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# Statement of Federal Financial Accounting Standards 7: Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

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## Status

<b>Issued</b>	May 10, 1996
<b>Effective Date</b>	For periods beginning after September 30, 1997.
<b>Interpretations and Technical Releases</b>	<ul style="list-style-type: none"><li>• Interpretation 1, <i>Reporting on Indian Trust Funds in General Purpose Financial Reports of the Department of the Interior and in the Consolidated Financial Statements of the United States Government: An Interpretation of SFFAS 7 (rescinded)</i></li><li>• Interpretation 5, <i>Recognition by Recipient Entities of Receivable Nonexchange Revenue: An Interpretation of SFFAS 7</i></li></ul>
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<b>Affected by</b>	<ul style="list-style-type: none"><li>• SFFAS 13 defers the effective date of paragraph 65.2 of SFFAS 7.</li><li>• SFFAS 20 rescinds paragraph 65.2 and amended paragraphs 107 and 187.1.</li><li>• SFFAS 21 rescinds paragraph 76.</li><li>• SFFAS 22 (<i>rescinded</i>) affects paragraphs 80 and 97.</li><li>• SFFAS 27 affects paragraphs 83 through 87.</li><li>• SFFAS 31 rescinds paragraphs 83-87 and paragraph 370, and amends paragraphs 142 and 276.</li><li>• SFFAS 32 amends paragraphs 43, 46, 65.1, and 65.3.</li><li>• SFFAS 33 amends paragraphs 67.1 and 67.2.</li><li>• SFFAS 53 amends paragraphs 80-82, 91-93, and 95-102.</li><li>• TB 2002-2.</li><li>• TB 2017-1.</li><li>• TB 2020-1.</li></ul>

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## Summary

This Statement contains two separate parts. The first, on revenue and other financing sources, is composed of the introduction, accounting standards, and appendices. The second part of this document amends Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, by adding a new concept to satisfy users' needs for information that reconciles budgetary and financial accounting. Statements of Federal Financial Accounting Concepts articulate the framework within which the Board considers and recommends accounting standards.

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## Classification, Recognition, and Measurement of Revenue and Other Financing Sources

Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. The term "revenue" does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, so this Statement includes accounting standards for them.

These accounting standards recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price likely to be received. Thus, with some differences that are explained in the standard, the accounting for earned revenue is comparable to the private sector's accrual accounting for earned revenue. Exchange revenue includes most user charges other than taxes.

Nonexchange revenues include income taxes, excise taxes, employment taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., reasonably estimable).<sup>1</sup>

In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power to demand payment becomes a legally enforceable claim

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<sup>1</sup>As explained in para. 44 of SFFAS Number 1, Accounting for Selected Assets and Liabilities, "more likely than not" means more than a 50 percent chance. "Not probable" means the converse, i.e., 50 percent or less.

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to cash or other assets. For this reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. This basis of accounting amends the standard for the recognition of accounts receivable for taxes and duties.

Budgetary resources are recognized from two perspectives: the proprietary accounting perspective and the budgetary perspective. From the proprietary perspective, appropriations are accounted for as a financing source when used. Appropriations are used when an entity acquires goods and services or provides benefits and grants that are authorized to be paid by an appropriation. The remaining amount of appropriations enacted into law, but not yet recognized as “appropriations used,” is treated as capital, i.e., “unexpended appropriations.” This treatment parallels the recognition of expended appropriations during budgetary execution.

To the extent that other standards require that costs not on the entity’s books be imputed to the entity, the standards for other financing sources require recognition of the corresponding imputed financing.

Financial statements have not previously presented budget execution information needed by users of those reports. The standards presented in this document require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. The standards also require a reconciliation of proprietary and budgetary information in a way that helps users relate the two.

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## Disclosures, Supplementary Information, and Other Information

The different types of revenue, and the complexity of accounting for revenue and other financing sources, increase the importance of certain disclosures and other information. Briefly, the standards provide for:

- Extensive disclosures and other information about taxes and duties;
- Certain disclosures about exchange transactions where the full cost of goods and services sold is not recovered;
- Limited disclosure concerning accountability for dedicated collections;
- Disclosures and supplementary information from trust funds and the entities that make the collections for these trust funds where trust funds may be over- or under-funded in terms of applicable law; and
- Disclosures about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

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## Concepts for Reconciling Budgetary and Financial Accounting

This statement amends Statement of Federal Financial Accounting Concepts 2, *Entity and Display*, by adding a category of financial information to further satisfy users' needs and the objectives of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how information on the use of budgetary resources relates to information on the cost of program operations . . ." (sub-objective 1C). The objective of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

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## Executive Summary

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### Scope

1. This Statement presents standards to account for inflows of resources from revenue and other financing sources. It provides standards for classifying, recognizing, and measuring resource inflows. These financial (proprietary) accounting standards differ from those used for budgetary accounting only to the extent essential to meet the Objectives of Federal Financial Reporting.

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### Classification, Recognition, And Measurement

2. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for “exchange revenue” is “earned revenue.” Nonexchange revenues arise primarily from exercise of the Government’s power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. The term “revenue” does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, so this Statement includes accounting standards for them.
3. These accounting standards recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price likely to be received. Thus, with some differences that are explained in the standard, the accounting for earned revenue is comparable to the private sector’s accrual accounting for earned revenue. Exchange revenue includes most user charges other than taxes. Such user charges include regulatory user charges, in which the exchange is not wholly voluntary but the revenue is generally, but not always, related to the cost of providing service to identifiable groups. One example is the revenue derived from the Securities and Exchange Commission’s registration fees. Exchange transactions also include those intragovernmental transactions where the price serves as a full or partial reimbursement for the costs incurred.
4. Distinguishing exchange revenue from nonexchange revenue and other financing sources enables the entity to report the net cost of operations of its programs (and the cost of the entity to the taxpayer) and provides the accounting foundation to report unit cost of output measures for performance evaluations. Requiring that exchange revenue be matched with



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the cost of outputs of goods and services sold to the public enables the entity to report the cost to the taxpayer of not charging the full cost of those goods and services.

5. Nonexchange revenues include income taxes, excise taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., reasonably estimable).<sup>1</sup>
6. In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power to demand payment becomes a legally enforceable claim to cash or other assets. For this reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. This basis of accounting amends the standard for the recognition of accounts receivable for taxes and duties. Cash basis tax revenue will continue to be accounted for as well, because of the fiscal importance of the information. The accrual accounting required will provide more accurate and complete information about receivables and refunds legally receivable and payable and about the components of the Government's revenue stream. The Board may review the standard for the accrual of taxes and duties after several years. The Board has provided that in the interim the IRS and Customs may on their own initiative modify this standard so that it reflects a fuller application of the accrual concept.
7. Budgetary resources are recognized from two perspectives: the proprietary accounting perspective and the budgetary perspective. From the proprietary perspective, appropriations are accounted for as a financing source when used. Appropriations are used when an entity has acquired goods and services or has provided benefits and grants that are authorized to be paid by an appropriation. The remaining amount of appropriations enacted into law, but not yet recognized as "appropriations used," is treated as capital, i.e., "unexpended appropriations." This treatment parallels the recognition of expended appropriations during budgetary execution.
8. To the extent that other standards require that costs not on the entity's books be imputed to the entity, the standards for other financing sources require recognition of the corresponding imputed financing.
9. Financial statements have not previously presented budget execution information needed by users of those reports. Furthermore, concerns have been expressed about whether the

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<sup>1</sup>As explained in para. 44 of SFFAS Number 1, *Accounting for Selected Assets and Liabilities*, "more likely than not" means more than a 50 percent chance. "Not probable" means the converse, i.e., less than a 50 percent chance.

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budget is being properly executed in all cases. The standards presented in this document require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. The standards also require a reconciliation of proprietary and budgetary information in a way that helps users relate the two.

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## Disclosures, Supplementary Information, And Other Information

10. The different types of revenue, and the complexity of accounting for revenue and other financing sources, increases the importance of certain disclosures and other information.
11. Extensive disclosures and other information about taxes and duties compensate to some extent for the limited accruals under the modified cash basis of accounting. Such disclosures and other information also provide a better basis for estimating future cash flows, overseeing the custodial responsibilities given to the tax collecting entities, and understanding how the tax burden is shared.
12. Certain disclosures are required about exchange transactions where the full cost of goods and services sold is not recovered.
13. Limited disclosure concerning accountability for dedicated collections is required of reporting entities responsible for administering such funds. Supplementary information is required from those entities and the entities that make the collections in cases where trust funds may be over- or under-funded in terms of applicable law.
14. Disclosures are required about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

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## Concepts For Reconciling Budgetary And Financial Accounting

15. This statement amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a category of financial information to further satisfy users' needs and the objectives of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how information on the use of budgetary resources relates to information on the cost of program operations ..." (sub-objective 1C). The objective of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

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## Part I: Accounting For Revenue And Other Financing Sources

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### Introduction

#### Background

16. The essential differences among exchange revenues, nonexchange revenues, and other financing sources affect the way they are recognized and measured under the accrual method of accounting. Properly classifying these inflows according to their nature, therefore, provides the basis for applying different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting objectives,<sup>2</sup> as they have been described in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.
17. To help meet those objectives, classifications were developed to determine what specific kinds of revenue should be deducted from the cost of providing goods and services by the reporting entities. Only revenue classified as exchange revenue should be matched with costs. Nonexchange revenue and other financing sources are not matched with costs because they are not earned in the operations process. Because they are inflows that finance operations, nonexchange revenues and other financing sources should be classified in accordance with other rules and should be recognized only in determining the overall financial results of operations for the period. This differs from the focus used in the private sector, where the focus is on net income for business organizations, and on changes in net assets for not-for-profit organizations. It is also a different focus from that used previously in reporting on U.S. Government operations. Under the old federal accounting standards, the focus was on matching all of an entity's financing with incurred expenses to report "net results of operations" which generally was not useful in evaluating performance. The new focus is on costs —both gross and net—which are useful in evaluating performance on many levels.
18. The concept of matching costs and revenue has little relevance in government except where there is an exchange transaction. An exchange transaction occurs when one party sacrifices value and receives a valuable good or service in return. The operations of an entity engaged in exchange transactions produce the revenue earned as well as the associated cost incurred. Therefore, financial accounting should relate the revenue to the

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<sup>2</sup>Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*.

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cost for these transactions. The net effect—the gross cost minus the revenue, or the net cost—generally determines the extent to which taxpayers bear the cost of the operations.<sup>3</sup>

19. Information about the net cost of exchange transactions serves other purposes as well. Net cost gives one indication of the extent to which people are willing to make voluntary payments to acquire goods or services of the kinds that are sold. It thus can give an indication of the extent to which people judge the products to have value. Net cost also can be used in evaluating an entity's pricing policy.
20. Most importantly of all, both net cost and gross cost can be compared with outputs and outcomes in assessing the effectiveness and efficiency with which resources are used to achieve results. Such comparisons can be used by agency management, the President, and the Congress in making decisions about allocating resources. These standards, together with those in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, provide information essential to effective implementation of the Government Management Reform Act, which requires agencies to report performance measures such as unit cost. These standards, when applied in the context of applicable entity and display concepts, will make federal financial reporting more meaningful to those concerned with performance measurement.
21. Nonexchange revenue transactions do not require a Government entity to give value directly in exchange for the inflow of resources. The Government does not “earn” the nonexchange revenue. The cost that nonexchange revenue finances falls on those who pay the taxes and make the other nonexchange payments to the Government. The different character of nonexchange revenues requires that they be distinguished from exchange revenues. They should, therefore, be shown in a way that does not obscure the entity's net cost of operations.
22. Although Board Members have differing views on whether social insurance programs result in exchange or nonexchange transactions, they agree that social insurance tax revenues should be shown in the same way as other tax revenues for the purposes of financial reporting.<sup>4</sup> Social insurance taxes, like other taxes, are determined by the Government's power to compel payment. Individuals and businesses that pay social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business. Especially for the major, broad-based social insurance programs—

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<sup>3</sup>The only major exception is for intragovernmental sales of goods and services. The extent to which taxpayers bear the costs of these goods and services depends on whether the goods and services are sold to entities that in turn sell goods and services to the public, or to entities that are financed by taxes. The net cost of operations may also be financed by other nonexchange revenue such as fines, forfeitures, and donations.

<sup>4</sup>See discussion of social insurance programs in FASAB's Exposure Draft, Supplementary Stewardship Reporting.

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Social Security, Medicare (hospital insurance), and unemployment compensation—the individuals and businesses have virtually no option except to pay.

23. The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.
24. Budgetary resources have a different character than both exchange revenue and nonexchange revenue. Budgetary inflows should be shown in a way that reflects two different perspectives: the proprietary effect and the budgetary effect. Proprietary accounting treats these resources much as capital and lines of credit are treated in private sector accounting, and provides information about their availability in the Balance Sheet or in notes. Appropriations are recognized as capital when enacted into law, while borrowing authority is disclosed in notes. Because Government entities are expected to expend capital from appropriations rather than maintain it, the accounting for the use of appropriations differs in this respect from the private sector's accounting for capital. The accounting for "appropriations used" has been simplified and parallels their budgetary effect.
25. The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.
26. Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations. U.S. Government financial statements have not been used for planning and control as well as they might have been. In part, this is because accounting standards have not been fully attuned to the Government's needs and circumstances. Another important reason is the continuing primacy of the budget as a financial planning and control tool. General purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

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## Accounting Standards

### Scope

30. These standards determine how a Government reporting entity should account for inflows of resources from revenue and other financing sources in its general purpose financial reports. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for “exchange revenue” is “earned revenue.” Nonexchange revenues arise primarily from exercise of the Government’s power to demand payments from the public, such as taxes, duties, fines, and penalties. Nonexchange revenue also includes donations.
31. The term “revenue” does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, although not to the Government as a whole. Accordingly, standards for accounting for these inflows are also provided.
32. Appendix B, “Guidance for the Classification of Transactions,” provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or other financing sources.

### Exchange Revenue

33. Exchange revenue and gains are inflows of resources to a Government entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return. That is, exchange revenue arises when a Government entity provides something of value to the public or another Government entity at a price.

### RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE

34. Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price.
35. When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.

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36. Revenue from specific types of exchange transactions should be recognized as follows:
- (a) When services are provided to the public or another Government entity (except for specific services produced to order under a contract), revenue should be recognized when the services are performed.
  - (b) When specific goods are made to order under a contract (either short- or long-term), or specific services are produced to order under a contract (either short- or long-term), revenue should be recognized in proportion to estimated total cost when goods and services are acquired to fulfill the contract. If a loss is probable (more likely than not), revenue should continue to be recognized in proportion to the estimated total cost and costs should continue to be recognized when goods and services are acquired to fulfill the contract. Thus, the loss should be recognized in proportion to total cost over the life of the contract.<sup>5</sup>
  - (c) When goods are kept in inventory so that they are available to customers when ordered, revenue should be recognized when the goods are delivered to the customer.
  - (d) When services are rendered continuously over time or the right to use an asset extends continuously over time, such as the use of borrowed money or the rental of space in a building, the revenue should be recognized in proportion to the passage of time or the use of the asset. The interest received on money borrowed in an intragovernmental transaction is an exchange revenue when the source of the borrowed funds is predominantly exchange revenue and is a nonexchange revenue when the source of the borrowed funds is predominantly nonexchange revenue or other financing sources.
  - (e) When an asset other than inventory is sold, any gain (or loss) should be recognized when the asset is delivered to the purchaser.
37. When advance fees or payments are received, such as for large-scale, long-term projects, revenue should not be recognized until costs are incurred from providing the goods and services (regardless of whether the fee or payment is refundable). An increase in cash and an increase in liabilities, such as “unearned revenue,” should be recorded when the cash is received. “Unearned revenue” should also be recorded if an agency requests advances or progress payments prior to the receipt of cash and records the amount.<sup>6</sup>

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<sup>5</sup>This standard is an exception to the general principle of SFFAS No. 5, Accounting for Liabilities of the Federal Government, which, but for this exception, would require a loss on a contract to be recognized at the time when expected costs exceeded expected revenue. However, the expected loss must be disclosed: see the disclosure requirement in paragraph (d) below.

<sup>6</sup>SFFAS No. 1, para. 41, provides that such request should be recorded if a claim to cash is established based on legal provisions, such as a payment due date.

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38. The measurement basis for revenue from exchange transactions should be the actual price that is received or receivable under the established pricing arrangements.
  39. When cash has not yet been received at the time revenue is recognized, a receivable should be recorded. An appropriate allowance for estimated bad debts should be established.
  40. To the extent that realization of the full amount of revenue is not probable due to credit losses (caused by the failure of the debtor to pay the established or negotiated price), an expense should be recognized and the allowance for bad debts increased if the bad debts can be reasonably estimated.<sup>7</sup> The amount of the bad debt expense should be separately shown.
  41. To the extent that realization of the full amount of revenue is not probable due to returns, allowances, price redeterminations, or other reasons apart from credit losses, the revenue that is recognized should be reduced by separate provisions if the amounts can be reasonably estimated. The amounts of such provisions should be reflected as revenue adjustments, rather than costs of operations, and should be separately shown.
  42. The recognition and measurement of revenue and credit losses due to direct loans and loan guarantees is determined by SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. Appropriate allowances should be established as determined by those standards.
  43. Exchange revenue should be recognized in determining the net cost of operations of the reporting entity during the period. The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the costs of outputs and the total net cost of operations of the reporting entity. The components of the net cost calculation should separately include the gross cost of providing goods or services that earned exchange revenue, less the exchange revenue earned, and the resulting difference. The components of net cost should also include separately the gross cost of providing goods, services, benefit payments, or grants that did not earn exchange revenue. The U.S. government-wide financial statements need not break out gross costs of providing goods, services, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue.

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<sup>7</sup>SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, paragraphs 40-52, is the standard for estimating bad debts. The standard is further explained in SFFAS No. 1's Basis for Conclusions, paragraphs 116-133.



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44. The net amount of gains (or losses) should be subtracted from (or added to) gross cost to determine net cost in the same manner as exchange revenue is subtracted. Exchange revenue that is immaterial or cannot be associated with particular outputs should be deducted separately in calculating the net cost of the program, suborganization, or reporting entity as a whole as appropriate. Nonexchange revenues and other financing sources should not be deducted from the gross cost in determining the net cost of operations for the reporting entity.

45. Under exceptional circumstances, such as rents and royalties on the Outer Continental Shelf, an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects.

45.1 The collecting entity should not offset its gross costs by such exchange revenue in determining its net cost of operations. If such exchange revenue is retained by the entity, it should be recognized as a financing source in determining the entity's operating results. If, instead, such revenue is collected on behalf of other entities (including the U.S. Government as a whole), the entity that collects the revenue should account for that revenue as a custodial activity, i.e., an amount collected for others.

45.2 If the collecting entity transfers the exchange revenue to other entities, similar recognition by other entities is appropriate.

a. If the other entities to which the revenue is transferred also recognize virtually no costs in connection with the Government earning the revenue, the amounts transferred to them should not offset their gross cost in determining their net cost of operations but rather should be recognized as a financing source in determining their operating results.

b. If the other entities to which the revenue is transferred do recognize costs in connection with the Government earning the revenue, the amounts transferred to them should offset their gross cost in determining their net cost of operations.

45.3 Because the revenue is exchange revenue regardless of whether related costs are recognized, it should be recognized and measured under the exchange revenue standards.

