- Commodity export programs which aid the development or expansion of export markets for U.S. agricultural commodities and products;
- Donation programs which, by statute, authorize USDA to donate commodities to domestic and international relief organizations and government agencies; and
- Special activity programs carried out under authority of special charter, specific statutory authorization, or directive.

**Commodities Acquisition and Disposal.** USDA acquires and disposes of commodities in a number of ways and through a variety of programs. These are described in this section.

**Price Support Purchase Operations.** Processed commodities, predominantly dairy products, are acquired through a price support program direct from processors and other non-producers (both referred to as vendors). Dairy products are purchased under a mandatory price support program that requires USDA to purchase all specified products offered at a price set by law. The inventories accumulate when demand is not sufficient to absorb available supplies at the support price.

**Other Direct Purchase and Supply Operations.** Periodically, USDA will be given authority to acquire and dispose of commodities via special programs, e.g., foreign and domestic sales or donations which are funded from other governmental agencies or external sources. In some cases, USDA commodities inventories may not be sufficient to cover the proposed sale and/or donation. In these instances, USDA may purchase additional commodities directly from vendors or other external sources. When such need exists, USDA will contract with appropriate parties to supply commodities at the cost and quantity needed to satisfy program requirements.

**Commodity Exchanges.** Once in inventory, USDA-owned commodities may be moved to another storage facility to reposition stocks or to meet a sales or donation requirement. These movements and dispositions are monitored to assure that the quality, quantity, and value of inventory are properly accounted for from initial acquisition to final disposition.

**Returns of Commodities.** Sold or donated commodities may be subsequently returned to USDA because they are no longer needed or because they have deteriorated or spoiled. Those commodities should be returned to inventory and valued at the expected net realizable value. Such commodities should be disposed of quickly to minimize costs.

**Commodities Acquired Through Non-recourse Loans.** 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.

**Purchase Agreements.** 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.

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 (loans, purchases, and direct payments) are addressed in this accounting standard.

**Recognition.** 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. 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 non-recourse loan or upon direct purchase (i.e., making payment and taking title) by the agency. Upon taking title of commodities, entities should establish an appropriate allowance for loss.

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. 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.

**Losses on Purchase Agreements.** Purchase agreement settlements are executed at the option of the producer (seller). This creates an uncertainty regarding losses to be incurred by the purchaser. At financial statement dates a loss shall be recognized if information indicates that it is probable that a loss has been incurred on purchase agreements outstanding and the amount of the loss can be reasonably measured or estimated. The amount of the loss shall be estimated and may be based on the contract price and the expected net realizable value of the commodities to be acquired.

**Disclosure of Contingency.** If the contingent loss is not recognized because it is less than probable or it is not reasonably measurable, disclosure of the contingency shall be made if it is at least reasonably probable that a loss may occur.

**Non-recourse Loans.** 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 reestimated on each financial reporting date.

**Losses on Purchase Agreements.** 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.

**Commodities Inventory Valuation.** At the time of acquisition and for financial statement purposes, all commodities shall be valued at the lower of cost or net realizable value. Upon taking title of commodities, entities should establish an appropriate allowance for loss.

**Commodities Acquired Through Non-recourse Loans.** The cost for commodities acquired via a non-recourse 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.

**Commodities Acquired Through Purchase Settlement.** 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.

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.

For cost determination, any of the following cost flow assumptions may be applied in arriving at inventory balances and cost of goods sold or transferred: first-in, first-out (FIFO); weighted average; moving average; and specific identification.

**Disclosure Requirements for Commodities:** Management shall develop and disclose in the financial statements the following information regarding commodities:

- 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.

## ***Investments in Treasury Securities***

### **Types of Treasury Securities**

Investments in Treasury securities includes investments by Federal entities in Treasury securities, including (a) non-marketable 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. Investments in Treasury securities do not include investments by Federal entities in securities (debt and equity) and other financial instruments issued by non-government entities. These three types of Treasury securities should be recognized at their acquisition cost. If there is a premium or discount from par value, amortization is recorded over the investment's remaining life using the interest method.

**Non-marketable Par Value Treasury Securities.** Non-marketable 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.

**Market-based Treasury Securities.** 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.

**Marketable Treasury Securities.** 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.

### **Expected To Be Held To Maturity**

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

### **Separate Accounting and Reporting for Federal and Non-Federal Securities**

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 non-Federal entities.

### **Initial Recording**

The three types of Treasury securities covered (non-marketable 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 non-monetary 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.

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



### **Valuation Subsequent to Acquisition**

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

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.

### **Disclosure of Market Value**

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.

### **Investment Reclassification**

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).

## ***Property, Plant and Equipment (PP&E)***

### **Definitions**

PP&E consists of tangible assets, including land, that:

- Have an estimated useful life of 2 or more years.
- Are not intended for sale in the ordinary course of business.
- Are intended to be used, or are available for use, by the entity.

PP&E also includes:

- Assets acquired through capital leases, including leasehold improvements.
- Property owned by the reporting entity but in the hands of another (e.g., a college, Federal contractor, state or local government, or university).

- Land rights. *However, only those land rights that conform to the definition of PP&E and to the characteristics of general PP&E are to be included.*

PP&E excludes items (1) held in anticipation of physical consumption, such as operating materials and supplies, and (2) for which the Federal entity has a reversionary interest. Capital leases are leases that transfer substantially all of the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease by the lessee. Otherwise, it shall be classified as an operating lease.

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory costs, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

### Categories

The PP&E categories are:

- General PP&E.
- Federal mission PP&E. USDA has no property that meets the FASAB definition of Federal mission PP&E; therefore, Federal mission PP&E will not be discussed herein.
- Heritage assets.
- Stewardship land.

One must identify the “base unit” against which the definitions of the categories are to be applied. For example, a unit as large as an entire facility, or as small as a computer, can be categorized. One should consider the cost of maintaining different accounting methods for the property and the usefulness of the information; the diversity in the PP&E to be categorized (e.g., alternative uses, useful lives, and values); the programs being served by the PP&E; and the future disposition of the PP&E (e.g., transferred to other entities or scrapped).

**General PP&E.** General PP&E is any PP&E used by a Federal entity to produce goods and services, and it typically has one or more of the following characteristics:

- It could be used for an alternative purpose (e.g., by another Federal entity, state or local government, or nongovernmental entity).
- It is used in a business-type activity.
- It is used by an entity in an activity whose cost can be compared to a similar activity (e.g., an activity in one hospital compared to the same or similar activity in another hospital).

For entities performing business-type activities, all PP&E shall be categorized as general PP&E whether or not it meets the definition of any other category of PP&E. Land and land rights acquired for or in connection with other general PP&E shall be included in general PP&E only when the cost of the land and land rights is identifiable.

### **Asset Recognition**

#### Capitalization Threshold

All general PP&E that meets the established capitalization threshold shall be recorded at cost. USDA policy establishes a capitalization threshold of \$25,000 for personal property effective with fiscal year 2003. The capitalization threshold for real property is \$25,000 effective with fiscal year 2002 and the accountability threshold is \$25,000 effective fiscal year 2003. However, the accountability threshold for personal property remains at \$5,000. This policy is not retroactive.