#### DISCLOSURES AND OTHER ACCOMPANYING INFORMATION

46. Each reporting entity that provides goods or services to the public or another Government entity should disclose the following:

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- (a) differences in pricing policy from the full cost or market pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, User Charges (July 8, 1993), or in subsequent amendments in circulars that set forth pricing guidance;
  - (b) exchange transactions with the public in which prices are set by law or executive order and are not based on full cost or on market price;<sup>8</sup>
  - (c) the nature of intragovernmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, with explanations of the amount and reason for disparities between the billing (if any) and the full cost; and
  - (d) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract, and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable).

The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements.

47. When making the disclosures called for by (a) and (b) in paragraph 46, cautionary language should be added to the effect that higher prices based on full cost or market price might reduce the quantity of goods or services demanded and, therefore, the difference between revenue received and such higher prices does not necessarily provide an indication of revenue foregone. If a reasonable estimate is practicable to make, the entity should provide as other accompanying information the amount of revenue foregone and should explain whether, and to what extent, the quantity demanded was assumed to change as a result of a change in price.

## Nonexchange Revenue

### RECOGNITION AND MEASUREMENT OF NONEXCHANGE REVENUE

#### The General Standard

48. Nonexchange revenues are inflows of resources that the Government demands or receives by donation. Such revenue should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. Nonexchange revenue should be **measured** by the collecting entities, but should be **recognized** by the entities legally

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<sup>8</sup>The pricing guidance in OMB Circular No. A-25 does not apply to prices set by law or executive order.

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entitled to the revenue (the recipient entities). Paragraphs 49 through 63 describe the application of this general standard.

#### Taxes and Duties

49. **Revenue measured by the collecting entities.** Taxes and duties also should be measured on the cash basis, and the cash basis amount(s) should be shown in conjunction with the accrual amounts recognized. The source and disposition of revenue from taxes, duties (which are a type of tax), and related fines, penalties and interest should be measured by the collecting entities in a manner that enables reporting of (1) cash collections, refunds, and the “accrual adjustment” necessary to determine the total revenue and (2) cash or cash equivalents transferred to each of the recipient entities and the revenue amounts to be recognized by each of them. The collecting entities function in a custodial capacity with respect to revenue transferred or transferable to the recipient entities. The collecting entities should not recognize such revenue, but should account for and report upon the above mentioned custodial activities. The entities that collect taxes and duties may change the general standard (para. 48) to accrue amounts now required to be presented as supplementary information (paragraphs 67.1 and 67.2) and make other changes that would result in a fuller and more complete application of accrual accounting.
50. **Cash collections** should be based on amounts actually received during the fiscal period, including withholdings, estimated payments, final payments, and collections of receivables. Cash collections include any amounts paid in advance of due dates unless they are deposits.
51. **Cash refunds** should be based on repayments of taxes and duties during the period. Refunds include refund offsets and drawbacks. Refund offsets are amounts withheld from refunds on behalf of other agencies and paid to such agencies. Drawbacks are refunds of duties paid on imported goods that are subsequently exported or destroyed.
52. **The “accrual adjustment,”** which modifies the net of cash collections and refunds to determine the amount of revenue recognized, should be the net increase or decrease during the reporting period in net revenue-related assets and liabilities. The net revenue-related assets and liabilities include accounts receivable, the allowance for uncollectible accounts, and amounts payable for refunds. Recognition standards for these accounts of the collecting entities are described in paragraphs 53 to 57.
53. **Accounts receivable** should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment processes to the extent the amount is measurable. This definition of accounts receivable from nonexchange transactions requires the standard for recognition of accounts receivable to be amended so that such receivables are not recognized on the

basis of payment due dates but rather on the basis of the completion of the assessment processes.<sup>9</sup> Under such processes, assessments are enforceable claims for which specific amounts due have been determined and the person(s) or entities from whom the tax or duty is due have been identified. Assessments include both self-assessments made by persons filing tax returns or entry documents and assessments made by the collecting entities.

54. Assessments recognized as accounts receivable include tax returns filed by the taxpayer (or customs documents filed by the importer) without sufficient payments, taxpayer agreements to assessments at the conclusion of an audit or to a substitute for a return (or importer agreements to supplemental assessments), court actions determining an assessment, and taxpayer (or importer) agreements to pay through an installment agreement or through accepted offers in compromise. Receivables determined to be currently not collectable are included, but assessments where there is no future collection potential such as where the taxpayer (or importer) has been either insolvent or deceased for specified periods are not included. Accounts receivable, therefore, include only unpaid assessments made through the end of the period plus related fines, penalties, and interest. Accounts receivable do not include amounts received or due with tax returns received after the close of the reporting period or amounts that are compliance assessments<sup>10</sup> or pre-assessment work in process.
55. **Compliance assessments and pre-assessment work in process.** Compliance assessments and pre-assessment work in process may or may not be legally assessed depending on the resolution of subsequent events.
- A. **Compliance assessments** are proposed assessments by the collecting entity in definitive amounts, but the taxpayer (or importer) still has the right to disagree or object, such as in the case of assessments made at the conclusion of an audit (or at the conclusion of a review by an import specialist or when a violation of applicable law is discovered), or the issuance by IRS of a substitute for a return, or where assessment is in appeals or in the tax court. These compliance assessments may become accounts receivable if the taxpayer files an amended return (or Customs' protest/retention period lapses), or an appeal or court action finally determines the assessment, or the taxpayer (importer) agrees to pay currently or through an installment agreement, or an offer in compromise is accepted.

<sup>9</sup>SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, para. 41, states that "a receivable should be recognized . . . based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due) . . ." Under the revenue standard, past due taxes are not recognized on the date they are due, but rather on the date when tax returns are received without sufficient payment or legally enforceable claims against non-compliant taxpayers are established through enforcement processes.

<sup>10</sup>Customs refers to "compliance assessments" as protested assessment amounts.

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- B. **Pre-assessment work in process** is assessments not yet officially asserted by the collecting entity which are subject to a taxpayer's right to conference in response to initial information notices, e.g., revenue agent reports (or are unasserted assessments on merchandise released into commerce for which the importer did not submit an entry summary document or for projected revenues due as a result of Customs' compliance measurement programs). The amount or range of amounts that will ultimately be assessed or the duration of the notice period may be reasonably estimable, but there are no amounts for pre-assessment work in process presently included in the dollar based accounting systems. Estimates of the amount or range of amounts of pre-assessment work in process that may ultimately be collectable are not presently sufficiently reliable to be recognized.
56. **Allowance for uncollectible amounts** should be recognized based on an analysis of both individual accounts receivable and groups of accounts receivable, as prescribed by other standards.<sup>11</sup> A provision to increase or decrease the allowance will result in an adjustment of nonexchange revenue, rather than a bad debt expense.
57. **Amounts payable for refunds** (including refund offsets and drawbacks) should be recognized when measurable and legally payable under established processes of the collecting entities. The amounts include those refunds, where returns (or claims for refund) have been filed by the taxpayer and the Government has determined the specific amounts refundable and has identified the payee. Refunds with respect to returns or claims filed as of the end of the reporting period that do not require specific approval before payment are included in accounts payable for refunds.
58. **Other claims for refunds.** Claims filed for which specific administrative actions are required before payments can be made and unasserted claims for refund by taxpayers or importers that may or may not become payable depending upon the resolution of subsequent events.
- A. Claims filed for refunds where required administrative actions are not yet complete as of the close of the reporting period are not recognized. The refunds, however, may be reasonably estimable.

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<sup>11</sup>SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, para. 44 to 51, provides the basis for determining this allowance.

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- B. Unasserted claims for refund such as unfiled claims for refunds or drawbacks for which no claim has been filed, are not recognized.<sup>12</sup> These amounts may be reasonably estimable, but are not presently included in dollar-based accounting systems.
59. **Deposits.** Amounts voluntarily paid to the reporting entities as deposits, such as those made to stop the accrual of interest or those made pending settlements and judgments, are separately recognized as deposit liabilities.
60. **Revenue recognized by the recipient entities** should equal the sum of (a) cash or cash equivalents transferred to them by collecting entities and (b) the net change in any related inter-entity balances between the collecting and receiving entities (i.e., the amount to be transferred to the recipient entities from the collecting entity or vice versa). Equivalents are normally special Treasury securities issued by the Treasury Department acting in conjunction with the collecting entities. Inter-entity balances of amounts to be transferred normally should be recognized when (1) a legally enforceable claim exists between a collecting entity and a recipient entity for the transfer or repayment of taxes or duties, and (2) payment of such claim is probable and measurable. Inter-entity balances typically represent estimated settlements of transfers made during the period and revenue received by the collecting entity at year end but not yet transferred. Revenue should be recognized as a financing source in calculating the results of operations and not as a deduction in determining net cost of operations. Principles for the application of this standard to major groups of recipient entities are described in paragraphs 60.1 through 60.4.

**60.1 Trust funds legally entitled to excise taxes collected.** Certain trust funds are legally entitled to receive only excise taxes that are actually collected by the collecting entity. However, transfers to such trust funds currently are based on assessed excise taxes, because data on the components of cash collections by type of tax are not currently obtained from taxpayers. This standard affirms that revenues may be recognized on the basis of assessed excise taxes in lieu of excise taxes actually collected.

**60.2 Trust funds legally entitled to receive Social Security taxes accrued.** By law, the trust funds are to receive Social Security taxes on the basis of the earnings of participants and the applicable tax rates. Social Security taxes accrued are presently determined by the assessment processes of the Internal Revenue Service (IRS). Non-compliance by taxpayers may result in such amounts being less than taxes based on actual earnings of participants. Amounts for individual participants are separately reported to the

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<sup>12</sup>Future income taxes from corporations may be reduced by more than \$100 billion dollars as a result of net operating loss carryforwards and tax credit carryforwards. Information in returns filed by corporations and in their financial statements appears to provide the basis for a reasonable estimate of the amount of potential reduced future income tax revenue attributable to these provisions of tax law. Information about net operating loss carryforwards is not an unasserted claim, as defined here.

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Social Security Administration (SSA), but because of employer reporting deficiencies these amounts are currently even less than amounts determined by the IRS. SSA is legally entitled to retain the higher amounts actually transferred by the IRS. This standard affirms that revenue should be recognized on the basis of the best available information, i.e., on the basis of the higher of the amount determined by the IRS assessment process or the individual participant amounts based on reports to SSA of participants' earnings, subject to any later adjustments necessary to bring the amounts transferred to the trust funds up to the amount of taxes due based on the actual earnings history of the participants.

**60.3 Collecting entities entitled to retain revenue.** When legally retained by the collecting entity as a reimbursement of the cost of collection, revenue should be recognized as an exchange revenue and deducted in determining the collecting entity's net cost of operations.

**60.4 General Fund.** The General Fund recognizes all nonexchange revenue not recognized by trust funds and other recipient entities. Interest on delinquent taxes should be recognized as exchange revenue. The General Fund should recognize in succeeding periods revenue adjustments for any recognized revenue that is determined after the books are closed for the period to have been properly transferable (or improperly transferred) to other recipient entities.

## Fines and Penalties

61. Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. They may be imposed by the entities collecting taxes and duties, or by other government entities. The time when a claim to resources arises will depend on the nature of the fine and the associated legal and administrative processes. Some examples of conditions that, depending on the circumstances, could establish a legally enforceable and measurable claim include (1) the date by which an individual may contest a court summons expires, (2) the offender pays the fine before a court date, or (3) the court imposes the fine. An allowance for uncollectible accounts should, as in the case of taxes and duties, be recognized as a revenue adjustment and determined in accordance with other standards.<sup>13</sup> The allowance should reduce the gross amount of the receivable and revenue to its net realizable value, based on the criterion that losses should be recognized to the extent it is probable (more likely than not) that some or all of the receivables will not be totally collected.

## Donations

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<sup>13</sup>SFFAS No. 1, para. 44-51.

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62. Donations are contributions to the government, i.e., voluntary gifts of resources to a government entity by a nonfederal entity. Donations may be financial resources, such as cash or securities, or nonfinancial resources such as land or buildings. Revenue arising from donations should be recognized for those inflows of resources which meet recognition criteria for assets<sup>14</sup> and should be measured at the estimated fair value of the contribution.

#### Other Nonexchange Revenue

63. The various types of nonexchange revenue are described in Appendix B: Guidance for the Classification of Transactions. Some of these are not specifically mentioned in this standard. They should be recognized and measured in accordance with the general rule (see para. 48) except where other Board standards apply.

### DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER ACCOMPANYING INFORMATION

#### Disclosures

64. **Basis of Accounting.** Collecting entities should disclose the basis of accounting when the application of the general rule of paragraph 48 results in a modified cash basis of accounting. The disclosure should point out the specific potential accruals which are not made as a result of this practice and the practical and inherent limitations affecting the accrual of taxes and duties. The disclosure should refer to the related other required disclosures and to the supplementary information and should mention that other accompanying information also provides related information. If a collecting entity adopts accounting standards that embody a fuller application of accrual accounting concepts, as permitted in paragraph 49, then the disclosure should describe that change in accounting and point out how it differs from that prescribed by this standard.
65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

65.1 **Accounts receivable.** Factors affecting collectability and timing of categories of accounts receivable and the amounts involved. The U.S. government-wide financial statements need not disclose factors affecting collectability and timing of categories of accounts receivable and the amounts involved.

65.2 [Rescinded by SFFAS 20.]

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<sup>14</sup>For the recognition criteria for donated property, plant and equipment, see SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 30, 62, and 71.



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**65.3 Cumulative cash collections and refunds by tax year and type of tax.** Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes. The U.S. government-wide financial statements need not disclose cumulative cash collections and refunds by tax year and type of tax for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.

66. If trust fund revenues are not recorded in accordance with applicable law, both the collecting and recipient entities should disclose the reasons.

#### Supplementary Information

67. Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial responsibilities:

67.1 The estimated realizable value, as of the end of the reporting period, of compliance assessments and, if reasonably estimable, pre-assessment work in process. The amounts furnished should represent management's estimate of additional revenues reasonably expected to be collected from compliance assessments and from pre-assessment work in process, appropriately qualified as to their reliability. A range of amounts may be provided for pre-assessment work in process if estimable. The change in the total(s) of compliance assessments and of pre-assessment work in process during the reporting period also should be provided.

67.2 If reasonably estimable, other claims for refunds that are not yet accrued but are likely to be paid when administrative actions are completed. If estimated, unasserted claims for refunds should be provided separately from claims filed and may be expressed as a range of amounts. The amounts furnished should represent management's reasonable estimates, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.

67.3 The amount of assessments that the entity still has statutory authority to collect at the end of the period, but that have been written off and thus excluded from accounts receivable.

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67.4 If reasonably estimable, the amounts by which trust funds may be over- or underfunded in comparison with the requirements of law.

68. Recipient entities that are trust funds should provide the same information as required for collecting entities in para. 67.4.

#### Other Accompanying Information

69. The following guidance for other accompanying information is intended to provide flexibility to enable preparers to present the most relevant information with respect to these topics, considering the needs and interests of users and the availability of data.

69.1 **A perspective on the income tax burden.** The IRS should provide a perspective on the income tax burden. This could take the form of a summary of the latest available information on the income tax and on related income, deductions, exemptions, and credits for individuals by income level and for corporations by size of assets. The objective is to show the tax burden borne by different classes of individuals and corporations and how that burden is affected by the tax rates, deductions, credits, etc., provided by the tax laws.

69.2 **Available information on the size of the tax gap.** Collecting entities should provide any relevant estimates of the annual tax gap that become available as a result of federal government surveys or studies. The tax gap is defined as taxes or duties due from non-compliant taxpayers or importers. Amounts reported should be specifically defined, e.g., whether the tax gap includes or excludes estimates of taxes due on illegally earned revenue. Appropriate explanations of the limited reliability of the estimates also should be provided. Cross references should be made to portions of the tax gap due from identified non-compliant taxpayers which are shown as supplementary information, i.e., compliance assessments and pre-assessment work in process (para. 67.1).

69.3 **Tax expenditures related to entity programs.** Information on tax expenditures that a reporting entity considers relevant to the performance of its programs may be presented, but should be qualified and explained appropriately to help the reader assess the possible impact of specific tax expenditures on the success of the related programs.

69.4 **Directed flows of resources related to entity programs.** Information on directed flows of resources related to an entity's programs may be presented, but if this information is presented the estimated amounts should be accompanied by a description of the basis for the estimates and appropriate cautionary language about their reliability. Information should also be appropriately qualified and explained to help the reader assess the possible impact on the success of the programs.

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## Other Financing Sources

70. Financing sources, other than exchange and nonexchange revenues, that provide inflows of resources that increase results of operations during the reporting period include appropriations used, transfers of assets from other Government entities, and financing imputed with respect to any cost subsidies.<sup>15</sup> Financing outflows may result from transfers of the reporting entity's assets to other Government entities or from exchange revenues earned by the entity but required to be transferred to the General Fund or another Government entity. Unexpended appropriations are recognized separately in determining net position but are not financing sources until used.

## RECOGNITION AND MEASUREMENT OF OTHER FINANCING SOURCES

### Appropriations

71. **Unexpended Appropriations.** Appropriations, until used, are not a financing source. They should be recognized in capital as "unexpended appropriations" (and among assets as "funds with Treasury") when made available for apportionment, even if a Treasury Warrant has not yet been received, or the amount has not been fully apportioned. Unexpended appropriations should be reduced for appropriations used and adjusted for other changes in budgetary resources, such as rescissions and transfers. The net increase or decrease in unexpended appropriations for the period should be recognized as a change in net position of the entity.
72. **Appropriations Used.** When used, appropriations should be recognized as a financing source in determining net results of operations.<sup>16</sup> Appropriations are used in operations when goods and services are received or benefits and grants are provided. Goods and services (including amounts capitalized) are considered received when a liability is established. Benefits are considered to be provided when the related liability is established. Grants are considered to be provided when grantees meet the requirements that allow them to use the grants.<sup>17</sup>

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<sup>15</sup>Other accounting standards will determine the criteria for the imputation of costs and how those costs shall be measured. This standard provides guidance for accounting for the corresponding financing source that is reported in such cases.

<sup>16</sup>As is explained in the Basis for Conclusions, in the private sector, the term "net results of operations" is synonymous with net income and net income is the "bottom line" measure of performance for profit-seeking businesses. For most Government reporting entities, on the other hand, this is not the "bottom line" for performance measurement. See para. 224 and following.

<sup>17</sup>FASAB plans to undertake a project on accounting for grants.

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### Financing Imputed for Cost Subsidies

73. Government entities often receive goods and services from other Government entities without reimbursing the providing entity for all the related costs. In addition, Government entities often incur costs, such as for pensions, that are paid in total or in part by other entities. These constitute subsidized costs to be recognized by the receiving entity to the extent required by other accounting standards. An imputed financing source should be recognized equal to the imputed cost. This offsets any effect of imputed cost on net results of operations for the period.

### Transfers of Assets

74. An intragovernmental transfer of cash or of another capitalized asset without reimbursement changes the resources available to both the receiving entity and the transferring entity. The receiving entity should recognize a transfer-in as an additional financing source in its result of operations for the period. Similarly, the transferring entity should recognize the transfer-out as a decrease in its result of operations. The value recorded should be the transferring entity's book value of the asset. If the receiving entity does not know the book value, the asset should be recorded at its estimated fair value as of the date of transfer.
75. To the extent that a Government entity's exchange revenue that is included in calculating net cost of operations is required to be transferred to the Treasury or another Government entity, the amount should be recognized as a transfer-out in determining the net result of operations.<sup>18</sup>

### PRIOR PERIOD ADJUSTMENTS

76. [Rescinded by SFFAS 21.]