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 PP&E might include:

- Amounts paid to vendors.
- Transportation charges to the point of initial use.
- Handling and storage costs.
- Labor and other direct and indirect production costs (for assets produced).
- Architectural, engineering, and other outside service charges 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.
- The cost of fixed equipment and its related installation.
- The direct cost of administration, inspection, and supervision of construction contracts and construction work.

- Legal and recording fees and damage claims.
- The fair value of facilities and equipment donated to the Government.
- Material amounts of interest paid.

Internally developed software shall be included in general PP&E or a separate asset account if its cost is intended to be recovered primarily through charges to users. USDA elected to include the capitalized cost of internally developed software in a separate asset account in such cases. Other internally developed software costs shall be expensed when incurred.

Internally developed software costs that may be capitalized are limited to:

- Costs incurred after technological feasibility has been established.
- Costs clearly identifiable with new software projects and distinguishable from recurring maintenance-type activities.
- Direct costs of documentation, initial training materials, and software development (e.g., the salaries of the administrative personnel, programmers, project managers, and systems analysts; the associated employee benefits; outside consultants' fees; and supplies).

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 unless the net present value exceeds the fair value of the asset, in which case the fair value is recognized as the cost of the general PP&E). The cost of general PP&E acquired through devise, donation, or judicial process, excluding forfeiture (see below), shall be the estimated fair value at the time acquired by USDA.

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. If the receiving entity cannot reasonably ascertain those amounts, the cost of the PP&E shall be its fair value at the time transferred.

The cost of general PP&E acquired through exchange shall be the fair value of the PP&E surrendered at the time of the exchange. 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 the 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. 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 the general PP&E acquired shall be increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received.

The cost of general PP&E acquired through forfeiture shall be recognized when the forfeited asset is placed into official use.

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. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

### **Expense Recognition**

Depreciation expense is calculated through the systematic and rational allocation of the acquisition cost of general PP&E, less its estimated salvage or residual value, over its estimated useful life. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration.

- Estimates of the useful life of general PP&E must consider factors such as physical wear and tear and technological change (e.g., obsolescence).
- Various methods may be used to compute periodic depreciation expense as long as the method is rational, systematic, and best reflects the use of the PP&E.
- Any change in the estimated useful life, or in the salvage or residual value, shall be treated prospectively. Such change shall be accounted for in the period of the change and in future periods. No adjustments shall be made to previously recorded depreciation.

Depreciation expense shall be accumulated in a contra asset account - accumulated depreciation.

Costs that extend the useful life of general PP&E, or enlarge or improve its capacity, shall be capitalized and depreciated over the remaining useful life of the associated property.

General PP&E shall be removed from the asset accounts along with its associated accumulated depreciation in the period of its disposal, retirement, or other removal from service. Any difference between the book value of the PP&E and the amount realized shall be recognized as a gain or a loss in the same period.

General PP&E shall be removed from the general PP&E accounts along with its associated accumulated depreciation if it no longer provides service in the operation of the entity. This could be 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 shall be recognized as a gain or a loss. No additional depreciation shall be taken once such assets are removed from service.

**Implementation Guidance for General PP&E.** If the historical cost of existing general PP&E has not been maintained, estimates are required based on:

- The cost of similar assets at the time of acquisition, or
- The current cost of similar assets discounted for inflation since the time of acquisition (i.e., use the general price index to deflate the current cost to the cost at the time of acquisition).

*USDA adopted the position of the Government-wide Audited Financial Statements Task Force that the cost of general PP&E should be based on documented actual cost; however, there is no way to satisfactorily develop such documentation after the fact. Therefore, any unsupported value of general PP&E that was acquired and capitalized in the agency's system prior to fiscal year (FY) 1995 shall be presented on the balance sheet and/or stewardship report and "accepted" by the auditors when:*

- The documentation needed to support the value of general PP&E is not available because of compliance with records retention policies of the National Archives and Records Administration.
- Adequate supporting documentation does exist for the value of general PP&E acquired after FY 1994.
- The value of general PP&E acquired after FY 1994 is based on the following hierarchy of valuation methodologies.
- Actual or historical cost.
- An estimated cost determined by appraisal, applicable inflation or deflation factor, or similar technique.
- The financial statements contain a footnote that fully describes (a) the nature and valuation of unsupported general PP&E, (b) why supporting documentation is not available, (c) how the cutoff date was established, and (d) the steps taken to ensure that adequate documentation exists to support the valuation of PP&E items acquired after FY 1994.

Accumulated depreciation shall be recorded based on the estimated cost and the number of years the general PP&E has been in use relative to its estimated useful life. Alternatively, general PP&E may be recorded at its estimated net remaining cost with depreciation charged over its estimated remaining useful life. USDA elected to disregard the alternative approach and record accumulated depreciation in all cases on the estimated cost and number of years the general PP&E has been in use relative to its estimated useful life.

For general PP&E that would be substantially depreciated 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 those improvements made during the period beyond the initial expected useful life of the general PP&E.
- Making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than building by building).

In recording existing general PP&E, the difference in amounts added to the asset and to the contra asset accounts shall be credited (or charged) to the 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 difference in amounts of general PP&E removed from the asset accounts shall be charged to the net position of the entity and the adjustment shown as a prior-period adjustment in the statement of changes in net position similar to heritage assets and to stewardship land.

For published financial statements presenting prior-year information, no prior-year amounts shall be restated.

In the period that these standards are implemented, the disclosure of adjustments by major class of general PP&E and the associated accumulated depreciation is required.

*USDA's mutually exclusive major classes and base units of general PP&E are as follows:*

*Personal Property:*

- *ADP hardware (central unit and accessories)*
- *Equipment (single unit)*
- *Vehicles (single unit)*
- *Other (single unit)*

*Real Property:*

- *Buildings (single structure)*
- *Dam systems (single structure)*
- *Developed sites (administrative (e.g., district compound) and recreation (e.g., campground))*
- *Land (acres)*
- *Roads and bridges (miles)*
- *Other (single unit)*

**Disclosure Requirements.** The following are minimum general PP&E disclosure requirements.

- The cost, associated accumulated depreciation, and book value by major class.
- The estimated useful life for each major class.
- The method of depreciation for each major class except for land.
- The capitalization thresholds, including any changes during the period.
- Any restriction on the use or convertibility of general PP&E.

**Heritage Assets.** Heritage assets are PP&E that are unique for one or more of the following reasons.

- Historical or natural significance.
- Artistic, cultural, or educational importance.
- Significant architectural characteristics.

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.

Heritage assets may, in some cases, be used in general Government operations (e.g., office buildings such as the main Treasury building). When a heritage asset is used as general PP&E it shall be subject to the general PP&E accounting standards. For example, the cost of any improvement, reconstruction, renovation, or restoration of such a capital asset shall be capitalized as general PP&E and depreciated over its expected useful life.

The cost of newly acquired or constructed heritage assets that are not used as general PP&E shall be recognized as a cost in the period incurred. In addition, the cost of improving, reconstructing, or renovating heritage assets that cannot be directly associated with Government operations shall also be recognized as a cost in the period incurred. These costs shall be disclosed as the “cost of heritage assets” on the statement of net cost. The cost shall include all of the costs incurred to bring the heritage assets to their current condition and location.

The cost of heritage assets transferred from other Federal entities shall be the book value of the asset recorded on the transferring entity's books. If the receiving entity does not know the book value, the fair value shall be disclosed in a note to the statement of net cost. If the fair value is not estimable, information related to the type and quantity of assets transferred shall be disclosed.