### BUDGETARY INFORMATION

77. The budget is the primary financial planning and control tool of the government. For this reason, and because of the importance of this information to users of federal financial information, the following material budgetary information should be presented by reporting entities whose financing comes wholly or partially from the budget:
- (a) total budgetary resources available to the reporting entity during the period;
  - (b) the status of those resources (including "obligations incurred");
  - (c) outlays.

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<sup>18</sup>These transfers are distinguished from custodial transfers in that transfers involve assets that have been earned or in use by the entity in carrying out its programs whereas custodial transfers involve funds that have been collected on behalf of another entity. Accounting for custodial transfers is described in the section covering nonexchange revenue.

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78. Recognition and measurement of budgetary resources should be based on budget concepts and definitions contained in OMB Circulars A-11 and A-34. In addition, the reporting entity should provide this information for each of its major budget accounts as supplementary information. Small budget accounts may be aggregated.
79. The following information about the status of budgetary resources should be disclosed.
- (a) the amount of budgetary resources obligated for undelivered orders at the end of the period;
  - (b) available borrowing and contract authority at the end of the period;
  - (c) repayment requirements, financing sources for repayment, and other terms of borrowing authority used;
  - (d) material adjustments during the reporting period to budgetary resources available at the beginning of the year and an explanation thereof;
  - (e) existence, purpose, and availability of permanent indefinite appropriations;
  - (f) information about legal arrangements affecting the use of unobligated balances of budget authority such as time limits, purpose, and obligation limitations;
  - (g) explanations of any material differences between the information required by paragraph 77 and the amounts described as "actual" in the Budget of the United States Government;
  - (h) the amount, and an explanation that includes identification of balance sheet components, when recognized unfunded liabilities do not equal the total financing sources yet to be provided; and
  - (i) the amount of any capital infusion received during the reporting period.
80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different. To better understand these differences, the reconciliation should explain the relationship between the net cost of operations<sup>18.1</sup> and net outlays by the entity during the reporting period. The reconciliation should reference the reported "net outlays"<sup>18.2</sup> and related adjustments as defined by Office

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<sup>18.1</sup>The terms "net cost of operations" and "net cost" are used interchangeably to refer to the total cost incurred by the reporting entity less exchange revenue earned during the period.

<sup>18.2</sup> OMB Circular A-11: Preparation, Submission, and Execution of the Budget states, "Outlay means a payment to liquidate an obligation (other than the repayment to the Treasury of debt principal). Outlays are a measure of Government spending. Subtract all offsetting collections (unexpired and expired) from gross outlays to yield net outlays so that the contribution of the budget account to the Federal Government's bottom line (the surplus or deficit) can be determined."

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of Management and Budget (OMB) Circular A-11: *Preparation, Submission, and Execution of the Budget*

81. The net cost of operations should be adjusted by
- (a) components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);
  - (b) components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and
  - (c) other temporary timing differences (e.g., prior period adjustments due to correction of errors).
82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis amounts used in financial accounting. A narrative explaining the purpose, the nature, and the line items of the reconciliation also should be presented with the reconciliation. The amount and nature of non-cash outlays should be disclosed. For purposes of this Statement, non-cash outlays are outlays that are recognized without a concurrent cash disbursement, such as interest accrued by the Department of the Treasury (Treasury) on debt held by the public and the change in allowance for subsidy cost.

#### ACCOUNTABILITY FOR DEDICATED COLLECTIONS

[Paragraphs 83 through 87 were rescinded by SFFAS 31 paragraph 34.]

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## Part II: Concepts For Reconciling Budgetary And Financial Accounting

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### Introduction

88. The Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, Entity and Display, was issued to provide conceptual guidance as to what would be encompassed by a federal entity's financial report. It identifies the types of financial information to be communicated to users and suggests the types of information to be included in an entity's report to help meet the objectives of federal financial reporting. Among other things, SFFAC No. 2 supports reporting both budget information and operating performance (i.e., proprietary) information to meet the needs of users and the objectives of reporting. The budget information focuses on the obligation and outlay of financial resources to acquire or provide goods and services as defined by budget concepts. Operating performance information focuses on the cost of resources used as defined by accrual accounting standards.
89. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition is necessarily different because of the difference in focus. To better understand the differences and make better use of the complementary information provided, information needs to be provided to reconcile the use of budgetary resources to acquire or provide goods and services with the net cost of using those goods and services. An approach to doing this was explored in the exposure draft, Accounting for Revenue and Other Financing Sources, and received substantial support from respondents. Therefore, Entity and Display is being amended to include in its concepts the need to communicate information about the differences between the use of resources as reported in the budget and in the net cost of operations.

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### Amendments To SFFAC No. 2, Entity And Display

90. The following heading and two paragraphs (numbered 91 and 92 in this document) are added to the section of SFFAC No. 2 titled "Displaying Financial Information."

#### Reconciliation Statement—Budgetary And Financial Accounting

91. Subobjective 1C of the Budgetary Integrity objective states that information is needed to help the reader to determine "how information on the use of budgetary resources relates to

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information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities." This objective arises because accrual-based expense measures used in financial statements differ from the obligation and outlay-based measures used in budgetary reporting.

92. To satisfy this objective, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a **Budget and Accrual Reconciliation** (BAR) that reconciles the net budgetary outlays for a federal entity's programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity.
93. The **Budget and Accrual Reconciliation** is added to SFFAC No. 2's suggested list of items included in the section titled "Financial Reporting for an Organizational Entity." In addition, a footnote (referencing the Reconciliation of Net Costs to Outlays) should be added stating the following:

OMB will provide guidance regarding details of the display for the Budget and Accrual Reconciliation, including whether it should be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

94. The following heading and paragraphs (numbered 95 through 101 in this document) are added to the section of SFFAC No. 2 titled "Recommended Contents for the Recommended Displays."

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## Budget and Accrual Reconciliation

95. The purpose of the reconciliation of Net Costs to Outlays is to explain how budgetary resources outlayed during the period relate to the net cost of operations for the reporting entity. This information should be presented in a way that clarifies the relationship between the outlays reported through budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship, the reconciliation provides the information necessary to understand how the budgetary outlays finance the net cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the reconciliation are indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from outlays to net cost of operations.
96. **Net Cost of Operations** is from the Statement of Net Cost.



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97. **Components of net cost that are not part of net outlays** are most commonly (a) the result of allocating assets to expenses over more than one reporting period (e.g., depreciation) and the write-down of assets (due to revaluations), (b) the temporary timing differences between outlays/receipts and the operating expense/revenue during the period, and (c) costs financed by other entities (imputed inter-entity costs).
98. **Components of net outlays that are not part of net cost** are primarily amounts provided in the current reporting period that fund costs incurred in prior years and amounts incurred for goods or services that have been capitalized on the balance sheet (e.g., plant, property and equipment acquisition and inventory acquisition).
99. **Other temporary timing differences** reflect special adjustments (e.g., prior period adjustments due to correction of errors).
100. **Net Outlays** is the summation of the above amounts and equals the Statement of Budgetary Resources net outlays amount.
101. The preparer should present material amounts separately in the reconciliation and discuss these in the narrative. The use of "other" captions should be minimized and individually material amounts should not be netted to report an immaterial amount.
102. The following is an example for the financial statement format. This format and its narrative will be added to the appendices of SFFAC No. 2.

## Entity and Display, Appendix 1-G

### EXAMPLE FINANCIAL STATEMENT FORMATS - BUDGET AND ACCURAL RECONCILIATION

#### NARRATIVE

*Budgetary and financial accounting information differ. Budgetary accounting is used for planning and control purposes and relates to both the receipt and use of cash, as well as reporting the federal deficit. Financial accounting is intended to provide a picture of the government's financial operations and financial position so it presents information on an accrual basis. The accrual basis includes information about costs arising from the consumption of assets and the incurrence of liabilities. The reconciliation of net outlays, presented on a budgetary basis, and the net cost, presented on an accrual basis, provides an explanation of the relationship between budgetary and financial accounting information. The reconciliation serves not only to identify costs paid for in the past and those that will be paid in the future, but also to assure integrity between budgetary and financial accounting. The analysis below illustrates this reconciliation by listing the key differences between net cost and net outlays.*

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*Unrealized valuation loss on investment in the reconciliation is related to the write down of security investment due to recent market volatility, which did not result in an outlay but did result in a cost. The large increase of accounts payable compared to last year is because this year's rent expense has not been paid but was included in the net cost this year and not included in the outlays. The large variance in the "transfers in/(out) without reimbursement" between fiscal year (FY) 201X and FY201X is primarily due to the transfer of program management responsibility from agency 1 to agency 2 as discussed in further detail in Note X. In addition, the decrease in "Imputed financing source" is a result of the payment in FY201X for the ABC Settlement.\**

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\*This is an illustration of what might be presented in the narrative paragraph. It is an example of how to explain the material line items in the reconciliation and describes why some material line items either increase or decrease net cost but do not have the same impact on net outlays.

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**RECONCILIATION EXAMPLE- For the year ended September 30, 201X**

	Intra- governmental	With the public	Total FY 201x
<b>NET COST</b>	\$xxx	\$xxx	\$xxx
<b>Components of Net Cost That Are Not Part of Net Outlays:</b>			
Property, plant, and equipment depreciation	xxx	xxx	xxx
Property, plant, and equipment disposal & revaluation	xxx	xxx	xxx
Year-end credit reform subsidy re-estimates	xxx	xxx	xxx
Unrealized valuation loss/(gain) on investments---	xxx	xxx	xxx
<b>Increase/(decrease) in assets:</b>			
Accounts receivable	xxx	xxx	xxx
Loans receivable	xxx	xxx	xxx
Investments	xxx	xxx	xxx
Other assets	xxx	xxx	xxx
<b>(Increase)/decrease in liabilities:</b>			
Accounts payable	xxx	xxx	xxx
Salaries and benefits	xxx	xxx	xxx
Insurance and guarantee program liabilities	xxx	xxx	xxx
Environmental and disposal liabilities	xxx	xxx	xxx
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	xxx	xxx	xxx
<b>Other financing sources:</b>			
Federal employee retirement benefit costs paid by OPM and imputed to the agency	xxx	xxx	xxx
Transfers out (in) without reimbursement	xxx	xxx	xxx
Other imputed financing --	xxx	xxx	xxx
<b>Total Components of Net Cost That Are Not Part of Net Outlays</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Components of Net Outlays That Are Not Part of Net Cost:</b>			
Effect of prior year agencies credit reform subsidy re-estimates	xxx	xxx	xxx
Acquisition of capital assets	xxx	xxx	xxx
Acquisition of inventory	xxx	xxx	xxx
Acquisition of other assets	xxx	xxx	xxx
Other	xxx	xxx	xxx

	Intra- governmental	With the public	Total FY 201x
<b>Total Components of Net Outlays That Are Not Part of Net Costs</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>Other Temporary Timing Differences</b>	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>
<b>NET OUTLAYS</b>	<b>\$xxx</b>	<b>\$xxx</b>	<b>\$xxx<sup>18.3</sup></b>

<sup>18.3</sup> Total Net Outlays can be linked to the Statement of Budgetary Resources, and equals gross outlays less actual offsetting collections and distributed offsetting receipts. The net outlays for Intra-governmental and With the Public listed in the format are calculated totals.

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## Appendix A: Basis For Conclusions

103. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important considerations that FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

104. FASAB published the exposure draft Accounting for Revenue and Other Financing Sources in July 1995. The exposure draft included 18 specific questions for respondents and invited comments on other topics. The Board received 42 letters of comment from the following sources:

<b>Source</b>	<b>Internal To The U.S. Govt.</b>	<b>External To The U.S. Govt.</b>	<b>Total</b>
Users, Academics & Others <sup>19</sup>	2	7	<b>9</b>
Auditors	10	1	<b>11</b>
Preparers	22		<b>22</b>
<b>Total</b>	<b>34</b>	<b>8</b>	<b>42</b>

105. FASAB also held a public hearing on the exposure draft on September 20, 1995. One individual (a professor of accounting), representatives of four federal organizations that prepare financial statements, and representatives of one federal audit organization presented comments and discussed the exposure draft with the Board. Most of those who commented orally or in writing supported most of the provisions of the exposure draft. Most responses did suggest widening the proposed disclosures for trust funds to include other funds with similar special accountability for dedicated collections. Also, most respondents suggested retaining the customary business practice of recognizing bad debt expense for credit losses from exchange transactions. The Board made these changes. (See paragraph 128 for details on the change regarding credit losses. See paragraphs 226 and following for details on the change regarding disclosures for trust funds and similar funds). Concurrently

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<sup>19</sup>This category includes representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other users

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with the widening of disclosures about funds, the Board required disclosures and supplementary information about any over- and under-funding of the trust funds (see para. 66, 67.4 and 68). The Board also made other less material changes in the exposure draft as a result of considering the comments it received.

106. As a result of further information received from IRS following the exposure draft, the Board made terminology changes with respect to “pre-assessments,” now referred to as “compliance assessments,” and “proposed assessments, now called “pre-assessment work in process.” More importantly, the Board provided for the possibility that amounts for pre-assessment work in process might not be reasonably estimable (see para. 67.1). As a result of further information from Customs following the exposure draft, the Board added a supplementary information requirement for unasserted claims for refund (see para. 67.2). (These include potential drawbacks that may approximate 20% of Customs reported revenue.)
107. After some deliberation, the Board also concluded that it would permit a fuller application of accrual accounting for taxes and duties than is required by the general rule (see para. 49). This would apply in the interim period between the issuance date of the Statement and any reconsideration of the standard by the Board. Coincident with extending the effective date of the standard for one year beyond that proposed in the exposure draft, and because of the importance of accurate information, the Board decided to require that material revenue-related transactions should be accounted for under a double entry accounting system (rather than estimated) and changed the designation of this information from supplementary to disclosure information ([Text deleted by SFFAS No. 20] see par. 65.3).
108. Finally, the Board recognized that, under certain circumstances, reporting entities may appropriately report information about tax expenditures and directed flows of resources that are related to their programs. However, the standard only permits this information to be presented as other accompanying information if it is properly qualified and explained (see para. 69.3 and 69.4).

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## Exchange Revenue

### Special Nature of Government Exchange Transactions

109. Revenue from exchange transactions plays a different role in Government than in private business. Most Government output is provided to the public directly as the result of political decisions rather than in exchange for revenue. This is regardless of whether the output is the provision of services, transfer payments to individuals, or grants to state and local governments. Likewise, most of the Government’s receipts are collected as a result of

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exercising its power to compel tax payments rather than earned by providing goods and services to the public at a price.

110. Where Government goods and services are provided in exchange for revenue, prices may be set to cover cost. Sometimes they may be set in the market as they would be set by a business (such as auctioning the right to drill for oil on Government land). However, law or policy sets many prices below the amount that might be obtained in an auction or other market transaction (such as fees for grazing rights). In some of these cases, prices may be set with little or no regard to the related cost (such as fees to visit national parks).
111. Exchange transactions also occur between entities within the Government, sometimes as stipulated by law and in other cases by mutual agreement. These exchange transactions, also, are often not conducted at fair market prices. Services are often provided to a program free, such as the litigation the Department of Justice does for the Internal Revenue Service. Another common example is a central computer used without charge by several programs within an agency. Where charges are imposed, the internal sales price or reimbursement is not necessarily based on the full cost of providing the goods or services or on competitive market equivalents.
112. Some exchange transactions within the Government are carried out by intragovernmental revolving funds. In many instances, these funds have been established with the goal of recovering their full cost by selling their output. This would allow them to be self-sustaining from their sales, including the maintenance of their capital, without the need for additional appropriations. Goods and services must be priced at full cost to achieve this goal, but full cost is not always charged. As a result, revolving funds have often failed to be self-sustaining and have required extra appropriations.<sup>20</sup>

### Recognition: General Considerations

113. **Matching revenue with cost.** It is often said that private sector accounting matches expense with revenue to measure the net income of the business. This provides a measure of effort compared with accomplishment that cannot be used for most government activities. Most government activity either provides collective goods and service (such as national defense and justice) or redistributes income and wealth (as in benefit payments and grants). Therefore, the Government's output—its goods, services, transfers, and grants—is usually not provided in exchange for voluntary payments. In such cases, directly measuring the value that the Government's activity adds to society's welfare is difficult.

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<sup>20</sup>Even revolving funds that are self-financing do not recover full cost from their customers if they are not charged for all of their own costs, such as pension and retirement health benefits for their employees.

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114. The Objectives of Federal Financial Reporting focuses on cost in relationship to accomplishment as the main objective in reporting an entity's operating performance. This is because of the fundamental importance of cost information. It is important to program managers in operating their activities efficiently and effectively. It is equally important to Executive and Congressional decision makers in making resource allocations. Subobjectives 2A and 2B declare that:

Federal financial reporting should provide information that helps the reader to determine ...the costs of providing specific programs and activities and the components of, and changes in, these costs... [and] the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.<sup>21</sup>

115. The Board's explanation of the operating performance objective defines more exactly what this means:

...expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.<sup>22</sup>

116. SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, discusses the need for Government accounting to emphasize cost as a way to improve decision making and program management. It says that good cost information can be used for: (1) budgeting and cost control, (2) performance measurement, (3) determining reimbursements and setting fees, (4) program evaluations, and (5) economic choice decisions (such as whether to contract-out a project).<sup>23</sup>

117. To meet these goals, cost must be matched with the provision of goods and services to the public or other Government entities. To determine the net cost of an exchange activity—i.e., the part of the cost that is not offset by revenue earned from the goods and services provided—the related revenue must be matched with the cost.

118. Matching revenue with cost in a uniform manner is essential in evaluating agency performance and setting price. Cost and revenue must pertain to the same output in order to estimate the extent to which the revenue covers the cost. Therefore, costs should be matched against the provision of goods and services with revenue matched against those costs and thus with revenue also matched against the same provision of goods and

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<sup>21</sup>SFFAC No. 1, *Objectives of Federal Financial Reporting*, paragraphs 126 and 128.

<sup>22</sup>Ibid., para. 124. For more extended discussion, see *ibid.*, chapter 8. As explained there, difficulties arise in practice for many reasons, e.g., the specific measures that are appropriate and feasible will vary from program to program, outcomes are influenced by external factors as well as actions of government, focusing attention on selected measures can have unintended—and sometimes undesired—consequences, etc.

<sup>23</sup>SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 31-40.



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services. When this is done, the gross and net cost of an entity can be compared with the related outputs and outcomes to evaluate its operating performance, pricing policy, and economic decisions. Similarly, when this is done, the net cost to the taxpayer can be estimated for the entity's related outputs provided to the public.

119. The standards in this Statement therefore use the accrual basis for recognizing exchange revenue and provide for matching exchange revenue against related cost as closely as practicable. The standards specify how the matching is to be achieved for different types of transactions.
120. **Assigning revenue to the costs of earning it.** Determining the net cost of producing outputs, providing programs, or carrying out missions will often be more important than determining the net cost for the reporting entity as a whole. A reporting entity may have several missions carried out by different suborganizations, all of them having component programs and outputs. For each of these, both gross and net cost are important in evaluating performance and managing cost. Furthermore, either an entity as a whole or its suborganizations and programs may have material costs that are not incurred to earn revenue, as well as material costs that are incurred for that purpose. Therefore, the revenue-earning and nonrevenue-earning components need to be separately evaluated in order to assess the net cost of particular activities. Additionally, various components may earn revenue but cover costs to different degrees.
121. In all these cases, the net cost of the reporting entity as a whole does not show the extent to which earned revenue covers the cost of providing a particular output. This can only be calculated for the entity's components. Determining the net cost for components is therefore essential to achieve the goals of the standards in this Statement: to match exchange revenue with the gross cost of outputs and to offset exchange revenue against that related gross cost.
122. To be most useful, therefore, the gross costs and net cost of operations should be calculated by suborganization, program, or output. Suborganizations are generally equivalent to responsibility segments as defined by the standards on managerial cost accounting.<sup>24</sup> Each responsibility segment must be able to assign full costs to the measurable outputs of its programs.<sup>25</sup> As a result, users of general purpose federal financial reports will be able to relate the net costs of a program to program outputs and outcomes.

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<sup>24</sup>See *ibid.*, para. 77-88. Also see SFFAC No. 2, Entity and Display, para. 75 and footnote 14.

<sup>25</sup>SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 89-104 and 116-143.

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123. Preparers should decide the exact classification of suborganizations and programs based on the nature of the entity, the missions and outputs for its GPRA strategic and annual performance plans, the concepts in Entity and Display, Federal accounting standards, and OMB's bulletin prescribing the form and content of agency financial statements. Exchange revenue should be assigned to the costs of outputs unless it is not reasonably possible to do so. If that cannot be done, exchange revenue should be assigned to the costs of programs, or, if that also is not reasonably possible, to the costs of suborganizations. Assigning exchange revenue to the components of an entity in this way is more effective for performance evaluation, price setting, and other purposes than assigning it to the reporting entity as a whole.
124. The gross cost, the exchange revenue, and the difference or net cost should be determined for each such component. The net cost and gross cost for each component could be used for such purposes as comparison with the outputs and outcomes of that component in order to assess the efficiency and effectiveness with which resources were used to achieve results.<sup>26</sup>
125. Good information on gross cost and net cost, determined and analyzed in this manner, is essential to the success of the Government Performance and Results Act of 1993 (GPRA)<sup>27</sup> in relating costs to accomplishments. GPRA requires agencies to set performance goals for program activity and establish performance indicators to measure outputs and outcomes of the program activity. Performance measurement under GPRA is to begin in FY 1999, and pilot projects started in FY 1994. Under the OMB plan to carry out GPRA, performance reports will show the results of what was actually accomplished (outputs and outcomes) with the resources used. The net cost of operations (as well as gross cost) should be a fundamental measure of these resources.
126. **Uncollectible amounts.** When realization of the full amount of recognized revenue is not probable, the standards require that a separate provision be made if the uncollectible amount can be reasonably estimated. The Board defines "probable" as "more likely than not." This definition, and measurability, are the criteria for recognizing losses due to uncollectible amounts of accounts receivable under Federal accounting standards.<sup>28</sup>
127. Government entities have an extraordinary responsibility to be accountable—to the President, the Congress, and the public. Because of this, it is appropriate to show

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<sup>26</sup>As noted previously, the specific measures of program economy, efficiency, and effectiveness that are feasible and appropriate will vary among programs.

<sup>27</sup>Public Law 103-62.

<sup>28</sup>SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 44-45 and 124-30.

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separately (1) the full revenue due under their established pricing arrangements, and (2) the amount of this revenue that they estimate will not be realized.

128. The Exposure Draft proposed that the entire provision for estimated uncollectible amounts be recognized as a revenue adjustment. It reasoned that, if some of the potential revenue is not likely to be received, this should be viewed as the failure to realize revenue or the absence of an inflow of resources. Some of the respondents also viewed the entire uncollectible amount as a shortfall in revenue, but a majority believed that credit losses were a cost of doing business. Businesses extend credit in order to finance their customers, and any losses in this line of activity are another kind of expense. Such treatment is required for direct loans and loan guarantees that follow the credit reform accounting standards of SFFAS No. 2. A particularly telling argument, made by some, was that credit losses should be a component of full cost when establishing prices for the sale of goods and services. This would be facilitated by recognizing credit losses as a bad debt expense rather than a revenue adjustment. For these reasons, the Board concluded that credit losses should be recognized as an expense.
129. Uncollectible amounts due to other reasons— such as returns, allowances, and price redeterminations—would, however, be recognized as revenue adjustments. This treatment is parallel with the treatment in this Statement of taxes and other nonexchange revenue, where refunds, adjustments, and abatements are deducted from gross revenue rather than recognized as an expense. Under current practice and private sector standards, these uncollectible amounts are commonly treated as revenue adjustments but are not always separately disclosed.
130. The bad debt expense and the revenue adjustment each needs to be separately shown in order for the entity to be accountable for the different reasons why revenue is not collectible.
131. The allowance for bad debts should be based on an analysis of both individual accounts and groups of accounts, as appropriate under the circumstances. This principle is explained in the standard for accounts receivable.<sup>29</sup> For intragovernmental transactions, allowances for bad debts may not always be needed, because full payment can often be assumed.

### Recognition: Special Cases

132. The general principles underlying exchange revenue recognition are supplemented for special cases.

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<sup>29</sup>Ibid., para. 44-51 and 131-133.

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133. **Gains and losses.** Gains and losses are recognized rather than revenues and expenses in order to differentiate unusual or nonrecurring transactions for evaluating an entity's performance or setting its prices. Material gains and losses are expected to be infrequent. They would normally be of a type that management would want to be considered in appraisals of its operations.
134. **Direct loans and loan guarantees.** Standards for direct loans and loan guarantees were established in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. The basic principle is to recognize the subsidy cost of the direct loan or loan guarantee as an expense when the loan is made. Subsidy cost is inherently a net concept: the present value of estimated cash outflows less the present value of estimated cash inflows over the life of the loan. This requires that the present value of estimated fees be recognized as a deduction in calculating subsidy cost, and that the present value of estimated defaults be included in calculating the subsidy cost. The standards for direct loans and loan guarantees that follow credit reform accounting thus differ from the standards in the present Statement in three respects: revenue is deducted in calculating the subsidy cost, bad debts are included in calculating the subsidy cost, and both revenue and bad debts are measured as present values.
135. Determining the subsidy cost in this way is a method of matching revenue with cost, and it is also a method of matching the subsidy cost with the provision of the subsidy to the public. SFFAS No. 2 is therefore consistent with the objectives of this Statement for exchange revenue, and the standards in this Statement do not apply to the recognition and measurement of revenue and credit losses for direct loans and loan guarantees that follow credit reform accounting. This exception includes pre-1992 direct loans and loan guarantees that have been restated on a present value basis. The guidance for classifying transactions in Appendix B reflects the provisions of SFFAS No. 2.
136. **Exchange revenue collected for others.** Many entities that collect exchange revenue keep that revenue for their own use. Revolving funds keep the revenue they earn. By their nature, they are expected to finance at least a material part of their cost by selling goods and services in a continuing cycle of business-type activity. Other collecting entities may also keep the revenue they earn. Sometimes, however, the exchange revenue is transferred to the General Fund or to other entities in whole or in part. For example, the Southeastern and Southwestern Power Administrations transfer the revenue they collect from the public to the General Fund of the Treasury; similarly the Western Area Power Administration, while retaining some of the revenue that it collects, transfers the rest to the General Fund and various special funds designated by law.
137. As a general rule, exchange revenue transferred to others must be offset against the collecting entity's gross cost to determine its net cost of operations. Exchange revenue reduces the net cost of operations incurred by the entity in producing outputs, regardless of

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whether the entity keeps the exchange revenue for its own use or transfers it to another operating entity or the General Fund. Likewise, exchange revenue reduces the net cost of the entity's operations to the taxpayer regardless of its disposition. Therefore, all exchange revenue related to the cost of operations must be deducted from gross cost to determine the net cost of operations for the entity.

138. Any exchange revenue that is transferred to others, however, does not affect the collecting entity's net position. Therefore, as required by the standards for other financing sources, such exchange revenue is recognized as a transfer-out in calculating the entity's operating results.
139. The only exception to the general rule occurs when the entity recognizes virtually no cost in earning the exchange revenue, as explained in the following section.
140. **Exchange revenue unrelated to recognized cost.** In exceptional cases, an entity may recognize virtually no costs in connection with earning exchange revenue that it collects. A major example for many years has been the Minerals Management Service (MMS) of the Department of the Interior. It manages energy and other mineral resources on the Outer Continental Shelf (OCS) and collects rents, royalties, and bonuses due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands. The rents, royalties, and bonuses are exchange revenues, earned by sales in the market. If the value of natural resources were recognized as an asset by MMS, then depletion could be recognized as a cost according to the units of production method as minerals were extracted.<sup>30</sup> The revenue from rents, royalties, and bonuses could then be matched against MMS's gross cost, including depletion and minor other costs, to determine its net cost of operations.
141. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards the value of natural resources is not recognized as an asset. As a result, this exchange revenue cannot be matched against the economic cost of operations and bears little relationship to the recognized cost of MMS. Therefore, it should not be subtracted from MMS's gross cost in determining its net cost of operations. If it were subtracted, the relationship between MMS's net cost of operations and its measures of performance would be distorted. The net cost of operations of the Department of the Interior would likewise be distorted.
142. MMS collects this revenue and distributes it to the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the

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<sup>30</sup>Methods of calculating depletion based on the economic cost of extraction, such as represented here, should be distinguished from depletion methods allowed under the Internal Revenue Code.

states, and Indian tribes and allottees. MMS should account for the exchange revenue it collects as an agent for the U.S. Treasury or other federal component entities as a custodial activity, which is an amount collected or to be collected for other federal entities, in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with SFFAS 31, *Accounting for Fiduciary Activities*. Because the revenue collected by MMS is exchange revenue, it should be recognized and measured under the exchange revenue standards when the rents, royalties, and bonuses are due pursuant to the contractual agreements.

SFFAS 31, *Accounting for Fiduciary Activities*, amended the provisions in paragraph 142. This amendment is effective for periods ending after September 30, 2008. To view the explanatory text prior to this date, please see the previous edition of the *FASAB Handbook* at <http://www.fasab.gov/codificaarchives.html>.

143. The rents, royalties, and bonuses transferred to Treasury for the General Fund or to other Government reporting entities should be recognized similarly by these recipient entities. The revenue is exchange revenue and should be recognized and measured under the exchange revenue standards. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, the revenue should not offset the cost of operations for the U.S. Government as a whole or for these entities. As in the case of MMS, offsetting cost by this revenue would distort the relationship between the net cost of operations and the measures of the performance of these entities. The exchange revenue should instead be a financing source in determining the operating results and change in net position.
144. The Board is addressing the accounting for natural resources in a separate project. If it concludes that the value of mineral rights should be recognized as an asset and depletion as a cost, it would be appropriate to recognize the exchange revenue from rents, royalties, and bonuses in determining the net cost of operations.
145. Although MMS is the most prominent case of an entity collecting exchange revenue for which it recognizes virtually no cost, there can be other instances. The Federal Communications Commission collects exchange revenue from the auction of the radio spectrum. Such revenue should be accounted for in the same way as the revenue collected by MMS.
146. One respondent to the Exposure Draft asked about the meaning of the term “virtually no costs.” If an entity sells scrap metal or fully depreciated equipment, the exchange revenue or gain is not related to any cost that is recognized at the time of sale. These assets are recorded on the balance sheet as having no value at the time of sale, so the gross proceeds

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from the sale are not offset by any remaining book value in calculating the entity's gain. However, unlike the auctions of petroleum rights or the radio spectrum, costs were recognized in past periods for the purchase of the materials or the use of the equipment. Therefore, offsetting the entity's cost by its gains from sale provides a more accurate measure of its net cost of operations over time for comparison with measures of its performance over time. The standard has been clarified to say that the term "virtually no costs" means that virtually no costs are recognized during past periods as well as during the current period.

147. It is also possible that an entity's cost accounting may not assign any costs to byproducts of its major goods or services. However, cost is recognized for the activities that produced both the major products and the byproducts. All revenue earned in connection with these activities needs to be offset against the cost of these activities in determining the entity's net cost for the purpose of making comparisons with its measures of performance.
148. **Specific goods (or services) made to order compared with goods made for inventory.** When an entity produces goods for sale, revenue can be matched with cost in either of two ways: (1) revenue and expense can be recognized as costs are incurred, or (2) the expenditures can be recorded in inventory, with the revenue and expense recognized subsequently when the goods are delivered to the customer.
149. For specific goods made to order under a contract (or specific services produced to order), the standard requires that revenue be recognized as goods and services are acquired to fulfill the contract. More precisely, the standard requires that revenue, as determined by the contract price, be recognized in proportion to the estimated total cost as goods and services are acquired to fulfill the contract. This means that the percentage-of-completion method must be used and the amounts of revenue must be calculated based on the costs of the goods and services acquired to date to fulfill the contract in relationship to the estimated total cost under the contract. If the time period and estimated total cost are uncertain, revenue recognition should be deferred until a firm basis can be established to assign cost. Goods and services made (or produced) to order include such projects as building construction and ship repair, where costs are incurred over a period of time to provide a particular good or service to a specific customer according to characteristics determined by contract. They do not include the sale of standard services, such as electricity, under a contract.
150. Recognizing revenue and cost in this way provides an up-to-date measure of the entity's operations in providing goods and services. The revenue and cost are generated by the entity's activities during the current reporting period, unlike alternative recognition standards. In particular, this is unlike the completed contract method, under which the revenue and cost recognized in a period may have been generated substantially during previous periods. Because the revenue and cost recognized in the reporting period are up-

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to-date, they can more readily be compared with each other and with current outputs in evaluating the entity's performance and pricing policy in that period.

151. In some instances, however, there may be no material difference between the percentage-of-completion method and the completed contract method. This is especially likely for small or short-term contracts. In such instances, the completed contract method could be followed.
152. The standard also requires that when a loss on a contract is probable (more likely than not) and measurable (reasonably estimable), it should be recognized over the life of the contract in proportion to the estimated total cost instead of immediately. This will come about by continuing to recognize revenue in proportion to estimated total cost and by continuing to recognize costs as goods and services are acquired to fulfill the contract. This requirement is an exception to SFFAS No. 5, Accounting for Liabilities of the Federal Government, under which a loss on a contract is recognized at the time when expected costs exceed expected revenue. The Board believes this exception is appropriate, because it provides a more accurate measure of the entity's net cost of operations during each reporting period than if the entire estimated loss were recognized in the single period when it was concluded that the loss was probable and measurable. The entire estimated loss, however, would be disclosed.
153. The standard is different when an entity produces goods to be kept "on the shelf" until ordered. It requires that manufacturing costs be charged to inventory and that revenue not be recognized until the goods are delivered to the customer. Costs and revenue are recognized later than when goods and services are made to order, because there is less assurance of revenue at the time when the costs are incurred. The term "delivery to the customer" includes instances in which the sale has taken place and the goods have been segregated or set aside for delivery.
154. **Classification of interest on intragovernmental balances.** Large amounts of interest are paid and received on intragovernmental balances. Most trust funds and some special funds and revolving funds have invested in special Treasury securities on which they earn interest due from the Treasury. Treasury and the Federal Financing Bank have made loans to a number of funds, on which those funds incur interest expense and on which interest is due to the Treasury or the Bank. The recorded interest revenue should be classified as exchange or nonexchange depending on the predominant source of funds upon which the interest payment is based. Other intragovernmental balances bear no interest. The Board is considering a project that might result in imputing interest where the balances bear no interest or the interest does not reflect the cost of borrowing by the Treasury.
155. The interest on these intragovernmental liabilities has the form of an exchange transaction, but often it does not also have the substance of an exchange. The standards in this



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Statement and the guidance in Appendix B, "Guidance on the Classification of Transactions," differentiate among inflows of resources according to whether or not they should be deducted from an entity's gross cost in determining its net cost of operations. This differentiation depends fundamentally on whether the inflow of resources is related to costs that the entity incurs and recognizes in order to produce outputs and the inflow of resources.

156. When applied to the receipt of interest by a Government account from the Treasury, this criterion implies that interest should be classified in the same way as the predominant source of revenue to the fund: as exchange revenue, if the predominant source is exchange revenue; and as nonexchange revenue, if the predominant source is nonexchange revenue. If the invested funds come from exchange revenue, the interest on these funds derives from exchange revenue and the costs incurred to earn that revenue; if the invested funds come from nonexchange revenue, the interest on these funds is based ultimately on the government's power to compel payment rather than on a market transaction. With certain exceptions, this means that interest received by trust funds and special funds should be classified as nonexchange revenue, whereas interest received by revolving funds and trust revolving funds should be classified as exchange revenue. This is explained below, together with the exceptions and certain analogous transactions.
157. Invested balances of trust funds (and special funds) predominantly derive from earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes). To a lesser extent they derive from other financing sources (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs any costs. Therefore, the interest on Treasury securities should not be deducted from the gross costs of the trust fund (or special fund) in determining its net cost of operations. As a result, that interest should not be classified as an exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue.
158. The invested balances of revolving funds, on the other hand, predominantly derive from the funds' business-type operations. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since the holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on their securities is related to the funds' costs of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue previously earned from the sales of goods and services, for which the funds incurred costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net

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cost of operations. For this reason, interest earned by revolving funds should be classified as exchange revenue.

159. A few revolving funds are classified by law as trust funds. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services; and the source is predominantly revenue previously earned from the sales of services, for which they incurred costs of operations. Their interest should therefore be classified in the same way as for other revolving funds, which is exchange revenue.
160. The three previous paragraphs explain the rationale for the normal classification of interest received by trust funds, special funds, revolving funds, and trust revolving funds. However, in some cases, the source of balances for trust funds and special funds may not be predominantly nonexchange revenue, and the source of balances for revolving funds and trust revolving funds may not be predominantly exchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and Disability Fund and the Military Retirement Fund, consists of exchange revenue and other financing sources. In such exceptional cases, interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.
161. Agencies may receive authority to borrow from Treasury (or the Federal Financing Bank), and they pay interest on their borrowings. The interest is a cost to the agency and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the agency borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the agency is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.
162. When debt securities are retired before maturity, there may be a difference between the reacquisition price and the net carrying value of the extinguished debt. This difference is a gain or loss that should be classified in the same category as the interest on the extinguished debt.

## Measurement

163. Exchange transactions with the public ordinarily take place at prices set by the agency or the Congress, such as electricity rates, book prices, and interest on delinquent taxes. Sometimes the market sets the price, as with the rents and royalties from companies that bid to explore and produce oil and gas on the Outer Continental Shelf. In either case the actual prices represent the inflow of resources to the entity and, therefore, are the appropriate basis for measuring revenue.