No cost shall be recognized on the statement of net cost for heritage assets acquired through devise or donation. The fair value of the heritage assets, if known, and material shall be disclosed in a note to the statement of net cost in the year received. If the fair value is not known or reasonably estimable, information related to the type and quantity of the heritage assets received shall be disclosed.



Heritage assets that were previously recognized as assets for balance-sheet reporting and which are not used as general PP&E shall be removed. The amounts removed shall be charged to the 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 note to the balance sheet.

If records are not available to determine which costs are associated with heritage assets and which are associated with general PP&E, the entity may estimate the costs by major classes of heritage assets (e.g., entire facilities rather than building by building).

*USDA's mutually exclusive major classes and base units of heritage assets are as follows:*

- *Historical structures (number of structures).*
- *Museum collections (number of collectible items).*
- *National forests (number of forests).*
- *Other (number of units).*

No prior-year amounts for heritage assets shall be restated on financial statements presenting prior-year information.

### **Stewardship Land**

Land is defined as the solid part of the surface of the earth. Excluded from the definition of land are materials beneath the surface of the earth (e.g., depletable resources such as mineral deposits and petroleum); the space above the surface of the earth (e.g., renewable resources such as timber); and continental-shelf resources. The materials excluded from the definition of land will be addressed in a separate accounting standard for natural resources that is under development by FASAB. USDA does not capitalize natural resources at this time but plans to do so once OMB establishes applicable accounting standards, including what natural resources are to be capitalized.

Land and land rights owned by the Federal government and not acquired for or in connection with items of general PP&E shall be reported as stewardship land. Examples of stewardship land include land used for forests, grazing, and wildlife.

The acquisition cost of stewardship land shall be recognized as a cost in the period incurred. The cost shall be disclosed as the “cost of stewardship land” on the statement of net cost. The cost shall include all of the costs incurred to bring the land to its current condition.

In some cases, land may be acquired along with existing structures and one of the following treatments shall apply.

- If the structure 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, a heritage asset, or both.
- If the structure is to be used in operations (e.g., as general PP&E) but (a) the value of the structure is insignificant as compared to the value of the land, (b) it has little or no

inherent value, and/or (c) it is merely a byproduct of the acquisition of the land, the entire cost shall be treated as the acquisition cost of stewardship land.

- Only structures that have a significant operating use (e.g., a recently constructed hotel or employee housing block) shall be treated as general PP&E by identifying the cost attributable to the general PP&E and segregating it from the cost of the stewardship land acquired.

*USDA's mutually exclusive major classes and base units of stewardship land are as follows:*

- *Land (acres)*
- *Road prisms (miles)*
- *Trails (miles)*
- *Other (single structure or unit)*

No cost shall be recognized on the statement of net cost for stewardship land acquired through donation or devise. The fair value of the land if known, and material shall be disclosed in a note to the statement of net cost in the year received. If the fair value is not known or reasonably estimable, information related to the type and quantity of the land received shall be disclosed.

Land may be transferred between Federal entities. In some cases, land included in general PP&E may be transferred to another entity for use as stewardship land. In this event, the cost of the land transferred shall be the book value of the land recorded on the transferring entity's books. That book value shall be expensed in the year received. If the receiving entity does not know the book value, the transfer shall be disclosed in a note to the statement of net cost if material. In other cases, stewardship land may be transferred between Federal entities. Transfers of stewardship land shall be disclosed in a note if material.

Any cost of preparing stewardship land for its intended use (e.g., razing a building) shall be expensed as part of the cost of stewardship land.

Land previously recognized as an asset for balance-sheet reporting shall be removed. The amount removed shall be charged to the 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 amount removed from the balance sheet shall be disclosed in a note to the balance sheet.

No prior-year amount for land shall be restated on financial statements presenting prior-year information.

The deferred maintenance standards require disclosures related to the condition and the estimated cost to remedy deferred maintenance of PP&E. These disclosures should be made in a footnote but be given prominence by including a reference to this unrecognized cost in the statement of net costs. The deferred maintenance standard applies to all PP&E whether reported on the balance sheet or through supplementary stewardship reporting.

For cleanup costs associated with operation using general PP&E, probable and measurable cleanup costs should be included in the statement of net costs. The amounts should be allocated to operating periods benefiting from operations of the general PP&E. This allocation should be

based on a systematic and rational method, such as allocation 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.

For cleanup costs associated with stewardship PP&E, probable and measurable cleanup costs should be expensed in the operating period that the stewardship PP&E is placed in service. Simultaneous to recognizing the expense, the related liability for cleanup costs should be recognized.

### ***Direct Loans and Loan Guarantees***

Although direct loans disbursed and outstanding are recognized as assets, and loan guarantees outstanding are recognized as liabilities, they are discussed in this section simultaneously as they are in Statement of Federal Financial Accounting Standards No. 2, “Accounting for Direct Loans and Loan Guarantees” ([SFFAS No. 2](#)).

A direct loan is a disbursement of funds by the government to a nonFederal borrower under a contract that requires the repayment of such funds within a certain time, with or without interest. The term includes the purchase of, or participation in, a loan made by another lender.

A loan guarantee is defined as 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.

The following are some of the direct and guaranteed loan and credit programs of the Department:

- loans for farm ownership, operations and emergencies
- loans to low-income families to own, repair, or rent housing in rural areas
- loans for rural businesses and community facilities such as water and waste disposal
- foreign credits to promote agricultural trade, provide humanitarian relief and aid in the economic advancement of developing countries
- guarantees of payments due U.S. exporters from their assignees from certain foreign banks on loans made for the purchase of agricultural commodities
- loans or guarantees of loans to provide initial or continued electric and telephone service, promote economic development, and help create jobs in rural areas.

Direct loans obligated and loan guarantees committed after September 30, 1991, must 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 and with the statutory authority and the provisions of OMB Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivable," and the Debt Collection Act of 1996. Additional information pertinent to the policies and standards for loans, credits, and guaranteed loans and credits may also be found in OMB Circular A-11, "Preparation and Submission of Budget Estimates," OMB Circular A-34, "Instructions on Budget Execution," and SSFAS No. 2, Accounting for Direct Loans and Loan Guarantees (and SFFAS No. 18 and 19 (Amendments to SFFAS No. 2)).

The standards contain the following essential requirements:

- Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance;
- For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.
- For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows.
- The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year, taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).
- When direct loans or loan guarantees are modified, the cost of modification is recognized at an 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.
- When property is transferred from borrowers to a Federal credit program, through foreclosure or other means, in partial or full settlement direct loans or as a compensation for losses that the government sustained under 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.

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

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

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

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

For post-1991 direct loans, the effect of using the present value measurement is to estimate the extent of the disbursed amounts that would be recovered, and the extent of the disbursed amounts that is a subsidy cost. The portion that can be recovered is the present value of projected net cash inflows discounted at the Treasury rate of similar maturity. This portion is not considered a cost to the government because it is expected to be returned to the government in future amounts. The remaining portion of the cash disbursement represents a cost to the government, resulting either from lending at a rate lower than the Treasury interest rate, or from default losses, or both.

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

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

**Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees.** 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).

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.

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.

The default cost of direct loans results from projected deviation by the borrowers from the payments schedule 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 cost of foreclosing, managing and selling the assets.

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 above.

The present value of fees and other collections is recognized as a deduction from subsidy costs. Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

**Subsidy Amortization and Reestimation.** Entities are required to reestimate the subsidy cost of a cohort for direct loans, direct credit, guaranteed loans, and credit guarantees at the beginning of each fiscal year following the year in which the initial disbursement was made (unless a different plan is approved by the Office of the Chief Financial Officer (OCFO) and OMB). The purpose of the reestimate is to make adjustments for changes of subsidy costs over the life of the loan. This activity examines the results of operations by risk category and cohort and adjusts direct loan, direct credit, guaranteed loan, and credit guarantee subsidy costs between risk categories within a cohort, and for the cohort as a whole, to account for changes in cohort subsidy costs resulting from interest rate changes and cash flow changes.

There are two kinds of reestimates: (a) interest rate reestimates and (b) technical/default reestimates. Entities should measure and disclose each program reestimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the reestimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

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

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

**Revenues and Expenses.** 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 (exchange revenue). Interest accrued on debt to Treasury is recognized as interest expense.

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.

**Modification of Direct Loans and Loan Guarantees.** The term “modification” means a major USDA or Federal government action, including new legislation or significant administrative action, that materially alters, directly or indirectly, the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

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

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

For valuation and disclosure requirements, refer to SSFAS No. 2.

**Negative Subsidy.** The estimated subsidy cost of direct loans or loan guarantees may be negative. Negative subsidies occur in cases where the present value of cash inflows to USDA exceeds the present value of cash outflows. The relevant appropriation bill must still provide specific authority before the direct loans or loan guarantees can be made. The amount of

Treasury borrowing includes both the loan amount and the negative subsidy amount. The Department has discretionary authority to, and as a matter of policy does, record negative subsidy as an increase in the present value of the loans receivable.

**Pre-1992 Direct Loans And Loan Guarantees.** The present value method shall be used for all pre-1992 direct and guaranteed loans. The PV method first estimates and then discounts expected cash flows. For direct loans, the difference between the face value and the present value of loans receivable is the allowance for credit program receivables. For guaranteed loans, the present value of the expected cash flows is booked as a liability. The allowance is amortized by the interest method. The amortized amount is recognized as interest income and/or interest expense.

**Non-Performing Interest.** Loans are accounted for as receivables after entities have disbursed funds. Loans are carried at their principal amount outstanding and accrue interest based on the contractual interest rate and terms. When a loan becomes non-performing (i.e., loan payments become more than 90 days delinquent or when borrowers enter into restructuring agreements), all interest previously accrued (and not paid) on the loan is removed from the accounts for financial reporting purposes. Interest income on the non-performing loan is then recognized only to the extent of collections received. Non-performing loans are reclassified as performing and again begin accruing interest when loan payments become current or less than 90 days delinquent. In addition, for restructured loans, interest income is generally recognized only to the extent that interest payments are received from borrowers.

### **Loans Not Subject to Credit Reform**

Loans and credits issued by the Department which are not covered by credit reform regulations include:

**Commodity Loans.** The Commodity Credit Corporation (CCC) makes recourse and non-recourse commodity loans to eligible producers on designated agricultural commodities. For non-recourse loans, producers may: (a) repay the principal plus interest; (b) for certain announced commodities, repay principal at the market rate (and no interest); or (c) at maturity, forfeit the commodity in satisfaction of the loan.

Interest is accrued on the unpaid principal balance of domestic commodity loans. Commodity loans are reported net of an allowance for doubtful accounts, which reduces the loans to net realizable value. The allowances are based on the estimated loss on ultimate commodity disposition. Losses on loans are 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. In addition, market loan options and the past history of loan charge-offs are considered and provided for as part of the allowance.

The allowance also takes into account losses anticipated on the disposition of inventory acquired through loan forfeiture. When forfeited commodities are subsequently disposed, any loss on the disposition is realized as either a cost of sales or donation, depending on the type of disposition.

Certain commodity loans may be protected by a No Net Cost Program that requires a commodity cooperative or association member-farmers to pay CCC a No Net Cost Assessment (NNCA) on



each quantity of the commodity put under loan and /or marketed. Purchasers of the commodity may also be required to pay a NNCA on each quantity of the commodity purchased. Additionally, importers of the commodity may have to pay a NNCA on each quantity of the commodity imported. CCC maintains these funds in interest earning deposit and trust liability accounts to apply against future loan losses of the respective commodity cooperative or association. If sales proceeds exceed the debt for a specific crop year, such gains are applied to other crop year debt. If the sales proceeds from the commodity collateral are insufficient to cover the debt, a recovery of the debt is made from the NNCA funds. If NNCA funds are insufficient to cover the loan debt, then the debt is recovered from future NNCA collections. Loan insolvency can only occur if NNCA funds are insufficient, and the commodity cooperative or association dissolves and terminates its relationship with CCC.

**Repayable Cooperative Agreements.** Repayable cooperative agreements represent receivables due from private entities based upon funds lent them for the joint venture. Proceeds are applied according to the terms of the agreement. If the agreement does not specify how the proceeds are to be applied, the proceeds are applied to the risk assessment percentage first, if stated or can be determined based upon the total amount due per the agreement, then principal. These receivables are adjusted by valuation allowances to their net present value based upon the Treasury rate of a similar termed instrument at the prevailing market yields during the fiscal year, excluding the last five days, on outstanding fixed rate Treasury securities. If the present value exceeds the agreement amount and management determines that recognizing the premium revenue would be premature since the entity is just in the development stage, no premium is recognized. Once management determines that the entity will meet the terms of the agreement, the revenue is recognized.

If a risk assessment percentage is stated and the agreement provides for a royalty to be paid based upon future events, the proceeds will be applied to the risk assessment percentage first, then principal. If no risk assessment percentage is stated and the agreement provides for a royalty to be paid based upon future events, the proceeds will be applied to principal first, then to income. Under these circumstances the receivables will be adjusted by valuation allowance to their net realizable value.

An allowance for losses on receivables is recognized when there is more than a 50 percent chance that the receivable will not be totally collected. These allowances are maintained at a level considered adequate by management and are revised periodically based upon management's assessment of repayment status, future risks, and economic conditions.

**Loans to Other Federal Entities.** Loans to other Federal entities are based upon legislation or agreements between agencies. These loans may be interest or non-interest bearing. Proceeds will be applied according to the terms of the agreement. If the agreement does not specify how the proceeds will be applied, the proceeds will be applied to the interest first, if stated or can be determined based upon the total amount due per the agreement, then principal. If the loan is non-interest bearing, the proceeds will be applied to principal. These loans will be adjusted to their net present value based upon the Treasury rate of a similar termed instrument.

No allowance for bad debts will be established since the proceeds are due from another Federal entity.

## **Allowance for Bad Debts**

Entities must calculate the allowance for bad debts on loans not covered under the Credit Reform Act of 1990 (except for loans made to other Federal entities). Entities must recognize losses on receivables when it is more likely than not that the receivables will not be totally collected (more than a 50% chance for a loss). An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realized value. 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 current.

For direct loans, the allowance should be based on appropriate factors, including but not limited to delinquency rates, current economic conditions, and historical trends. For large loans for which an allowance may be calculated individually, entities should consider borrowers' credit histories, borrowers' outstanding balances, and an analysis of each borrower's financial condition in calculating the allowance.