164. Except for prices set by law, OMB Circular No. A-25 and other regulations generally provide that user charges for transactions with the public should be set at full cost or market price.<sup>31</sup> However, compliance with these regulations is partial, and potential revenue is not realized in many cases. To help report users understand how the entity's operations are financed, disclosures are needed about (1) differences in pricing policy from the guidance in OMB's circular on user charges and (2) transactions where prices are set by law or executive order and are not based on full cost or market pricing. Other accompanying information is needed about the revenue foregone in these transactions but only if a reasonable estimate is practicable. The other accompanying information should explain whether, and to what extent, the quantity demanded was assumed to change as a result of the change in price.
165. Circular A-25 defines "full cost" as "all direct and indirect costs to any part of the Federal Government of providing a good, resource, or service."<sup>32</sup> This generic definition and the accompanying examples in the circular are generally consistent with the definition of "full cost" in the managerial cost accounting standards<sup>33</sup> and the recognition and measurement of many particular expenses in other Federal accounting standards.<sup>34</sup> However, unlike those standards, Circular A-25 also includes as part of the definition of full cost an annual rate of return on land, structures, equipment, and other capital resources (unless they are rented),<sup>35</sup> and it includes depreciation not only on structures and equipment that are classified as general PP&E (property, plant, and equipment), which is required by Federal accounting standards, but also on structures and equipment classified as stewardship PP&E, which in a

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<sup>31</sup>Circular No. A-25, User Charges, as revised July 8, 1993, establishes Federal policy regarding fees assessed for government services and for the sale or use of government goods or resources. It implements the provisions of Title V of the Independent Offices Appropriations Act of 1952 (31 U.S.C. 9701), which generally calls for "each service or thing of value provided by an agency . . . to a person . . . to be self-sustaining to the extent possible" and says that charges shall be based on a number of specified criteria including "the costs to the Government." The guidance of Circular A-25 also applies to the assessment of user charges under other statutes. However, Circular A-25 is intended to be applied only to the extent permitted by law or executive order; it does not apply to the legislative and judicial branches or to mixed-ownership government corporations; and its requirements are deemed to be met by other OMB circulars that provide guidance concerning a specific user charge area.

<sup>32</sup>Circular A-25, section 6(d)(1).

<sup>33</sup>SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 93-107.

<sup>34</sup>For example, the standards for expenses related to credit are stated in SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*; and numerous standards for expense are stated in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.

<sup>35</sup>The Board currently has a project to consider whether the rate of return on capital should be recognized as a cost in financial accounting statements.

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few cases may be used in connection with the production of goods or services for sale.<sup>36</sup> Aside from these differences, the cost accounting and other accounting standards should enable the Circular A-25 definition of full cost to be measured more accurately than has been possible heretofore.<sup>37</sup>

166. The appropriate basis for measuring revenue from intragovernmental exchange transactions is likewise the actual price (or reimbursement) that the seller receives from the buyer. Accounting systems should be able to provide the information needed to set the reimbursement at full cost, but often the full cost is not charged. In these cases, the amount of the reimbursement is an incomplete measure of the economic value of the transaction. When one entity receives goods or services from another without paying all related costs, the net operating cost of the receiving entity is understated if it does not recognize (by imputation) the additional cost paid by the providing entity.
167. Other Federal financial accounting standards require such inter-entity cost subsidies to be recognized by the receiving entity in certain cases.<sup>38</sup> This Statement, in the section on "Other Financing Sources," provides standards to recognize other financing sources that are imputed to offset whatever subsidy costs those other standards require to be recognized and imputed. Accounting for the imputed cost of goods and services provided by one Government entity to another requires the exercise of judgment, based on the specific circumstances of each case. Therefore, whether costs are imputed or not, the providing entity should disclose an explanation of the amount and reason for material disparities between the billing (if any) and the full cost.

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<sup>36</sup>The extent of differences between Circular A-25 and Federal accounting standards can be found by comparing Circular A-25, section 6(d)(1)(b), with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

<sup>37</sup>Circular A-25 says that "full cost shall be determined or estimated from the best available records of the agency, and new cost accounting systems need not be established solely for this purpose." See section 6(d)(1)(e). The cost accounting and other standards should improve agency records and specify the nature of costs more precisely and comprehensively.

<sup>38</sup>The general principles for recognizing imputed cost are stated in SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 105-115. The accounting is similar to the accounting for employee pensions and retirement health benefits, where the entity administering the plan does not provide goods or services to the reporting entity but does pay some or all of the cost. See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 56-93 and 148-181.

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## Nonexchange Revenue

### Inherent Limitations

168. **Inherent limitations on the ability to perform accrual accounting for nonexchange revenue.** Accrual accounting recognizes the financial effects of transactions and events when they occur, whether or not cash changes hands at that time. As it does with respect to exchange revenue, full accrual accounting for nonexchange revenue would enhance financial planning, control, and accountability. Full accrual accounting could provide important data with respect to future cash flows and tax policy and could improve the ability to evaluate the performance of the collecting entities and the exercise of their custodial responsibilities.
169. Unfortunately, the degree of accrual accounting that is practicable to perform for taxes and duties is limited by difficulties in ascertaining the amount of revenue arising from the underlying events and by the assessment processes used to manage the collecting functions. Taxpayers may not ascertain taxable income until after the underlying events. They may not file returns on their due dates, and due dates are generally set by the administrative processes after the occurrence of the underlying event. Also, the extent of non-compliance is a function of the laws establishing these entities and the expectations by the Congress and the Administration about how diligently the collecting entities should perform their collection functions. These inherent limitations on the ability to perform accrual accounting were considered by the Board.

### Practical Limitations

170. **Practical limitations were also considered by the Board.** The Board's standards for accrual accounting require that accruals mirror the established assessment processes of the collecting entities. As such, they do not require, for example, the accrual of taxes or duties which are likely to be assessed under established processes, but only those that are actually assessed under the defined processes of the collecting entities. Having accounting mirror the established process by which collecting entities interact with taxpayers has value, though arguably accounting for revenue should not be so limited.
171. At the time the Board began deliberations on this standard, accounting systems necessary to determine even the limited revenue accruals that are now required for taxes did not exist. The changes in systems required by this standard are limited to those necessary to mirror the established assessment processes. The Board understands that the Internal Revenue Service is attempting to improve its collection function and the related management information systems. Because such systems must also provide accounting information, the Board decided not to impose accounting standards at this time that might conflict with

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systems changes needed to improve the efficiency and effectiveness of the collection process or go beyond the minimum changes considered necessary to enable the collecting entities to properly discharge their responsibilities.

### Modified Cash Basis for Taxes and Duties

172. As a result of both the inherent limitations and the practical limitations accepted by the Board, the accrual standard, as it applies to taxes and duties, might be best characterized as a “modified cash” basis of accounting. These limitations on full accrual accounting required the amendment of the accounting standard on recognition of receivables as provided in paragraph 41 of SFFAS No. 1, which said, in effect, that taxes should be recognized as receivables when they are due from taxpayers.
173. In the future, the general standard for accrual as it applies to taxes and duties could be tightened to produce a fuller application of the accrual concept. For fines, penalties and donations, no accountable event precedes the recognition point established by this standard. Therefore, the general standard for recognition as it applies to these sources of revenue results in full accrual accounting for them.

### Cash Basis Information Needed

174. Cash basis information on taxes and duties continues to be very important because it is widely used for planning purposes at present and is a component of the budget. It is also available soon after the close of the reporting period and is needed to comply with laws that require cash-basis accounting in particular instances. Unfortunately, accurate cash-basis information to meet certain legal requirements and other information needs is not presently available. This standard accepts the importance of both types of information and requires entities that collect taxes and duties to provide both types of information.

### Potential Changes

175. Requirements for disclosures, supplementary information, and other accompanying information compensate to some extent for the modified cash basis of accounting for taxes and duties being approved at this time. In the future, the Board plans to evaluate users’ satisfaction with reports prepared on the basis of the standard and to give consideration to improvements being made in IRS processes and related management information systems. Based on this evaluation and consideration, it may propose to extend the degree of application of accrual accounting in several years time. In the interim, the Board will permit changes in accounting made at the initiative of a collecting entity if the changes represent a fuller application of accrual accounting than that prescribed by the standard. For example, compliance assessments for taxes or unasserted claims for drawbacks may be recognized

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rather than shown as supplementary information if the amounts are both probable and reasonably estimable.

### Entities Responsible for Measuring and Recognizing Revenue

176. Collecting entities, e.g., the Internal Revenue Service and the Customs Service, collect cash and administer the assessment processes that provide the basis for adjusting those collections to an accrual basis. They, therefore, have measurement and reporting responsibilities for these inflows of resources. They also, at the direction of the Treasury Department, account for the disposition of these inflows to recipient entities. The Treasury determines the amounts payable to the recipient entities and, in conjunction with the collecting entities, makes the actual cash payments, or issues special Treasury securities, as necessary, to fund the amounts transferred. Because the recipient entities are designated by law to receive the inflows and make ultimate disposition of the funds, they, rather than the collecting entities, must recognize the inflows as revenues in order to provide financial statements which are meaningful to users.

### Possible Over- and Under-funding of Trust Funds

177. The standard provides that trust funds should recognize the amounts transferred (and the change during the period of the amounts to be transferred) from the collecting entity as revenue despite the fact that those transfers may not be made on the basis of applicable law. In the case of excise taxes, transferring more than the amounts actually collected may cause these trust funds to be over-funded. The Board is advised by its legal counsel that this is a violation of law by the IRS. Such violations cannot be remedied unless, and until, the IRS adopts methods to collect the needed data from taxpayers. In the case of Social Security, weaknesses in the data collection methods may cause these trust funds to be under-funded. The Board is advised by its legal counsel that so long as IRS and SSA act on the basis of the best available information there is no violation of law. In considering these two situations, the Board concluded that it should not set an accounting standard with which the recipient entities could not comply and, therefore, accepted the present basis of making transfers to them as the basis of recognition of revenue by them. However, the Board believes that both the collecting entity and the recipient entity have the responsibility to disclose any violation of law and to provide, as supplementary information, if estimable, amounts by which the trust funds may be over- or under-funded.

### Conceptual Criteria for Accrual and Limitations on Their Application

178. As mentioned earlier, this standard recognizes both inherent and certain practical limitations on the application of the accrual concept to taxes and duties. The conceptual criteria for full accrual accounting for taxes and duties are the underlying taxable events, a precondition for

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the government to assert a demand for payment, and a demand date itself. A demand date conceivably could be as early as a date contemporaneous with the underlying events.

179. **The underlying taxable events.** Conceptually, certain Government taxes and duties could be accrued based on particular events, and certain others on events that take place over a period. Excise taxes and customs duties are examples of taxes based on particular events (sales or importing goods). Individual and corporation income taxes are examples of taxes based on events that take place over a period (e.g., income earned over the course of a year). Indeed, some taxpayers who prepare accrual-basis financial statements for themselves normally accrue taxes due to the government based on the underlying events.
180. Data about underlying events is supplied to collecting entities through returns required to be filed by taxpayers. Unfortunately, non-compliance with return requirements is estimated to account for more than \$100 billion annually in uncollected taxes. Only a relatively small portion of this amount is ultimately collected through the enforcement processes of the collecting entities. Estimates of this tax gap made from time-to-time have provided some information to guide enforcement efforts with respect to particular groups of tax payers, but do not provide sufficient information to establish claims against individual non-compliant taxpayers or defined groups of non-compliant taxpayers. Therefore, the underlying-event criterion for recognition can only be applied to the extent that taxpayers file tax returns<sup>39</sup> or the collecting entities determine through their enforcement processes that specific non-compliant taxpayers owe or might owe taxes.
181. **The demand date.** To obtain taxes and duties, the government must demand the payment. The criterion for revenue recognition under this concept could be that the demand date for taxes and duties is the same as the date the underlying taxable event occurs or over the period that the underlying taxable event occurs, e.g., as taxable income is earned by the taxpayer. However, demand dates presently defined by established assessment processes are the dates payments are required to be received by the collecting entities. They include dates for withholding and estimated tax payment as well as the final due dates for tax returns. These dates provide administrative convenience for taxpayers and generally lag the underlying events. Because of the emphasis on cash, those payments made in advance of due dates for payment are not deferred for accounting purposes. Past-due taxes as a result of taxpayer failure to comply with established payment dates are not accrued until the collecting entities receive late tax returns from such taxpayers, or until the collecting entities determine through their enforcement processes that the Government has a legally

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<sup>39</sup>Even if all taxpayers filed returns, the underlying event criterion for most taxpayers is their income for the calendar year, whereas the government's fiscal year ends September 30. Presently required estimated tax payments do not eliminate the problem of measuring taxes based on an "artificial" nine months period ending September 30 for calendar year taxpayers whose income for the following three month "stub" period ending December 31 could be disproportionate.



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enforceable claim. Only then are accounting accruals triggered under this standard. Those dates lag the underlying events by more than necessary to determine an accrual. The aforementioned limitations on the application of the demand criterion, which are arguably practical ones, further constrain the conceptual basis for accrual.

### Limitations on the Scope of Accounting

182. Although relevant to the cost of the Government from an economic perspective, to Government fiscal policies, and to performance evaluation of Government reporting entities, the Board concluded not to require information on “tax expenditures” or expenditures that federal laws require others to make, i.e., “directed flows of resources.” There were a variety of opinions among Board members on the need for this information and different reasons given for not requiring some form of disclosure, but all Board members agreed that relevant amounts are not normally measured under present accounting concepts. However, information may be provided under certain circumstances, but outside the financial statements themselves.

### Some Benefits of this Standard

**183. Some of the benefits of the accrual requirements of this standard:**

- Reporting the “accrual adjustment” as a separately identified adjustment of taxes and duties collected. This preserves needed cash-basis information.
- Improving the data for both accrual- and cash-basis information. The standard accomplishes this because all transactions for which accounting could be performed under the standard will need to be processed. Some of these have not been accounted for in past financial reports because of delays in processing transactions at the end of the year.
- Accrual of assessments. Accounts receivable would be accrued based on returns filed or enforcement actions taken through the end of the period where such returns or actions have not yet resulted in cash receipts. A statistical estimate of the effect of this standard, as of September 30, 1993, disclosed approximately \$29 billion of net accounts receivable after deducting an allowance for uncollectible amounts of \$42 billion. Heretofore, net accounts receivable were thought to be in excess of \$100 billion. The accounting requirements for accrual should further improve the accuracy of the amount of accounts receivable.
- Recognition of refunds payable will provide some indication of the lag in making refunds to taxpayers.

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## Some Things this Standard Does Not Accomplish

### 184. **Some of the things this standard does not accomplish:**

- Recognizing events after the close of the reporting period, such as cash received on later due dates, even if the receipt results from the underlying taxable events of the period. For example, unemployment taxes for the September 30 quarter are due in October and will be recognized in October if received on the October due date.
- Deferring recognition of revenue for tax payments that may be received before the demand or underlying event. For example, voluntary over-withholding by taxpayers will be treated as revenue.
- Recognizing compliance assessments and pre-assessment work in process or refunds before completion of the assessment processes. As a result, variations in the speed and effectiveness of the assessment processes will affect the amount accrued at the end of a fiscal period. Another result is that accounting information relative to measurement of the performance of the compliance functions by the collecting entities will not be available.
- Recognizing the tax gap, i.e., taxes (which include duties) due from unidentified non-compliant taxpayers and importers. As a result, this large potential source of revenue will not receive as much attention as it would if it could be made a formal part of the collecting entity's accountability.
- Accounting for "tax expenditures," which may contribute to the programs of reporting entities, or "directed flows of resources," which may substitute for program costs which might otherwise need to be incurred by reporting entities. These amounts are very large in relation to the "on budget" program amounts which are measured by accounting. As a result, these materially important performance and cost related data may not be fully considered.

## Accounting Systems Changes

185. The IRS accounting system at present does not account for revenue transactions on an accrual basis and, therefore, does not establish accounts receivable, refunds payable, and the allowance for uncollectible accounts on the basis of the flow of all the various events and transactions affecting these balances. Instead of being an accrual accounting system, all assessments are recorded in an operating file not designed to do accounting and not operated under a double entry concept where the revenue effects of assessments are determined. That operating file, for example, includes multiple assessments made for the same tax claim so that the IRS can pursue all potential sources for the payment of that claim. As a result of the present limitations of this operating file, to determine the accounts receivable at any point in time, the IRS must make a statistical projection of a representative sample of valid tax claims. The potential error in the estimates made to date have been material, i.e., in excess of \$5 billion.

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186. This standard contemplates that systems and accounting records will be put in place to permit the accurate determination and disclosure of all revenue and cash transactions which are reflected in the formal assessment process. By treating information relating to compliance assessments, pre-assessment work in process, and refunds before the completion of the assessment process as supplementary information, this standard contemplates that statistical estimates, rather than transaction-driven accounting systems and auditable subsidiary accounting records for individual taxpayers, may be used to provide the dollar values for these important revenue-related items.

### Disclosures, Supplementary Information, and Other Accompanying Information

187. This additional information will help users of federal financial reports in understanding the following:

**187.1 Components of the revenue stream.** By disclosing the dollar amounts of the material types of transactions reflected in the required “modified cash basis” revenue stream (from initial recognition by the established assessment process through cash collections and refunds), important accountability information for oversight and performance evaluation will be provided about the tax collection function. Providing as much accurate and detailed information as possible about the annual flow of taxpayer funds (now over \$1 trillion) is important because the administration of the collection function is to some degree discretionary.<sup>40</sup>

**187.2 Cash flows.** By disclosing cash flows by type of tax and tax year, accurate historical information will be provided about the source and timing of the annual flow. Material trends in collection and refund patterns may be apparent from the comparative financial statements presented and by reference to financial statements of prior periods. Both the ability to accurately forecast future flows and to understand the speed and effectiveness of the collection function should be enhanced by this information. Also, an indication of the degree of potentially correctable “error” from the use of a modified cash basis of accounting should be provided by this cumulative cash flow data.

**187.3 Other future-oriented information.** Disclosures about categories of accounts receivable provide additional information about collection problems and timing of future cash flows. At IRS, different categories of receivables vary considerably in terms of ultimate collectability and timing of collection.

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<sup>40</sup>Pursuant to law, Customs establishes legal assessments for fines in amounts which frequently materially exceed the value of the goods, then subsequently abates the fine to a fraction of that value, also in accordance with applicable law. Full disclosure and explanation of practice should aid better understanding of the significance of assessments, abatements, and uncollectible amounts reported by Customs. [Text deleted by SFFAS No. 22.]

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**187.4 Other potentially reportable revenue.** Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment processes provides indications of the amounts of potentially accruable revenue. If such amounts were ultimately accrued, the “accrual adjustment” on a modified cash basis would be converted to an “accrual adjustment” that came closer to an estimate of the effect of full accrual accounting. Some or all of these potential accounts receivable and payable may become measurable by the collecting entities, and the Board may require their accrual when the collecting entities’ management systems are improved.

**187.5 Sharing of the income tax burden.** Other accompanying information about the tax gap and IRS historical information showing income, deductions, and credits by income level (assets for corporations) responds to those concerned with the extent of non-compliance with the laws and how the income tax burden is shared among compliant taxpayers.

**187.6 Administration of the tax laws by the collecting agencies.** Disclosures, supplementary information, and other accompanying information provide a more complete picture of how the collecting agencies are functioning. This information may be relevant to allocation of resources to collecting agencies, to their performance appraisal, and to their oversight.

- Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment process shows the backlog in processing assessments and refunds.
- The disclosure and supplementary information with respect to over-and under-funding of the trust funds identifies administrative problems to be overcome.
- Disclosure of abatement of assessed taxes with respect to non-compliant taxpayers (\$37 billion by the IRS in 1993) provides some information about the administrative discretion exercised by collecting entities. However, no information is required about reductions of possibly material amounts in compliance assessments and pre-assessment work in process as a result of the resolution of examinations, investigations, protests, and litigation. Therefore, accounting reports will not include data about these processes, which involve an even higher degree of administrative discretion than the formal assessment process. Nor will they provide data, e.g., compliance assessments made during the reporting period, that might be related to the cost of compliance, e.g., salaries of revenue agents and related administrative costs, that might be relevant to evaluating the performance of the collecting entities’ compliance function.