For guaranteed loans, the allowance is based upon future cash flows (i.e., expectations of loan losses and an estimate of interest assistance payments to be made on guaranteed loans) discounted at the average interest rate of U.S. Treasury interest-bearing debt. The estimate is recorded and reported as an expense of the period, and a corresponding accrual for estimated losses on loan guarantees is reported as a liability on the balance sheet.

## **Reporting**

Entities must produce external reports required by OMB and Treasury, including those associated with the Federal Credit Reform Act of 1990 and the Chief Financial Officers Act of 1990. Entities must also conform to IRS reporting requirements for interest received and miscellaneous income. In addition, direct and guaranteed loans, direct credit, and credit guarantees are reported on the USDA consolidated financial statements.

The preparation and submission of timely and reliable reports that fully disclose the results of all programs and activities and the consolidation of the information are the responsibility USDA entity chief financial officers. In all cases where the same data are reported as of the same date, all amounts should be reviewed carefully for consistency.

**OMB Reporting.** OMB Circular A-34 requires the preparation of several specific external reports, which include direct and guaranteed loan information. An example of this is SF-133, "Report on Budget Execution."

**Treasury Reporting.** Entities are required to submit a quarterly report entitled "Report on Receivables Due from the Public" on the status of loans and accounts receivable to the Department of the Treasury. The report comprises three parts: receivables; debt collection management; and footnotes. Entities must submit separate reports for direct loans, defaulted guaranteed loans, and non-credit receivables (i.e., receivables which are not generated from loans or loan guarantees). The report includes the number of receivables, the dollar value of principal; and the dollar amount of accrued interest and late charges.

Entities are also required to submit a quarterly report entitled “Report on Guaranteed Loans” on the status of guaranteed loans. These reports comprise four parts: guaranteed loans; portfolio management; lender management; and footnotes. Entities must submit reports at the reporting entity level. These reports include the number and dollar amount of guaranteed loans outstanding, the number and dollar amount of outstanding claims, and the number of certified lenders and penalties assessed against them.

### ***Advances and Prepayments***

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.

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.

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.

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. 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).

Advances and prepayments made to Federal entities are intragovernmental items and should be accounted for and reported separately from those made to non-Federal entities.

### ***Other Assets***

Reporting entities should disclose in the footnotes the amount and nature of major categories of Other Assets. Advances and prepayments, which were previously reported as separate line items, should be reported in Other Assets.

### ***Liabilities***

#### **Introduction**

This section establishes accounting standards to measure and recognize liabilities in general

purpose financial reports, which are issued for both internal and external users. This chapter also defines the points at which liabilities associated with different types of events and transactions would be recognized. Recognition means recording a dollar amount in the general ledger and reporting that amount on the face of the financial statements. The existence of a past event is a prerequisite for liability recognition.

### **Characteristics of a Liability**

A liability for USDA accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. The existence of a past event (which includes transactions) is essential for liability recognition. General purpose financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from four separate types of transactions or events:

- past exchange transactions
- government-related events
- government-acknowledged events
- nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.

**Events.** An event is a happening of financial importance or significance to an entity. An event may occur internally, such as transforming raw materials into a product or externally involving 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.

**Transactions.** A transaction involves the transfer of something of value and can be either exchange transactions or nonexchange transactions, which are both described in greater detail below. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in Federal accounting.

**Probable.** For an entity to recognize a liability, including a contingent liability, the future outflow or other sacrifice of resources from the entity must be both probable and measurable. “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 threatening litigation and unasserted claims. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances that include the law that provides general authority for Federal entity operations and specific budget authority to fund programs. If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.

**Measurable.** “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).

**Exchange Transactions.** An “exchange transaction” is one in which each party to the transaction sacrifices value and receives value in return. A liability arising from reciprocal or “exchange transactions” 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). 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. 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.

**Nonexchange Transactions.** A liability arising from nonreciprocal transfers or “nonexchange” transactions should be recognized for any unpaid amounts due as of the reporting date. A “nonexchange transaction” is one in which one party to the 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 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. 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, or government entities providing the service directly, on the behalf of the disaster relief beneficiaries.

Many grant and certain entitlement programs are nonexchange transactions (such as the Food Stamp Program, which provides food stamps exchangeable for certain food items to eligible recipients). 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.

Some deposit and trust fund liabilities are classified as nonexchange liabilities because the entity does not receive value in exchange for the funds. In these cases, a liability is recognized for any unpaid amounts as of the reporting date. “Unpaid amounts” includes amounts being held in suspense accounts pending identification of the proper account for or owner of the funds.

**Estimation of Amounts.** Unreported amounts must be estimated, accrued, and reported on the financial statements and other general purpose financial reports. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in Federal accounting.

**Government-related Events.** Government-related events are nontransaction-based events that involve interaction between USDA entities and their environment. The event may be beyond the control of the entity. If the future outflow or other sacrifice of resources is probable and measurable or as soon thereafter as it becomes probable and measurable, a liability is recognized for a future outflow or other sacrifice of resources when the event occurs.

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 clean-ups caused by USDA operations or accidents and catastrophes caused by natural forces that affect USDA-owned property. 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.

**Government-Acknowledged Events.** Government-acknowledged events are nontransaction-events that are of financial consequence to the Federal government because it chooses to respond to the event, for which it has no prior legal obligation. A liability is recognized for a future outflow of resources that results from a government-acknowledged event when and to the extent that the Federal government formally acknowledges financial responsibility for the cost of the event and a nonexchange or exchange transaction has occurred. Examples of government-acknowledged events include toxic waste damage caused by nonFederal entities and damage from natural disasters.

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.

**Contingencies.** A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized, disclosed, or not reported, depending on the circumstances.

When a loss contingency (e.g., collectibility of receivables, pending or threatened litigation, and possible claims and assessments) exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can range from probable to remote. The probability classifications are as follows:

- Probable: The future confirming event or events are more likely than not to occur.
- Reasonably possible: The chance of the future confirming event or events occurring is more than remote but less than probable.
- Remote: The chance of the future event or events occurring is slight.

A contingent liability should be recognized when all of the following conditions are met:

- A past event or exchange transaction has occurred (e.g., a Federal entity has breached a contract with a nonFederal entity).
- A future outflow or other sacrifice of resources is probable (e.g., the nonFederal entity has filed a legal claim against a Federal entity for breach of contract and the Federal entity's management believes the claim is more likely than not to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (e.g., the Federal entity's management determines an estimated settlement amount).

**Note:** *SSFAS No. 12, Recognition of Contingent Liabilities Arising from Litigation amends SSFAS No. 5, Accounting for Liabilities of the Federal Government to provide an exception to the definition of "probable" with regard to a contingent liability for recognizing loss contingencies on matters of pending or threatened litigation and unasserted claims.*

To conform with FASB Financial Accounting Standard No. 5, Accounting for Contingencies, this standard redefines probably to "likely to occur." Therefore, a contingent liability is recognized when a future outflow or other sacrifice of resources is "likely to occur." This standard also requires disclosure for loss contingencies resulting from pending or threatened litigation and unasserted claims if it is at least reasonably possible that an additional loss may have been incurred.

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. 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.