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## Tax Gap

188. The exposure draft proposed that available information about the nonexchange revenue gap, including the tax gap, be provided as “other accompanying information.” This information would not have been subject to audit, and the auditor’s responsibility would have been limited to reporting if it was materially misleading in light of the information gathered during the audit. Substantially all of the revenue gap is the tax gap because duties are technically a type of tax, so the Board decided to deal only with the tax gap. The sources of non-compliance that cause the tax gap include unreported income, overstated exemptions, and overstated deductions. The largest component of the tax gap relates to income taxes. IRS originally estimated the gross income tax gap at \$94 billion for tax year 1987. The net income tax gap for 1987, which is the gross income tax gap less the estimated amount that has been or will be collected through IRS’s enforcement efforts, is now estimated at \$72 billion. Thus, with respect to 1987, later collections from non-compliant taxpayers are about \$22 billion. Estimates of the income tax gap cover only taxes on legally earned income of individuals and corporations—not taxes owed from illegal sources of income such as drugs and prostitution.<sup>41</sup>
189. Estimates of the tax gap by IRS have been made from time to time. Congress recently concluded not to authorize a current study<sup>42</sup> and there is no present plan to conduct another one. On the other hand, Customs makes estimates of amounts due from unknown non-compliant importers. The Board concluded, therefore, that the standard should require only that any estimates by the Government of the tax gap be presented when they were relevant, i.e., provided reasonably current information is available.
190. Some respondents to the exposure draft believed that tax gap information is important, but others believed it is too imprecise to be a required disclosure. The Board considered establishing a new category of information “Required Supplementary Stewardship Information” (RSSI) for the “unidentified persons or entities” portion of the tax gap. This concept is also being considered for application to certain “Stewardship Information.” The Board concluded that for the time being this standard should say that available information about the tax gap should be provided as other accompanying information. In addition to the tax gap information requirements (see para. 69.2), other accompanying information is required or permitted under certain circumstances with respect to (a) the income tax burden (see para. 69.1), (b) tax expenditures (see para. 69.3), (c) directed flows of resources (see para. 69.4), and (d) revenue foregone for exchange transactions (see para. 47).

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<sup>41</sup>For details see [Net Tax Gap and Remittance Gap Estimates](#) (Supplement to Publication 7285), Publication 1415 (4-90), Internal Revenue Service; and [Tax Gap: Many Actions Taken, But a Cohesive Compliance Strategy Needed](#), GAO/GGD-94-123, May 1994.

<sup>42</sup>The Tax Compliance Measurement Program (TCMP) planned for 1996.

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191. The Board intends to review the requirements in this standard to provide other accompanying information when it considers standards for the Management Discussion and Analysis (MD&A). The Board may decide to modify the information requirements when it considers the degree to which this information should be subject to some sort of audit scrutiny. Auditing standards for the MD&A have not been established by any auditing standard setters, including the Comptroller General, who establishes standards for auditors who audit federal organizations, programs, and activities. It is expected that audit standards for an MD&A will be considered by the Comptroller General's Advisory Council and standards may be set later by the Comptroller General. Particular audit requirements for MD&A may be set by agreement between OMB and GAO if consistent with any such standards then existing. When the Board's project on MD&A is considered, OMB and GAO plan to give consideration to the auditing requirements for MD&A and to the concept of RSSI.

## Tax Expenditures

192. Tax expenditures are estimates of the revenue foregone because of preferential provisions of the tax structure. They are due to special exclusions, exemptions, deductions, credits, deferrals, and tax rates that depart from a "baseline." These exceptions are generally intended to achieve public policy objectives by providing benefits to qualifying individuals or entities or by encouraging particular activities. They also may be intended to improve tax equity or offset imperfections in other parts of the tax structure. Tax expenditures are not revenue. They are not inflows of resources to the reporting entity.

193. The following are some examples of tax expenditures (with estimates from the Treasury Department of the revenue foregone in FY 1995):

- the exclusion from gross income of the housing and meals provided military personnel (\$2.0 billion);
- tax credits for expenditures to preserve and restore historic structures (\$0.1 billion) and to produce "alternative" fuels (\$1.0 billion);
- exclusion from gross income of employee compensation in the form of health insurance premiums and other medical care (\$59.4 billion); and
- deductions for mortgage interest (\$48.1 billion) and state and local property taxes (\$15.3 billion) on owner-occupied homes.

194. The Board considered a proposal to require each reporting entity to provide supplementary information on tax expenditures related to its missions. The amounts reported would have been the Treasury Department's estimates that are published in the President's budget.

195. Those who supported that proposal believe that this information is relevant to evaluating the performance of Government programs that have related tax expenditures. Some of these

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tax expenditures are very closely tied to program operations. Others are less closely tied to an agency's operating activities but still relate to its mission. For example, the preferential treatment of owner-occupied homes can be related to HUD's mission to promote good housing for the nation.

196. Furthermore, policy makers may compare changes in tax expenditures with changes in direct budgetary outlays. They did so, for example, in 1983 and 1993 when they increased the taxation of Social Security benefits but alternatively could have reduced the cost-of-living adjustment. In ways such as these, the reporting on the costs and accomplishments of an entity is incomplete unless it includes the tax expenditures related to its missions.
197. The Board decided not to require supplementary information on tax expenditures in component entity financial statements for several reasons. The definition of the baseline for comparison is in part a matter of values and judgment. In some cases the association with particular programs is not sufficiently clear. Furthermore, the information is available elsewhere now. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on tax expenditures that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

#### Directed Flows of Resources

198. The Board considered a proposal to require each entity to provide supplementary estimates of the material annual expense to nonfederal entities of existing federal laws and regulations associated with its programs. The requirement would have been limited to regulations that establish standards for the characteristics of products or for the methods of production, or that mandate expenditures by state and local governments. These estimates would not necessarily have included nonpecuniary costs, although nonpecuniary costs might have been included to the extent identifiable. Each entity also would have provided any appropriate explanations about availability of data and limitations on the reliability of the estimates.
199. Advocates of the proposal believe that the Government pursues some of its goals by requiring states, local governments, and private entities to spend funds for specified public purposes. For example, the Government may require states to extend the coverage of Medicaid, communities to have water treatment plants that meet Government safety standards, firms to minimize their workers' exposure to asbestos, and automobile manufacturers to install air bags. When the regulations apply to state and local governments, they are generally called "unfunded mandates."
200. The costs and financing of federal regulations do not flow through the Government, but their effects are similar to the effects of direct federal expenditures and revenue. Fundamentally, both regulation and federal expenditure allocate resources to the purposes specified by the

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Government. The cost of regulation includes regulations imposed in the past as well as newly issued regulations. Furthermore, expenditure required by regulation may be an alternative means of achieving the same public policy goals as direct federal expenditure or other methods. For example, Medicaid coverage may be extended with or without more federal grants.

201. Advocates of this requirement believe that financial reports that omit important financial effects of Governmental action do not fairly present the results of the Government's operations. Such reports fail to achieve the objectives of federal financial reporting. They believe that the efforts and accomplishments with which an agency pursues its goals can be properly assessed only if the financial reports include all material information. This means that the reports should bring together information about the net cost of operations, the tax expenditures, and the directed flows of resources that are intended to achieve the same or similar missions.
202. The Board decided not to require supplementary information on directed flows for several reasons. Much of this information is not available now and will not be available to preparers of financial reports without added expense. In some cases the estimates would be very imprecise. Finally, most Board members believe that the scope of Government financial reporting should not extend to flows of financial resources that are not inflows to, or outflows from, federal Government reporting entities. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on directed flows of resources that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

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## Other Financing Sources And Budgetary Resources

### General Principles

203. The standards for other financing sources and budgetary resources should satisfy several of the objectives of financial reporting such as: (1) explaining the relationship of budgetary resources obligated to the net cost of operations, (2) showing how budgetary resources were used and the status of budgetary resources at the end of the period, and (3) indicating the effect on the net results of operations of the entity of all the financing sources used to finance the net cost of operations. However, financing from a financial accounting (proprietary) perspective is different than the budgetary accounting perspective.
204. The budget is the primary financial planning and control tool of the Government. Its objectives, such as planning resource allocation, authorizing and controlling obligations, planning cash disbursements, and raising revenue, differ from those of financial reporting where the focus is on net cost of the entity's programs and activities and stewardship of its



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assets and liabilities. Differing objectives are responsible for some but not all of the many differences in these two financial management tools. Differences in standards for measuring and reporting budgetary and financial information, coupled with unreliable data, have caused financial statements to be under-utilized by Government managers, the budget community, and others who might benefit from financial information.

### Reducing Differences

205. The problem of unreliable data is being addressed through financial statement audits that will include both proprietary and budgetary information and improvements in financial management systems. These federal accounting standards reduce unnecessary differences between the information reported in these two tools of financial management and require reconciliations and data to explain necessary differences. This should increase the utility of the financial planning and control information provided by the flow statements in general purpose financial reports and enhance the usefulness of the other accountability information provided, e.g., the Balance Sheet. This should occur because those who focus on the budget will better understand the financial statements and find them to be reliable and useful reports.
206. The new recognition and measurement standards for financial accounting adopt budgetary flow concepts for appropriations and provide consistent flow standards for nonbudgetary resources. As explained earlier, standards for recognition of nonexchange revenue reported by Government entities reflect legal requirements. These changes make the reporting on financing for entity net costs more consistent among entities and more comparable to the budget.
207. However, differences inherent in the different objectives of the budget and the financial statements must remain. The obligation basis for the budget differs from the costs-incurred basis for the financial statements. This difference must continue in order for both types of information to serve their purposes. Some budgetary resources are used to invest in assets and therefore are not reflected in operating costs. Also, an entity may incur costs that were covered by previously provided budgetary resources (e.g., depreciation), costs not yet covered by budgetary resources (e.g., accrued annual leave), or costs covered by budgetary resources of other entities (e.g., some pension costs). Continuing these differences in the accounting reports is essential if financial statements are to report cost information that can be related to entities' outputs and if the statements are to report other information on the resources over which the entities are accountable. These remaining differences need to be explained in the financial statements to increase the utility of the financial statements.

### The Budgetary Process and Its Linkage to Accounting

208. The budget controls obligations and thus ultimately controls expenditures by Government entities. In this sense, it is about their outflows of resources. Conversely, the budget makes inflows of resources available to component entities to finance expenditures. The inflows

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are reported in the financial statements as revenues and other financing sources (e.g., appropriations).

209. The budgetary process provides a component entity with budgetary resources through appropriations acts. Budget authority may be provided in the form of appropriations, borrowing authority, contract authority, or spending authority from offsetting collections. An appropriation may make funds available from the General Fund, special funds, or trust funds—including amounts received from earmarked taxes—or may authorize the spending of offsetting collections credited to expenditure accounts. Budgetary resources also include unobligated balances remaining from prior reporting periods and a number of adjustments (e.g., recoveries of prior year obligations). Execution of the budget includes the obligation of budgetary resources and the outlays to liquidate the obligations.
210. Borrowing authority is sometimes used instead of appropriations to incur obligations and make payments to liquidate them out of borrowed money. However, borrowing money under this authority does not change the net position of the entity. The liability created by the borrowing is recorded along with the related asset (the cash borrowed). Repayment of the liability later will normally require the use of an offsetting collection or an appropriation. Assets acquired as a result of borrowing may be later amortized or written off and become part of an entity's costs. When this occurs, or in the unusual event that the borrowing finances expenses rather than assets, the entity's net position will be reduced.
211. Contract authority is not a reportable financing source because it only allows agencies to incur obligations in advance of receiving funds to pay for any resulting liabilities. The funds to liquidate any resulting liabilities will come from an appropriation or offsetting collections. For financial statement purposes, a financing source is recognized in accordance with the appropriate accounting standards for the type of financing received to liquidate the liability. Under past practice the financing was recognized at the time liabilities were incurred, but under the new standard the financing will not be recognized until liquidating appropriations are made available, which may be in the same reporting period as the liability is incurred or a later period.
212. Appropriations, including permanent indefinite appropriations, are the most widely used form of budget authority. When obligated by orders for, or receipt or provision of, goods, services, or benefits, they are reflected as obligations incurred.<sup>43</sup> When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.
213. From the budgetary perspective, appropriations include dedicated tax receipts, such as Social Security taxes and Highway Trust Fund excise taxes. From a proprietary perspective,

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<sup>43</sup>Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered budget authority.

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on the other hand, unexpended appropriations do not include dedicated tax receipts, because these receipts are accounted for as nonexchange revenue. Therefore, appropriations used do not include dedicated tax receipts, thus avoiding double counting of these amounts as financing sources.

214. The accounting treatment for recognizing “appropriations used” as a financing source parallels the budgetary accounting for expended appropriations. Expended appropriations are recognized when goods and services ordered have been delivered, when benefits are payable to recipients, or when funds available under a grant agreement are payable, and there is an available appropriation to pay these amounts. Under this standard, this is also the time when “appropriations used” is recognized as a financing source in the proprietary accounts.
215. Thus, at the time a liability is established which will be paid by an available appropriation, appropriations are considered used. Liabilities should be established in accordance with SFFAS No. 5. Under that standard, a liability can be established in several ways, and the type of transaction that has occurred governs when a liability has occurred. For example, grants can be provided under different transactions. Some can be provided without any required exchange of service with the federal government, while others may require specific activities to occur before the funds are available.
216. Providing funds from an appropriation does not necessarily cause the recognition of a financing source if that payment is an advance. For example, an entity may advance funds to a grantee under the grant agreement. This should not cause recognition of a financing source. The recognition of appropriations used would not occur until the grantee meets the requirements that allow it to use the funds in accordance with the grant agreement.
217. The focus on net cost rather than on matching financing with expenses as incurred provided an opportunity to simplify the accounting for appropriations and to eliminate one of the differences between financial and budgetary accounting. Reporting entities will no longer have to defer recognition of appropriations used nor accrue appropriations before they become available.
- Recognition was previously deferred for appropriations used to finance capitalized transactions, such as the purchase of a fixed asset or the making of a loan under pre-credit reform programs which have not converted their accounts to a present value basis. The use of financing was previously recognized at the same time and rate that depreciation of the asset’s cost was recognized as an expense or that bad debts expense was recognized on pre-credit reform receivables which had not been converted to present values.
  - Accrual of appropriations as amounts receivable was sometimes allowed for costs incurred but not funded until after the period the costs were incurred, such as subsidy

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reestimates under the Credit Reform Act. Reestimates of subsidy cost for credit programs are made at or after the end of a period for which the reestimate applies and for which an expense is recognized, but the permanent indefinite authority is not available until the following period. When a financing accrual was not used for unfunded expenses, the unfunded expenses were removed from cumulative results of operations and reported separately in net position as future funding requirements.

218. These changes eliminate reporting invested capital and future financing sources in equity. These two equity accounts did not provide accurate information because invested capital was never expected to be returned and future financing requirements did not cover all future financing needed but only that amount which had been recognized as expenses.
219. An appropriation may provide an agency with the authority to obligate and expend earmarked receipts to which it is legally entitled and its offsetting collections. Most of these inflows of resources are classified and accounted for as either exchange or nonexchange revenue in accord with the accounting standards previously discussed. However, the relationship is not exact between these revenues and related new budget authority. For example, some offsetting collections are neither a revenue nor a financing source. They only change the form of a resource already reported on the Balance Sheet (e.g., funds received from the sale of an asset at book value). Some offsetting collections are credited to receipt accounts instead of expenditure accounts and cannot be obligated without specific appropriation. Some of these revenues are precluded from obligation in a fiscal year by a provision of law, such as a benefit formula that determines obligations, or by a limit on the amount of obligations that can be incurred. Amounts precluded from obligation are not counted as budget authority in that year.
220. By recognizing nonbudgetary resources, e.g., imputed financing and transfers, the financial statements of the entity will show how its recorded costs were financed by the budgetary resources of other entities as well as its own.
- (a) “Imputed financing” sources are reported to offset budgeted costs of another entity that applicable accounting standards impute to the reporting entity.<sup>44</sup> The imputing process recognizes these costs in the net cost of operations of the responsible entity. By reflecting “imputed financing” in the changes in net position, the net position of the responsible entity is not affected and there is no double counting.
  - (b) “Transfers-in” and “Transfers-out” are necessary to show transfers of assets or revenue from one Government entity to another. In the case of assets, the transferor’s

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<sup>44</sup>Imputed financing sources may be reported to recognize imputed costs that have not yet been budgeted for other entities, such as for pensions and retirement health care.

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budget reflected the original expenditure for the asset, but the budget normally does not reflect the subsequent transfer of the asset. The transfer changes the entity's financial position at the time of transfer but not its net cost of operations. Therefore, it is recognized in determining the net results of operations for the reporting period but not net cost.

221. In the case of earned revenue, the budget may require the earned revenue inflow related to the entity's costs to be paid to the General Fund or another entity. Reporting the transfer-out of such revenue as a reduction in net results of operations lets the responsible entity properly report its earnings in net cost of operations without increasing its net position.
222. Donations are not included as receipts in the budget, except for cash and near-cash items. However, some other kinds of donations are also recognized as revenue. Such revenues are permanent differences between the budget and the financial statements. Donation revenue will increase net results of operations under these standards. Under the standard, accounting for donations is consistent with current practice in the private sector where contributions are recognized as revenue.
223. Costs that are not yet covered by budgetary resources are "permanent" differences until Congress acts to finance them in the budget or until permanent budget authority becomes available. Under the new standards, financing yet to be provided for recorded costs will not be accrued. Accordingly, it will not increase cumulative results of operations.

#### Implications of the Term "Net Results of Operations"

224. Some of those who commented on the exposure draft expressed concern that some readers might infer that the amount of "net results of operations" reported on the new Statement of Changes in Net Position was a relevant performance measure. Some financial statement users might draw such an inference because, in the private sector, the term "net results of operations" is synonymous with net income and net income is the "bottom line" performance measure. Similarly, the statement of operations used by federal reporting entities prior to implementation of SFFAS No. 7 focused on a similar bottom line, net results of operations. This was the result of showing the flow of all operating activities on a single statement. For most governmental entities, however, no single bottom line can accurately measure performance, and "net results of operations" normally provides little information on either the costs or the benefits of an entity's operations.
225. The new reporting model, illustrated in Entity and Display, focuses on measuring costs and reporting on performance. Both gross and net cost are key financial performance measures that can be related to outputs and outcomes of the entity's programs and activities.

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## Dedicated Collections

226. The exposure draft proposed disclosure requirements for trust funds that were included within the reporting entity's financial statements in total and for material individual fund. The information was proposed to provide users a basis for understanding these funds and for holding the Government accountable for the use and disposition of earmarked collections. Based on comments received, this standard changes what was proposed as follows.
- A. The proposed standard did not cover funds administered by a federal entity in a fiduciary relationship with beneficiaries that were not included in the entity's financial statement. In addition, it did not cover other funds which are of the same nature as many trust funds. The standard now requires disclosures for these funds also.
  - B. The requirement for a total for all funds was modified. If the fund is not material to the reporting entity, disclosure may be made in a special report to the contributors and beneficiaries (or their representatives) and only disclosure of the total of these funds is required.
227. **User needs.** Funds that account for dedicated collections are of great interest to users of federal financial statements. First and foremost are the contributors and beneficiaries to which the Government needs to be accountable for the receipt and disposition of earmarked collections and for the balances that remain available to pay beneficiaries in the future or serve other purposes determined by law. Other users are interested in the financing of other government operations with these fund balances.
228. External users of federal financial reports sometimes misunderstand the relationship of these funds, especially trust funds, to the Government. Very few Government trust funds are held "in trust" in a fiduciary relationship as is customarily the meaning of this term outside the Government. Also, some of the trust funds currently spend less than the receipts they collect each year. Most of the cash surplus that arises when receipts are greater than outlays is invested in Treasury securities until the amounts are needed for the trust fund to use in accordance with benefit formulas or other provisions of the law.
229. The Treasury uses these additional receipts to meet the cash needs of general operations, thus reducing the need to borrow from the public, raise taxes, or reduce spending. In the consolidated financial statements of the Government, the investments in Treasury securities held by trust funds and other fund entities and the corresponding debt owed by the Treasury to these funds cancel out. They are eliminated from the amounts reported in the consolidated Balance Sheet but footnote disclosure of these amounts normally has been included.