A contingency 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 incurred. "Disclosure" in this context refers to reporting information in the footnotes regarded as an integral part of the basic financial statements. 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.

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.

Note that contingencies are different from “subsequent events.” 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.

In addition, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability. Note therefore that in the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the Federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due.

**Availability of 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. Liabilities not covered by budgetary resources must be recorded and presented on agency financial statements and other reports as appropriate; however, budgetary entries for such liabilities may not be made until budgetary resources are available.

**Other Current Liabilities.** 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.

Typical examples of “other current liabilities” to be recognized are:

- accrued employees' wages, bonuses, and salaries for services rendered in the current fiscal year for which paychecks will be issued in the following year.
- accrued entitlement benefits payable, such as Old Age Survivors Insurance and Veterans Compensation and Pension benefits applicable to the current period but not yet paid.
- 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.

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 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.

### *Authoritative Sources*

**The policies and guidelines issued in this chapter are issued pursuant to the following guidelines:**

*SFFAS 1, Accounting for Selected Assets and Liabilities*

<http://www.fasab.gov/pdf/sffas-1.pdf>

The provisions of SFFAS 1 and related amendments are described above in the Assets section.

*SFFAS 2, Accounting for Direct Loans and Loan Guarantees and related amendments (SFFAS 18 and 19)*

<http://www.fasab.gov/pdf/sffas-2.pdf>

<http://www.fasab.gov/pdf/sffas-18.pdf>

<http://www.fasab.gov/pdf/sffas-19.pdf>

The provisions of SFFAS 2 and related amendments are described above in the Assets section.

*SFFAS 5, Accounting for Liabilities of the Federal Government*

<http://www.fasab.gov/pdf/sffas-5.pdf>

This Statement serves to establish accounting standards to recognize and measure liabilities in general purpose Federal financial reports, which are issued for both internal and external users. Appendixes provide background, rationale, and examples of how to apply this standard to liabilities associated with Federal programs' transactions and events.

This Statement articulates a general principle that should guide preparers of general purpose Federal financial reports. It also provides more detailed guidance regarding liabilities resulting from deferred compensation, insurance and guarantees (except social insurance), certain entitlements, and certain other transactions. The Statement addresses liabilities not covered in Statement of Federal Financial Accounting Standards (SFFAS) Number 1, “Accounting for Selected Assets and Liabilities,” and in Statement of Federal Financial Accounting Standards Number 2, “Accounting for Direct Loans and Loan Guarantees.”

*SFFAS 12, Recognition of Contingent Liabilities Arising from Litigation*

<http://www.fasab.gov/pdf/sffas-12.pdf>

This standard amends SFFAS No. 5, Accounting for Liabilities of the Federal Government. It provides an exception to the definition of “probable” with regard to a contingent liability for

recognizing loss contingencies on matters of pending or threatened litigation and unasserted claims.

To conform with FASB Financial Accounting Standard No. 5, Accounting for Contingencies, this standard redefines probably to “likely to occur.” Therefore, a contingent liability is recognized when a future outflow or other sacrifice of resources is “likely to occur.” This standard also requires disclosure for loss contingencies resulting from pending or threatened litigation and unasserted claims if it is at least reasonably possible that an additional loss may have been incurred.

*Federal Credit Reform Act of 1990*

<http://www.fms.treas.gov/ussgl/creditreform/fcratoc.html>

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

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

- Require that, for each fiscal year in which the direct loans or the loan guarantees are to be obligated, committed, or disbursed, the USDA budget reflects the long-term cost to the government of the subsidies associated with the direct loans and loan guarantees. The subsidy cost estimate for the USDA budget is to be based on the present value of specified cash flows discounted at the average rate of marketable Treasury securities of similar maturity.
- Require that, before direct loans are obligated or loan guarantees are committed, annual appropriations generally be enacted to cover these costs. (However, mandatory programs have permanent indefinite appropriations.)
- Provide for borrowing authority from Treasury to cover the non-subsidy portion of direct loans.

Establish budgetary and financing control for each credit program through the use of three types of accounts: the program account (budgetary), the financing account (non-budgetary), and the liquidating account (budgetary).

*OMB Circular No. A-129, Policies for Federal Credit Programs and Non-Tax Receivable*

<http://www.whitehouse.gov/omb/circulars/a129/a129rev.html>

This Circular prescribes policies and procedures for justifying, designing, and managing Federal credit programs and for collecting non-tax receivables. It sets principles for designing credit programs, including: the preparation and review of legislation and regulations; budgeting for the

costs of credit programs and minimizing unintended costs to the Government; and improving the efficiency and effectiveness of Federal credit programs. It also sets standards for extending credit, managing lenders participating in Government guaranteed loan programs, servicing credit and non-tax receivables, and collecting delinquent debt.

*Debt Collection Act of 1982*

<http://www.fms.treas.gov/debt/dcia.html>

The purpose of this legislation was to increase the efficiency of the Government's efforts to collect debts owed the United States and to provide additional procedures for the collecting and reporting of debts owed the United States. The additional procedures include the use of credit reporting agencies, interest charges on outstanding debts, salary offset, administrative offset, and screening of potential debtors.

The reports must contain information regarding:

- Total amount of loans and accounts receivable owed to the agency (department) and when the funds owed to the agency are due to be repaid;
- Total amount of receivables and number of claims that are at least 30 days past due;
- Total amount written off as uncollectible, actual, and allowed for;
- Rate of interest charged for overdue debts and the amount of interest charged and collected on debts;
- Total number of claims and total amount collected;
- Number of claims and the total amount of claims referred to the Department of Justice for settlement and the number of claims and the total amount of claims settled by such Department; and
- Other information that the Director of OMB determines is necessary to assess agencies' efforts to collect claims.

### ***Accounts Payable***

Accounts payable are amounts owed by a Federal entity such as for goods and services received from, rents due to, and progress payments on contract performance provided by other entities. Amounts owed for goods or services received from Federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public.

When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize an exchange liability for the unpaid amount of the goods. If invoices for those goods are not available, the amounts owed should be estimated and reported on all applicable general purpose financial reports.

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 government specifications, formal acceptance of the products by the government is not the determining factor for accounting recognition.

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.

Accounts payable are not intended to include liabilities related to on-going continuous expenses such as employee's salaries and benefits, which are covered by other current liabilities.

### **Interest Payable**

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 payments by the Federal entity and on refunds. Interest payable of an entity on borrowed funds and unpaid bills should be recognized at the end of each period. Interest payable to Federal entities is an intragovernmental liability and should be accounted for separately from interest payable to the public.

### ***Accruals for Personnel Related Liabilities***

#### **Accrued Payroll and Benefits**

Accrued payroll and benefits include the total funded but unpaid personnel compensation and benefits that have been earned by employees as of the close of the period. Personnel compensation includes accrued employees' wages, bonuses, and salaries for services rendered in the current fiscal year, for which payment will be issued in the following fiscal year. Employee benefits include pensions and post-employment and retirement benefits other than pensions. The cost of payroll and benefits must be distributed to organizational cost centers, programs, activities, functions, and projects in the period they are incurred.

#### **FECA Liabilities**

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees for injuries on the job, work-related occupational disease, and to beneficiaries of covered employees. FECA liabilities consist of:

- FECA Actuarial Liability that includes the expected liability for death, disability, medical and other approved costs.

- **Accrued Unfunded FECA Liability**, which is the difference between the FECA benefits paid by the FECA Special Benefits Fund and the agency's actual cash payment to the Fund.

### **Accrued Unfunded Annual, Compensatory and Sick Leave**

Unfunded annual leave accrued to employees is the amount of annual leave earned but not used at the end of the fiscal year. It is expected to be paid from future years' appropriations. Annual leave (including home leave) is an expense, which accrues as it is earned by employees. Except for work under a revolving fund, no obligation is incurred for annual leave until it is used. The expense for unfunded annual leave must be recorded as an unfunded liability, and serves to bridge obligations to the total cost of personnel compensation.

Initially, a liability accruing annual leave will be recorded at the wage rate at which it is earned and adjusted each year to reflect pay increases, unused leave balances, and statutory limitations to leave amounts, and to provide for employees transferred in or out during the year. Any resulting increase should be charged to current year expenses. Unused sick leave, compensatory, or credit time may be tracked for budget or management purposes, but will not be recorded as a liability. However, sick leave must be accrued for any contractor employees if a contractual requirement exists for employees to be paid for unused sick leave.

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***Pensions, Other Retirement Benefits, and Other Post-Employment Benefits***

Federal civilian employee benefits include pensions and post-employment and retirement benefits other than pensions. Pension plans 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 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. 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.

In addition to or in lieu of pension benefits, a liability for post-employment and other retirement benefits may be incurred outside the pension plan. Post-employment benefits other than pensions (OPEB) include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. Special termination benefits (such as specially authorized separation incentive programs) are considered other post-employment benefits and should be recognized as such. Inactive employees are those who are not currently rendering services to their employers and who have not been terminated, but who are not eligible for an immediate annuity, including those temporarily laid off or disabled. OPEB include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity.

The terms "employer entity" and "administrative entity" are used 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.

Other retirement benefits (ORB), not including pensions 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. 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. With regard to pensions and ORB, if estimates, averages, or such devices can reduce the cost of applying this Statement, their use is appropriate provided the results do not materially differ from a detailed application of the standard.

Pension benefits include all retirement, disability, and survivor benefits financed through a pension plan, including unfunded pension plans. USDA employees are covered primarily under two defined benefit retirement plans: the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). The payments to social insurance plans (such as Social Security) 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. This chapter establishes standards of accounting for pension expense and related pension liability for USDA employer entities.

The employer entity should recognize an expense for Service Cost pensions, ORB, and OPEB in its financial report that equals the service cost for its employees for the accounting period, less the amount contributed by the employees, if any. "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." 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.

The employer entity's expenses for pensions, ORB, and OPEB should be balanced by: (a) a decrease to its "fund balance with Treasury" for the amount of its contribution to the post-employment benefits, 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. The employer entity's contribution represents intragovernmental revenue, which should be eliminated for government-wide consolidated financial statements.

## ***Debt***

Federal debt transactions are recognized as a liability when there is an exchange between the involved parties. There are two types of Federal debt securities: fixed-value and variable-value. Examples of Federal debt transactions include borrowings from the Treasury Department and the issuance of commodity certificates, both under the authority of the Commodity Credit Corporation. Rural Development and Forest Service also borrow from Treasury.

**Fixed-value Securities.** 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 (if applicable). 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.** Variable-value securities (i.e., securities that have unknown Variable-value Securities redemption or maturity values at the time of issue) should be originally valued and periodically revalued at their current value on the basis of the regulations or offering language.

**Related Interest Cost.** The related interest cost of the Federal debt includes the Related Interest Cost accrued (prorated) share of the nominal interest incurred during the accounting period (if any), the amortization amounts of discount or premium for each accounting period (this applies to fixed-value securities only), and the amount of change in the current value for the accounting period for Variable-value Securities.

## ***Unearned Revenue and Other Liabilities***

**Unearned Revenue**

Unearned revenue consists of advances received from other Federal agencies or the public prior to the requirement to provide goods or services. Advances from sources outside the organization unit must be recorded and liquidated under terms of the agreements as services are performed.

**Funds Held for Others**

A liability shall be established whenever USDA has physical possession or responsibility for non-Government personal property or cash. This includes certain funds that belong to others, such as payroll deductions and deposit funds. Funds held for others also include amounts held in suspense accounts awaiting disposition or reclassification. The individual details for each of these accounts reside in the asset accounts. The balances in these accounts must be supported by schedules of voucher deductions, collections, and transfers between accounts.

**Deposit Funds and Suspense Accounts**

Deposit funds are accounts outside the budget that a Government entity is holding temporarily in trust for others or until ownership is determined. They include:

- Money withheld by the Government from payments for goods and services. This type of transaction may be treated as a deposit fund liability if a budget account has been charged and funds are being held pending payments, e.g., payroll deductions for savings bonds and state income tax withholdings.
- Deposits received from outside sources and temporarily held in custody by the Government.
- Money held by the Government awaiting distribution pending a legal determination or investigation.
- Unidentified remittances are to be credited as suspense items outside the budget.

Treasury's Financial Management Service has grouped these suspense items into a special class called Budget Clearing Accounts.

There are three types of Budget Clearing Accounts:

- Suspense - for unidentified remittances presumed to be applicable to budget accounts in general, but held in suspense because of inadequate information, uniqueness of the transaction, or similar complications. Such items are to be credited to the suspense account to avoid undue delays of monthly closing. All suspense items should be credited accordingly to the proper account as soon as it is determined.



- Deposits - reserved for adjustments by Financial Management Service for discrepancies relating to deposit tickets and/or debit vouchers.
- Disbursements - for temporary disbursement differences between the Statement of Transaction disbursements and Regional Financial Center/On-line Payments and Collections (OPAC) payments.

Each agency should review its deposit fund practices periodically, or at least on a quarterly basis, and take whatever corrective action to minimize balances held in the Budget Clearing Accounts. Sizable balances in these accounts are indications of weakness in internal control. For more details on deposit funds, refer to Treasury's TFM Vol 1, Part 2, Chapter 1500 (T/L-555).

### **Accrued Environmental and Non-environmental Disposal Cost Liabilities**

This section prescribes the accounting policy and principles for measuring (estimating) and recognizing (recording in the accounting system and reporting in the financial statements) liabilities associated with the disposition of property, structures, and equipment. The timing of disposal liability measurement will vary depending on whether the disposal effort involves the removal and disposal of hazardous waste (environmental disposal). The accounting entry used to record an environmental disposal liability is dependent on whether the liability existed at September 30, 1997, and on when the liability is first recorded. The recording and reporting of disposal cost estimates in financial statements is subject to materiality. Liability recognition shall not be based on the availability of funds.

This discussion does not apply to costs that are incurred to bring land to a form suitable for intended use; nor does it apply to the disposal costs associated with excess, obsolete, or unserviceable inventories. Disposal cost measurements (estimates) may be prepared at the installation or other organizational level. Cost estimates prepared for this purpose shall consider, on a current cost basis, the anticipated costs of the level of effort required to dispose of the item, as well as the costs of complying with associated applicable legal and/or regulatory requirements. Such cost estimates should be based on the current disposal or reuse technologies available. Cost estimates shall be revised when there is evidence that significant changes in the cost estimates have occurred, (e.g., changes in scope, ownership, regulation, or technology). As a minimum, long-term cost estimates shall be adjusted (upward or downward) annually, through indexing, to maintain them on a current cost basis (i.e., as if acquired in the current period).