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230. **Funds covered by the standard.** As pointed out by respondents, trust funds are not the only type of fund that collects dedicated moneys. However, the exposure draft did not specifically delineate which funds might be included in the wider scope. The Board decided to limit these disclosures to funds where there was a need to show accountability to contributors and expected beneficiaries. Therefore, the funds that are covered by this standard are all trust funds, all special funds that are similar to trust funds, and all fiduciary funds whether or not in the budget.
231. The federal government does not use a consistent fund designation for these types of collections. Funds classified by law as trust funds are established by specific legislation to carry out activities stipulated by law and frequently are financed by taxes. While the Government's use of the term "trust funds" ordinarily differs from use of the term in the private sector, a few trust funds within the federal universe have the stringent fiduciary characteristics similar to those of trust funds in the private sector. Furthermore, some funds within the budget are classified as special funds and are similar in nature to non-fiduciary trust funds within the budget. Providing precise criteria for which non-trust funds are covered by this requirement is difficult. The Board realized that it will not always be easy for management to identify accountability expectations of contributors and beneficiaries.
232. On the other hand, no special accountability of a fund is needed for the sake of those who make voluntary payments in contemporaneous exchange for goods or services. Once goods and services have been rendered for the payment made, the purchaser generally does not expect the fund to provide additional accountability. For this reason the special reporting requirements do not apply to revolving funds or other funds financed similarly. However, special accountability may exist for a revolving fund that collects receipts for goods and services that are expected to be provided at a later period, such as long-term insurance contracts, and preparers are encouraged to provide the needed information in such cases.
233. **Funds not part of the reporting entity's financial statements.** In most cases, the requirement will apply to a fund that is included in the financial statements of the reporting entity. In the case of most fiduciaries, however, the fund is administered by a reporting entity but is not part of the reporting entity itself or included in its own general purpose financial statements. The disclosure requirement applies to such funds as well.
234. **Special reports.** Since the primary purpose of this requirement is accountability to the contributors and expected beneficiaries, all funds that meet the stated criteria are deemed material in this respect. Therefore, information needs to be provided regardless of whether it is material to the reporting entity. However, to minimize the amount of additional information required in financial statements, where the disclosures for dedicated collections are made to the contributors and beneficiaries in special reports and the information required is not material to the reporting entity, minimal disclosures are included in the reporting entity's

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general purpose financial statements or notes thereto. Special reports provided to representatives of contributors or beneficiaries may satisfy this requirement (for example, a report to an Indian tribal government).



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## Appendix B: Guidance For The Classification Of Transactions

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### Introduction

235. The Government of the United States has a great many types of transactions that finance its cost of operations, and they must be classified in various ways for revenue accounting in order to achieve the objectives of the standards in this Statement. The type of transaction may be an exchange transaction, a nonexchange transaction, or an other financing source; the transaction may be made between a Government reporting entity and the public or between two reporting entities within the Government (i.e., an intragovernmental transaction). If it is an exchange transaction, it will normally produce revenue but may produce gains and losses. This appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources, and the reasoning behind these standards as explained in the Introduction and the Basis for Conclusions.
236. To serve that purpose, this appendix provides guidance for classifying all major transactions that finance the Government's cost of operations and a significant number of lesser transactions. It is intended that these classifications—together with the explanation of these classifications, interpreted in the light of the Standards, the Basis for Conclusions, and the Introduction—will provide guidance for classifying all the financing transactions of the Government, including those that are not specifically listed. It should be understood that while some classifications are unequivocal, others are the result of balancing different considerations.
237. The transactions in this appendix are divided into several groups. Transactions recognized in the financial statements have a two-fold division: first, whether they are with the public or intragovernmental; and second, whether they are nonexchange transactions, exchange transactions that produce revenue, exchange transactions that produce gains or losses, or other financing sources. A separate group consists of gains and losses due to revaluation.
238. Exchange transactions are classified as producing gains or losses if they are likely to be unusual or nonrecurring. If the transactions classified in this appendix as gains or losses are usual and recurring for a particular reporting entity, that entity should classify them as producing exchange revenue or expense instead of gains or losses.
239. The final group of transactions in this appendix consists of transactions that produce amounts not recognized as revenues, gains, or other financing sources. Although in some instances there is overlap with other groups, they are presented together as a convenient reference to amounts not classified in any of the other categories. They include:

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- A number of transactions in which there is no net inflow of resources (or the net inflow is less than the full amount of the transaction) because one asset is exchanged for another or there is an increase in both assets and liabilities.
  - Certain transfers and donations that do not affect net cost or net position.
  - A number of transactions involving direct loans and loan guarantees, which are recognized as expenses or reductions in expenses according to the standards in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees.
  - Deposit fund transactions.

240. As a guide to this appendix, the following table lists in order the transactions that are illustrated, group by group, and cites the page. Unless otherwise stated:

- Revenue from nonexchange transactions is included in determining the net operating results and hence the change in net position.
- Revenue from exchange transactions is subtracted from gross cost in determining the net cost of operations. (Gains and losses from exchange transactions also affect net cost.)
- Other financing sources are included in determining the net operating results and hence the change in net position.

241. In addition, the collection and disposition of most nonexchange revenue and a small part of exchange revenue is accounted for as a custodial activity of the collecting entity.

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## Transactions With The Public

### Nonexchange transactions with the public

242. Individual income taxes, corporation income taxes, social insurance taxes and contributions,<sup>45</sup> excise taxes, estate and gift taxes, and customs duties.—Taxes (including customs duties) are levied through the exercise of the power of the Government to compel payment. In broad terms, taxes are “the price we pay for civilization.” More specifically they finance spending of many types to promote the general welfare, provide for the common defense, and ensure domestic tranquility: national defense, a judicial system, aid to the elderly, construction of infrastructure, education and training, and so forth. The relationship between the tax paid and the value received is too indirect and disproportionate to relate the revenue that is received from any identifiable taxpayer to the cost that is incurred for providing that identifiable taxpayer with benefits. This is especially the case where the benefits are of a collective or public nature, such as national defense, in which case consumption by one taxpayer does not reduce the consumption available for another; or

<sup>45</sup>“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans. “Social insurance” taxes and contributions do, however, include payments made by or on behalf of Federal employees to social insurance plans, such as Social Security and Medicare.

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where the benefits are designed to redistribute income from one group of people to another. Therefore, tax revenue is nonexchange revenue.

243. All excise taxes, like other taxes, are classified as resulting in nonexchange revenue. Some excise taxes (considered to be benefit taxes) are levied on bases that are related to the use of publicly provided goods and services or the public provision of other benefits, such as the gasoline tax; certain other excise taxes are levied on bases related to a cause of some damage and are dedicated to pay down costs, such as the tax on domestically mined coal, which is dedicated to the black lung disability trust fund. Even in these cases, however, the relationship between the tax and the benefit received by an identifiable recipient is relatively indirect and disproportionate. Moreover, these excise taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Therefore, like other taxes, they are classified as producing nonexchange revenue.
244. Board members have differing views on whether social insurance programs result in exchange or nonexchange transactions.<sup>46</sup> However, they agree that social insurance tax revenue should be reported in the same way as other tax revenue for the purposes of financial reporting. This is because social insurance taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Furthermore, individuals and businesses subject to social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business, so especially for the major, broad-based social insurance programs—Social Security, Medicare (hospital insurance), and unemployment compensation—they have virtually no legal option except to pay.
245. Tax receipts are generally collected from the public by the IRS (Internal Revenue Service) and, to a lesser extent, by the Customs Service and other entities acting as agents for the recipient entities rather than on their own behalf. The collecting entity receives the cash and then transfers it to the General Fund, trust fund, or special fund on whose behalf it was collected. The amount so collected should be accounted for as a custodial activity by the collecting entity. The tax is recognized as a nonexchange revenue by the entity that is legally entitled to the amount. This would be a trust fund or special fund in the case of an earmarked (i.e., dedicated) tax. If collected on behalf of the Government as a whole, it would be recognized in the Government-wide consolidated financial statements.

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<sup>46</sup>See discussion of social insurance programs in FASAB, Exposure Draft, Supplementary Stewardship Reporting (August 1995).

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246. Social insurance taxes and contributions paid by Federal employees.<sup>47</sup>—Federal employees may be covered by social insurance programs such as Social Security<sup>48</sup> and Medicare under the same terms and conditions as the remainder of the covered population. The payments made by Federal employees are in the nature of taxes, compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to employees of the United States government, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employee contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have obtained similar benefits. For these reasons, the employee contribution should have the same classification as contributions by non-Federal employees, which is nonexchange revenue.

247. Deposits by states for unemployment trust fund.—States deposit the receipts from the state unemployment tax to the U.S. Treasury for the unemployment trust fund in order to finance most of the benefits under the unemployment compensation system. The state unemployment tax differs from state to state in terms of the tax rate, tax base, and certain other characteristics, and unemployment benefits also differ from state to state. Nevertheless, the deposit has long been construed as a Federal budget receipt (a governmental receipt), and the unemployment trust fund has long been included as an account in the Federal budget.

248. This is for a combination of reasons taken together: (a) the unemployment compensation system—including the system of taxes, the system of benefits, and the trust fund—was established by the Social Security Act of 1935 and has been amended by Federal law many times; (b) deposits are held in a trust fund operated by the U.S. Government; (c) Federal law specifies extensive requirements for the state unemployment tax and unemployment benefits; (d) the Federal unemployment tax finances grants to states to cover their entire cost of administering the unemployment system; and (e) Federal law effectively coerces states to participate in the system, with participation requiring them to levy the state unemployment tax and deposit the collections in the U.S. Treasury. If a state does not participate (or is not certified by the Department of Labor as meeting Federal requirements): (i) the Federal unemployment tax is levied within the state at its maximum rate, (ii) the system does not pay any unemployment compensation benefits within the state, and (iii) the

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<sup>47</sup>“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

<sup>48</sup>Most Federal civilian employees hired before 1984 are not covered by Social Security.

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Federal Government provides no grants to state governments to pay for the costs of administration. The deposits of the state tax are therefore nonexchange revenue of the unemployment trust fund. (The Federal unemployment tax is levied and collected separately from the state unemployment tax.)

249. User fees, Harbor Maintenance trust fund.—This is an example of a tax that is termed a “user fee” by law while classified in the budget as a governmental receipt together with other taxes and duties. It is an ad valorem tax of 0.125 percent imposed on commercial cargo loaded and unloaded at specified U.S. ports open to public navigation. The receipt is earmarked to the Harbor Maintenance trust fund. It is similar in nature to other excise taxes that result from the Government’s power to compel payment and that are dedicated to a trust fund or special fund to be spent for a designated purpose (for example, the gasoline excise tax, which is dedicated to the Highway Trust Fund). It therefore should be recognized as nonexchange revenue by the Harbor Maintenance trust fund.
250. Customs Service fees.—The Customs Service collects revenue primarily from duties on imported merchandise but also from two types of fees: the merchandise processing fee and a group of fees called “user fees.”
251. The merchandise processing fee is primarily an ad valorem charge on formal merchandise entries into the United States (at 0.19 percent) subject to a maximum and minimum charge. It also includes flat fees on informally entered goods. The collections are earmarked by law to a special fund from which receipts are made available to finance Customs Service operations to the extent provided by current appropriations.
252. The merchandise processing fee is associated with the cost of the Customs Service’s operations. The fee as originally enacted was modified by the Customs and Trade Act of 1990 to make it consistent with U.S. obligations under GATT (the General Agreement on Tariffs and Trade) after a GATT panel had ruled that the original fee (a straight ad valorem fee) exceeded the cost of services rendered and was a tax on imports that discriminated against imports in favor of domestic production. The maximum and minimum fees and the flat fees were enacted to meet the U.S. obligation.
253. However, the associated cost is primarily some of the costs of assessing and collecting duties on imported merchandise, such as the salaries of import specialists (who classify merchandise) and the costs of processing paperwork. The importer pays duties that are required by law; it does not receive anything of value from the Government in the nature of an exchange. Furthermore, these costs are not likely to depend significantly on the value of the merchandise, and the fee is levied through the power of the Government to compel payment. Therefore, for the purpose of a classification system for financial reporting, the fee is akin to dedicated taxes that are also related in the aggregate to associated costs and that



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are classified as nonexchange revenue (e.g., the excise tax on gasoline). The merchandise processing fee is therefore classified as a nonexchange revenue.

254. The user fees consist of a group of flat fees charged on passengers and conveyances entering the country.<sup>49</sup> The collections are dedicated by law to a special fund whose receipts are made available by permanent indefinite appropriation to finance Customs Service operations.
255. These fees are intended to offset certain inspection costs that relate to the processing of passengers and conveyances entering the country. They are levied through the power of the Government to compel payment, and the person or entity that pays these fees does not receive anything of value from the Government in exchange. The inspection activities are for a variety of purposes: to ensure that dutiable merchandise is declared, to seize contraband (such as narcotics and illegal drugs), to detect infringements of patent and copyright laws, and so forth. Some of these purposes are related to the Government's powers to raise taxes, which are nonexchange revenue, and to enforce laws. Only to a limited extent are they like regulatory user fees, based on the Government's power to regulate particular businesses or activities. Therefore, like the merchandise processing fee, the user fees are classified as nonexchange revenue.
256. Deposits of earnings, Federal Reserve System.—The Federal Reserve System consists of the Board of Governors of the Federal Reserve System and twelve regional Federal Reserve Banks. Under Federal accounting concepts, it is not considered to be part of the Government-wide reporting entity. Therefore, payments made to or collections received from the Federal Reserve System would be reported in the financial statements of the Federal Government and its component reporting entities.<sup>50</sup> The Federal Reserve earns large amounts of interest on its portfolio of Treasury securities and deposits to the Treasury all net income after deducting dividends and the amount necessary to bring the surplus of the Federal Reserve Banks to the level of capital paid-in.
257. The Federal Reserve was established by Act of Congress pursuant to the Government's sovereign power over the nation's money, and its investment in Treasury securities is necessary for carrying out its monetary function. It does not receive anything of value from the Government in exchange for its deposit of earnings, and on occasion it has been required by law to make extra payments. The revenue from the deposits is therefore nonexchange.

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<sup>49</sup>These fees are sometimes called the "COBRA user fees." This term comes from the Consolidated Omnibus Budget Reconciliation Act of 1985, which established these fees.

<sup>50</sup>SFFAC No. 2, *Entity and Display*, para. 47.

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258. Donations: except types of property, plant, and equipment that are expensed.—Donations are contributions to the Government, i.e., voluntary gifts of resources to a Government entity by a non-Federal entity.<sup>51</sup> The Government does not give anything of value to the donor, and the donor receives only personal satisfaction. The donation of cash, other financial resources, or nonfinancial resources (except stewardship property, plant, and equipment) is therefore a nonexchange revenue.
259. The exception, stewardship PP&E, consists of Federal mission PP&E, heritage assets, and stewardship land. Such PP&E is expensed if purchased, but no amount is recognized if it is received as a donation. Correspondingly, no revenue is recognized for such donations.
260. Fines and penalties.—Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. The person or other entity that pays a fine or penalty does not receive anything of value in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through the exercise of its power to compel payment. Fines and penalties are therefore a nonexchange revenue.
261. Fines from judicial proceedings are collected by the entity acting as an agent for the Government as a whole rather than on its own behalf. They are therefore accounted for as a custodial activity of the collecting entity and recognized as a nonexchange revenue in the Government-wide consolidated financial statements.
262. Fines and penalties produced by an entity's operations—such as inspections to ensure compliance with Federal law and with regulations that are the responsibility of the entity (e.g., inspections by the Office of Surface Mining) or compliance with regulations for the conduct of a Federal program—are recognized as nonexchange revenue by whichever entity is legally entitled by law to the revenue. In some cases, but not all, this would be the collecting entity. If the collecting entity transfers the nonexchange revenue to the General Fund or another entity, the amount is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.
263. Penalties due to delinquent taxes in connection with custodial activity.—The person or other private entity that pays a penalty on delinquent taxes does not receive anything in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through its power to compel payment. Penalties on delinquent taxes are therefore a nonexchange revenue. The penalties are accounted for as a custodial activity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in

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<sup>51</sup>The term "donations" includes wills disposing of property and judicial proceedings other than forfeitures.

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the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.

264. **Forfeitures.**—Property may be seized as a consequence of various laws and regulations and forfeited to the Government. Forfeited property may be acquired through forfeiture proceedings, be acquired to satisfy a tax liability, or consist of unclaimed and abandoned merchandise. Forfeited property is principally managed by the Asset Forfeiture Fund of the Justice Department and the Treasury Forfeiture Fund of the Treasury Department. Revenue is recognized from forfeited property unless the property is distributed to state or local law enforcement agencies or foreign governments or is received in satisfaction of a previously recognized revenue (e.g., accrued tax receivables).<sup>52</sup>
265. The timing of revenue recognition depends on how the property is forfeited and the nature of the property. In the case of unclaimed and abandoned merchandise, revenue is recognized in the amount of the sales proceeds at the time the property is sold. In the case of property acquired through forfeiture proceedings, the timing of recognition depends on the nature and disposition of the property. For monetary instruments, the revenue is recognized at the time of obtaining forfeiture judgment; for property that is sold, at the time of sale; and for property that is held for internal use or transferred to another Federal agency, at the time of obtaining approval to use the property internally or transfer it.<sup>53</sup>
266. The method of measuring revenue depends on the nature of the property. The amount of revenue recognized for monetary instruments is the market value when the forfeiture judgment is obtained. For property that is sold, it is the sales proceeds. For property that is held for internal use or transferred to another Federal agency, it is the fair value of the property less a valuation allowance for any liens or third party claims.
267. The revenue from forfeiture is nonexchange revenue, because the Government seizes the property through the exercise of its power. The Government does not sacrifice anything of value in exchange and the entity that forfeits the property does not receive anything of value. More than half of the forfeiture revenue of the two funds mentioned above is from currency and other monetary instruments. Although other types of forfeited property must be sold in order to recognize revenue, or constructively sold (if transferred to another Federal

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<sup>52</sup>This amends SFFAS No. 3, *Accounting for Inventory and Related Property*, with respect to forfeitures related to satisfying tax liabilities.

<sup>53</sup>SFFAS No. 3, para. 57-78. The standard also requires deferred revenue to be recognized when a forfeiture judgment is obtained, but the deferred revenue is reversed when revenue is recognized. The amount of revenue ordinarily differs from the amount of deferred revenue. In some cases, an adjustment subsequent to the original forfeiture judgment may be necessary when it is later determined that a portion of the forfeiture is to be distributed to state or local law enforcement agencies or foreign governments.