Estimates for disposal costs may be specific amounts or a range of amounts. If some amount within a range is considered a better estimate than any other estimate, that amount should be used. If no amount within a range is considered a better estimate than other estimates, then the minimum amount in the range should be used. Estimates for disposal costs should be offset by estimated cash proceeds only when the proceeds (resale, recycle, salvage, etc.) are permitted to be retained and used by the organization that will fund the disposal costs.

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## Accrued Environmental Restoration Cleanup Liabilities

This section prescribes the accounting policy and principles for measuring (estimating) and recognizing (recording in the accounting system and reporting in the financial statements) liabilities associated with removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. Hazardous waste is a solid, liquid, or gaseous waste, which because of its quantity, combination, 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. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and postclosure costs.

This discussion does not apply to the costs of environmental compliance, pollution prevention, conservation activities, contaminations or spills, or treaty obligations, all of which are accounted for as part of ongoing operations. Accrued environmental restoration (cleanup) costs relate to General Property, Plant, and Equipment (PP&E), including acquired land, and Stewardship Land.

Cleanup costs shall be estimated when the associated PP&E is placed in service. 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. Cost estimates shall be revised when there is evidence that significant changes in the cost estimates have occurred (e.g., changes in scope, ownership, regulation, or technology), or as appropriate when preparing annual reports to Congress. At a minimum, long-term cost estimates shall be adjusted (upward or downward) annually, through indexing, to maintain them on a current cost basis (i.e., as if acquired in the current period).

Cost estimates for some aspects of cleanup activity (e.g., studies, investigations, remedial actions, or monitoring) may be specific amounts or a range of amounts. If some amount within a range is considered a better estimate than any other estimate, that amount should be used. If no amount within a range is considered a better estimate than other estimates, then the minimum amount in the range should be used. Restoration cost estimates should include the following cost elements, as appropriate:

- Studies, plans and designs, restoration activities, remedial actions, and operations (to include operating and maintenance costs of remedial systems), and the costs of contractors, engineers, and consultants.
- Facilities, machinery, and equipment dedicated to a restoration effort that do not have alternative uses, and their associated operating and maintenance costs.
- Compensation and benefits of government personnel that devote significant time directly to an environmental restoration effort, to include security and surveillance.

SFFAS No. 6 applies 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). However, due to the nature of the liability and the timing associated with cleanup costs, additional guidance is provided 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.

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. The liability shall be adjusted when the estimated total cleanup costs are reestimated. Adjustments to the liability shall be recognized in expense as “changes in estimated cleanup costs from prior periods.” As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs.

Two implementation approaches have been provided for liabilities related to general PP&E:

- 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.
- If costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total cleanup cost as a liability upon implementation. In addition, in periods following the implementation period, any changes in the estimated total cleanup cost shall be expensed when reestimates occur and the liability balance adjusted.

### ***Crop Insurance Programs***

The USDA crop insurance 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)]. In addition, the crop insurance programs subsidize the provision of insurance to achieve social objectives, such as a stable food supply. Program participants pay fees and/or premiums for specific services. These funds are held in revolving funds; losses sustained by participants are paid from these funds (sometimes supplemented with appropriated or borrowed funds as needed to pay excess claims or defaulted loans.

The USDA crop insurance programs represent the type of insurance or guarantee contract in which the insurer (USDA) cannot cancel the insurance, or the insured is guaranteed the ability to renew the insurance. The insurer (USDA) 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.

The crop insurance programs should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. In addition, 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 and a future outflow or other sacrifice of resources is both probable and measurable.

The crop insurance 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. The change in a contingent liability during the reporting period should also be recognized as a component of expense.

All Federal insurance and guarantee programs (except loan guarantees discussed in the previous section) should also report as required supplementary stewardship information the expected losses that are based on risk inherent in the insurance and guarantee coverage in force. 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.

### ***Net Position***

The nature of proprietary accounting for a Federal agency closely resembles that of a private sector firm, as assets equal liabilities plus capital. However, “capital” in Federal accounting is called “Equity of the U.S. Government.” Therefore:

ASSETS = LIABILITIES + EQUITY OF THE U.S. GOVERNMENT

The following section establishes accounting standards for measuring and reporting equity of the U.S. government. Equity includes cumulative results, capital stock, invested capital, and related accounts which represent ownership of the government by its own agencies or by third parties.

On the “Statement of Changes in Net Position,” several equity accounts appear under the heading of “Financing Sources,” viz., “Appropriations Used,” “Donations,” “Transfers In” and “Transfers Out” (from the “Additional Paid-in Capital” account); and “Net Change in Cumulative Results of Operations.”

Individual USDA entities will report material amounts of the following equity accounts as separate line items on their individual entity balance sheets, and USDA will report material amounts of capital account balances on the USDA consolidated Balance Sheet. SGL accounts exist only for two of the following equity accounts, “Unexpended Appropriations” (SGL Account 3100) and “Cumulative Results of Operations” (SGL account 3310). For the other equity accounts, some of which may be unique to USDA, internal-use-only accounts have been created. While these internal accounts would be presented on both individual entity and departmental consolidated financial statements, the internal accounts would roll up to SGL account 3310, “Cumulative Results of Operations,” for purposes of reporting to Treasury for the Government-wide consolidated financial statements through the annual Federal Agencies Centralized Trial-balance System (FACTS) submissions.

**Unexpended Appropriations**

“Unexpended Appropriations” (SGL Account 3100) represents equity from an appropriation authorized but for which goods and services to be funded by the appropriation have not been ordered or received. This account is presented on the Balance Sheet in the “Net Position” section.

**Cumulative Results of Operations**

“Cumulative Results of Operations” (SGL account 3310) is roughly equivalent to the “Retained Earnings” account for a commercial corporation. This account summarizes:

- Financing sources, revenues, and gains, including appropriations used to fund agency operations for which goods and services have been received; earnings from provisions of goods and services to other agencies, on an accrual basis; and gains from the disposal of assets. The SGL provides financing source, revenue, and gains accounts in the 5000 and 7100 series. The financing source account for expenses funded by appropriations is “Appropriated Capital Used,” account 5700. Because increases in financing source, revenue, and gain accounts increase Equity of the U.S. Government, the accounts all normally have credit balances.
- Expenses and Losses, which represent consumption of goods and services on an accrual basis, and losses from the disposal of assets. The SGL provides for these accounts in its 6000 and 7000 series. The SGL expense account pertinent to a basic operating appropriation is 6100, “Operating/Program Expense.” Because expenses and losses decrease Equity of the U.S. Government, the accounts all normally have debit balances.

## **CHAPTER 5 – USDA SPECIFIC POLICY AND PROCEDURES**

This section is reserved for the reader/user to file specific Office of the Chief Financial Officer (OCFO) policies and guidelines that are issued as memorandums, guides, and bulletins. Many of these documents may also be found on the USDA OCFO website at [www.usda.gov/ocfo/acctpol](http://www.usda.gov/ocfo/acctpol) and at [www.nfc.usda.gov/pubs/na-pubsmain.html](http://www.nfc.usda.gov/pubs/na-pubsmain.html).

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