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agency or placed into internal use), this is the last step in a process that is inherently nonexchange.

268. The disposition of the revenue from forfeiture is determined by law. Revenue or the property itself may ultimately be distributed to the seizing entity, state or local law enforcement agencies, foreign governments, or the general fund. Revenue is recognized as nonexchange revenue by the entity that is legally entitled to use the revenue or to use the property itself. If the property is distributed to a state or local law enforcement agency or a foreign government, revenue is not recognized by a Federal Government reporting entity. If the revenue is transferred to the General Fund, it is recognized as nonexchange revenue in the Government-wide consolidated financial statements.
269. Some entities may be involved in the management and liquidation of forfeited property but not themselves be entitled to the revenue or to the use of the property. For example, a central fund created to support the seizure activities of multiple entities may manage forfeited property and the collection and disposition of the revenue from that property. These entities should account for the property as a custodial activity. Revenue is shown when it is recognized, and it is shown as transferred to others when the cash is disbursed or the property is delivered. The disposition of property to an entity outside the Federal Government is also accounted for.

#### Exchange transactions with the public: revenue

270. Sales of goods and services.—The cost of production for goods and services such as electricity, mail delivery, and maps is defrayed in whole or in part by revenue from selling the goods or services provided. The sales may be made by a public enterprise revolving fund (such as the Bonneville Power Administration), an intragovernmental revolving fund (such as the Government Printing Office), or a fund that is not a revolving fund (such as the Geological Survey). Each party receives and sacrifices something of value. The sale is therefore an exchange transaction, and the revenue is exchange revenue for the entity making the sale.
271. Sales of goods and services in undercover operations.—The cost of the Government's undercover operations is defrayed in whole or in part from the proceeds of sales of goods that have been purchased (as opposed to goods that have been forfeited). Each party receives and sacrifices something of value. These characteristics of the transaction are not affected by whether the sale is illegal. The sale is therefore an exchange transactions, and the revenue is exchange revenue of the entity making the sale.
272. Interest (unless classified elsewhere), dividends, and rents (except for mineral rights) on Government property.—Each party receives and sacrifices something of value, so the inflow of resources is an exchange transaction.

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273. Interest is classified as exchange revenue notwithstanding the fact that the entity may not be charged a cost of capital for the assets that yield these inflows; or, if the entity borrowed from Treasury to acquire the assets, it may have been charged a below-market interest rate. The gross cost of the entity is understated in such cases; and to recognize an exchange revenue is to recognize a revenue without some or all of the related costs, and hence to understate the entity's net cost of operations. Nevertheless, in some cases the entity does pay the Treasury at least some interest; and the Government's cost of borrowing to acquire the assets is recognized as a cost of the Government as a whole. Since some cost is recognized, even if not always the full cost of the entity,<sup>54</sup> an exchange revenue is recognized for the entity that receives the inflow of interest.
274. Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights.—Rents, royalties, and bonuses are exchange revenues, because each party receives and sacrifices something of value. The amounts are earned by sales in the market and therefore are exchange revenue. They are collected by the Minerals Management Service (MMS) of the Department of the Interior, which manages the energy and minerals resources on the OCS and collects the amounts due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands.
275. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards natural resources are not recognized as an asset and depletion is not recognized as a cost. As a result, this exchange revenue bears little relationship to the recognized cost of MMS and cannot be matched against its gross cost of operations. Therefore, although the inflows are exchange revenue, they should not be subtracted from MMS's gross cost in determining its net cost of operations.
276. MMS collects rents, royalties, and bonuses and distributes the collections to the recipients designated by law: the General Fund, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, *Accounting for Fiduciary Activities*. The amounts of revenue should be recognized and measured under the exchange revenue standards when they are due pursuant to the contractual agreement.
277. The rents, royalties, and bonuses transferred to Treasury for the General Fund, or to other Government reporting entities, should be recognized by them as exchange revenue. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, this exchange revenue

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<sup>54</sup>The partial recognition of associated cost distinguishes interest from rents, royalties, and bonuses on the Outer Continental Shelf and the auction of the radio spectrum. For the latter transactions, see the subsequent paragraphs.

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should not offset their gross cost in determining their net cost of operations. It should instead be a financing source in determining their operating results and change in net position.

278. Proceeds from the auction of the radio spectrum.—The proceeds from auctioning the right to use the radio spectrum are exchange revenues, because each party receives and sacrifices something of value. The amount of revenue is earned by sales in the market at auctions. It bears little relationship to the costs recognized by the Federal Communications Commission (FCC), which collects the revenue, or to the costs recognized by the U.S. Government as a whole. Therefore, it should not be offset against the costs of the FCC in determining its net cost of operations or against the costs of the Government as a whole in Government-wide consolidated financial statements.
279. The FCC should therefore account for this exchange revenue as a custodial activity, acting as an agent on behalf of the General Fund; and it should be included as exchange revenue in the Government-wide consolidated financial statements.
280. Interest on post-1991<sup>55</sup> direct loans.<sup>56</sup>—Interest on direct loans is an exchange transaction, because it is part of a broader exchange transaction in which the entity makes a loan to the borrower and the entity and borrower each receives and sacrifices something of value. Interest on direct loans that are budgeted according to the provisions of the Federal Credit Reform Act of 1990 consists of two components: the nominal interest (the stated interest rate times the nominal principal) and the amortized interest (change in present value of the loans receivable due to the passage of time). The combined effect of these components equals the effective interest, which is directly defined as the present value of the loans receivable times the Treasury interest rate applicable to the particular loans (i.e., the interest rate used to calculate the present value of the direct loans when the direct loans were disbursed). The effective interest causes an equal increase in the aggregate value of the assets on the balance sheet, and therefore the effective interest is the amount recognized as exchange revenue.<sup>57</sup>

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<sup>55</sup>Post-1991 direct loans consist of direct loans that were obligated after September 30, 1991, whereas pre-1992 direct loans consist of direct loans that were obligated before October 1, 1991. The same accounting that is used for post-1991 direct loans is also used for pre-1992 direct loans that were modified and transferred to financing accounts; loans receivable arising from defaulted post-1991 guaranteed loans; and loans receivable arising from defaulted pre-1992 guaranteed loans that were modified and transferred to financing accounts.

<sup>56</sup>For interest on pre-1992 direct loans, see the preceding section on “interest (unless classified elsewhere) . . .”

<sup>57</sup>See SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, paragraphs 30-31 and 37; for an illustrative case study, also see Appendix B.

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281. Interest on delinquent taxes and other receivables that arise as the result of custodial operations.—Receivables that arise as the result of custodial operations are custodial (or non-entity) assets, held by the IRS or another entity as an agent for the Government as a whole rather than on its own behalf (e.g., IRS tax receivables on which the delinquent taxpayer must pay interest). The interest is an exchange revenue, because each party receives and sacrifices something of value, but it is not related to the costs incurred by the collecting entity. The interest is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the interest is recognized as exchange revenue in the Government-wide consolidated financial statements because it is related to the government's cost of borrowing; if transferred to another entity, it is recognized as nonexchange revenue by the entity that receives the transfer.
282. Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees.—Regulatory user fees are charges based on the Government's power to regulate particular businesses or activities. The revenue is related to the cost in one of two ways. Special benefits may be provided to identifiable recipients who pay the fees, beyond the benefits, if any, that accrue to the general public (e.g., passport fees); or the Government may incur costs in order to regulate an identifiable entity for the benefit of the general public or some other group, in which case the user charge compensates the Government for its regulatory costs that were caused by the activity of the party that pays the charge (e.g., SEC and Nuclear Regulatory Commission fees). Because in general the revenue is closely related to the cost of operations, these fees are classified as exchange transactions and the revenue is an exchange revenue of the entity that charges the fee.
283. Diversion fees, Department of Justice.—Registrants in the Diversion Control Program (e.g., physicians) pay fees to the Drug Enforcement Administration, in exchange for which the DEA provides the registrants with the authority to prescribe controlled substances. The diversion fees are intended to cover the costs of the Diversion Control Program. Because the revenue is related to the cost and the registrants both receive and sacrifice value, the payment of these fees is an exchange revenue of the Diversion Control Program.
284. Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance.—In exchange for a premium and other considerations, the Government promises to make payments to program participants if specified events occur. The premium offsets the cost of the program in whole or in part. The degree to which participation is voluntary differs from program to program. Because the revenue is related to the cost of the providing service, it is an exchange revenue of the insurance program.

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285. Federal employee contributions to pension and other retirement benefit plans.<sup>58</sup>—

Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary) and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government promises a pension to its employees after they retire. The Government also promises other retirement benefits, notably health benefits. In return, the employee provides services and, under some plans, makes a contribution to the retirement fund out of his or her salary. The financing of these benefits may include contributions paid by the employee to the retirement fund.

286. In broad terms, the employee contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More narrowly, it is a payment by the employee as part of an exchange of money and services for a future pension or other retirement benefit. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.<sup>59</sup>

287. Federal employee contributions to health benefits plan for current coverage.—Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of its employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of the employees.

288. In broad terms, the employee contribution out of his or her salary is an inflow of resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage by a health benefits plan. Therefore, it is an exchange revenue of the entity that administers the health benefits plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.

289. Reimbursement for collecting revenue.—The Customs Service collects duties on goods imported by Puerto Rico and the Virgin Islands. The Customs Service retains an amount

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<sup>58</sup>Federal employee retirement plans do not include social insurance, such as Social Security and Medicare.<sup>8</sup>

<sup>59</sup>For further discussion of the accounting standards for pensions and other retirement benefits of Federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.



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equal to the estimated cost of collecting these duties, including all costs of operations in Puerto Rico and the Virgin Islands and an allocation of overhead; it transfers the remainder to the Treasury, which, in turn, transfers the collections to Puerto Rico or the Virgin Islands.

290. The total amount of duties collected on these goods should be accounted for as a custodial activity by the Customs Service. Notwithstanding that duties are a nonexchange revenue, these particular duties are a nonexchange revenue of an entity other than the United States and therefore are not recognized as a nonexchange revenue of the U.S. Government.
291. The method of disposing of these collections combines two distinct transactions into one. The entire amount of the duties could be transferred to Puerto Rico and the Virgin Islands, and these governments could then pay the Customs Service to reimburse it for its services of collecting duties. The payment to Customs would be exchange revenue of the Customs Service. The actual procedure for reimbursement, whereby Customs retains an amount equal to the estimated cost, is simpler but equivalent in substance. Hence, the custodial transfer to Treasury (for Puerto Rico and the Virgin Islands) and the amount retained by Customs should be shown as separate components of the disposition of the revenue from customs duties. The amount retained by Customs to reimburse itself for its costs is exchange revenue of the Customs Service and is offset against its gross cost in calculating its net cost of operations.
292. Reimbursement for cleanup costs.—The Coast Guard or other Federal entities may incur costs to clean up environmental hazards caused by private parties and, in some cases, require these private parties to reimburse it for the costs incurred. Notwithstanding that the Government demands the revenue under its power to compel payment, the revenue arises from the action of the private parties and is closely related to the cost of operations incurred as a result of that action. Therefore, the revenue is an exchange revenue of the entity that incurs the cost.

#### Exchange transactions with the public: gains and losses

293. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.
294. Sales of Government assets: other than property, plant, and equipment and forfeited and foreclosed property.—The sale of Government assets (other than property, plant, and equipment and forfeited and foreclosed property) is an exchange transaction, because each party receives and sacrifices something of value. If the sales price equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than the book value of the property, a gain or loss, respectively, is

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recognized to the extent of the difference. The amount of the difference between sales price and book value is ordinarily a gain or loss rather than a revenue or expense, because sales of property are ordinarily an unusual or nonrecurring inflow of resources.

295. Sales of property, plant, and equipment.— The transaction is an exchange transaction, because each party receives and sacrifices something of value. If the sales price<sup>60</sup> equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than book value, a gain or loss, respectively, is recognized to the extent of the difference. The amount of the difference is ordinarily a gain or loss rather than a revenue or an expense, because sales of property, plant, and equipment are ordinarily an unusual or nonrecurring inflow of resources.
296. The entire sales price is a gain if the book value of the asset is zero. The book value is zero (a) if the asset is general property, plant, and equipment (PP&E) that is fully depreciated or written-off or (b) if the asset is stewardship PP&E, for which the entire cost is expensed when the asset is purchased.<sup>61</sup>
297. Acquisition of property, plant, and equipment through exchange.—The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).
298. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss.<sup>62</sup> It is a gain or loss rather than a revenue or expense, because ordinarily the amount would be an unusual or nonrecurring inflow of resources.

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<sup>60</sup>The sales price may include the fair value of items received in exchange.

<sup>61</sup>SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, has divided property, plant, and equipment (PP&E) into two basic categories: general PP&E and stewardship PP&E (which consists of federal mission PP&E, heritage assets, and stewardship land). General PP&E is capitalized and recognized on the balance sheet; stewardship PP&E is expensed and thus has no book value. (Stewardship PP&E is presented in a stewardship statement.)

<sup>62</sup>See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 32.

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299. If the fair value of the PP&E acquired is less than the fair value of the PP&E surrendered, the PP&E acquired is recognized at its cost and subsequently reduced to its fair value. The difference between the cost of the PP&E acquired and its fair value is recognized as a loss.<sup>63</sup>
300. Sales of foreclosed property: associated with pre-1992 direct loans and loan guarantees.—Foreclosed property associated with pre-1992 direct loans and loan guarantees is recognized as an asset at net realizable value. The sale is an exchange transaction, and any difference between the sales proceeds and book value is recognized as a gain or loss.<sup>64</sup>
301. Sales of receivables: except direct loans.—The transaction is an exchange transaction, because each party receives and sacrifices something of value. Upon sale, any difference between the sales proceeds and book value is recognized as a gain or loss. If the sales price equals book value, there is no gain or loss, because the exchange of one asset for another of equal value is not a net inflow of resources.
302. Sales of direct loans.—The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990, regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.<sup>65</sup> Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.<sup>66</sup>
303. Retirement of debt securities prior to maturity.—Debt securities may be retired prior to maturity if they have a call feature or if they are eligible for redemption by the holder on demand. Many Treasury bonds issued before 1985 are callable; savings bonds, the Government account series, the foreign series, and the state and local series of Treasury securities are redeemable on demand, although sometimes with a penalty or other adjustment or only after a specified period of time.
304. Each party receives and sacrifices something of value in buying and selling debt securities that may be retired prior to maturity. The sales price reflects such features. Therefore, the

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<sup>63</sup>Ibid., footnote 38.

<sup>64</sup>See SFFAS No. 3, *Accounting for Inventory and Related Property*, para. 79-91.

<sup>65</sup>This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is made and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

<sup>66</sup>See SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, para. 53-55 and Appendix B, Part II(B).

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transaction is an exchange transaction. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt is recognized as a loss or gain.<sup>67</sup>

#### Other financing sources from the public

305. Seigniorage.—Seigniorage is the face value of newly minted coins less the cost of production (which includes the cost of the metal, manufacturing, and transportation). It results from the sovereign power of the Government to directly create money and, although not an inflow of resources from the public, does increase the Government's net position in the same manner as an inflow of resources. Because it is not demanded, earned, or donated, it is an other financing source rather than revenue. It should be recognized as an other financing source when coins are delivered to the Federal Reserve Banks in return for deposits.

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### Intragovernmental Transactions

#### Nonexchange transactions—intragovernmental: revenue

306. Interest on Treasury securities held by trust funds and special funds (except trust revolving funds).—Many trust funds and special funds hold Treasury securities on which they receive interest. In most cases the invested balances of these funds derive predominantly from the funds' earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes), and to a lesser extent from other financing sources received from other government entities (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs a cost.
307. Therefore, in such cases, the interest on Treasury securities should not be deducted from the gross costs of the trust fund (or special fund), or the organization in which it is administered, in determining its net cost of operations. As a result, that interest should not be classified as exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue. The interest received from invested balances of trust funds and special funds (except trust revolving funds) is therefore normally a nonexchange revenue.

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<sup>67</sup>SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 54.

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308. The source of balances for some trust funds and special funds may not be predominantly nonexchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and Disability fund and the Military Retirement fund, consists of exchange revenue and other financing sources. In such exceptional cases, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances—in these cases, as exchange revenue—rather than according to the normal rule.
309. Interest received by one fund from another.—One fund within the Government may borrow from another. For example, in 1983 the Old-Age and Survivors Insurance trust fund borrowed from the Disability Insurance and Hospital Insurance trust funds. When that occurs, the lending fund sacrifices interest from Treasury securities on its invested balances and instead receives interest from the borrowing fund on the amount of the loan. Since the predominant source of balances to the lending fund is the same regardless of whether it invests in Treasury securities or lends to another fund, the interest received from the other fund should be classified in the same way—as nonexchange or exchange revenue—as the interest received on Treasury securities.
310. Employer entity contributions to social insurance programs.<sup>68</sup>—Federal employees may be covered by social insurance programs such as Social Security<sup>69</sup> and Medicare under the same terms and conditions as the rest of the covered population. Intragovernmental contributions to social insurance programs such as Social Security and Medicare are nonexchange transactions, just as payments made by private employers to these programs are nonexchange transactions. Contributions by private employers are in the nature of taxes; i.e., compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to Federal employees, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employer entity contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have received similar benefits. For these reasons, the employer entity contribution should have the same classification as private employer contributions, which is nonexchange revenue.

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<sup>68</sup>“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

<sup>69</sup>Most Federal civilian employees hired before 1984 are not covered by Social Security.

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### Nonexchange transactions—intragovernmental: gains and losses

311. Retirement of debt securities prior to maturity: trust funds and special funds (except trust revolving funds).—Treasury securities held by trust funds and special funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other Treasury securities held by these funds may also be callable or redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For trust funds (except trust revolving funds) and special funds, as explained elsewhere, the interest is normally but not always a nonexchange revenue.
312. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the trust fund or special fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.
313. Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity's operations and is not directly related to the entity's costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.

### Exchange transactions—intragovernmental: revenue

314. Intragovernmental sales of goods and services by a revolving fund.—The cost of providing goods or services by a revolving fund is defrayed in whole or in part by selling the goods or services provided. Intragovernmental sales may be made by an organization that maintains either an intragovernmental revolving fund (such as the Defense Business Operations Fund) or a public enterprise revolving fund (such as the Postal Service). Each party receives and sacrifices something of value. The proceeds are an exchange revenue.
315. Intragovernmental sales of goods and services by a fund other than a revolving fund.—The cost of providing goods or services is defrayed in whole or in part by selling the goods or

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services provided. Each party receives and sacrifices something of value. The proceeds are an exchange revenue.

316. Employer entity contributions to pension and other retirement benefit plans for Federal employees.—Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary); and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this transaction, the Government promises a pension and other retirement benefits (especially health benefits) to the employees after they retire. The financing of these benefits may include contributions paid by the employer entity to the retirement fund.
317. In broad terms, the employer entity contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More narrowly, it is a payment by the employer entity in exchange for the future provision of a pension or other retirement benefit to its employees. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.<sup>70</sup>
318. Employer entity contributions to health benefit plans for current coverage of Federal employees.—Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of the employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of its employees.
319. In broad terms, the employer entity contribution is an inflow of resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage of the employer entity's employees by a health benefits plan. Therefore, it is an exchange revenue of the entity that operates the health benefits plan and thus is an offset to that entity's gross cost in determining its net cost of operations.

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<sup>70</sup>For further discussion of the accounting standards for pensions and other retirement benefits for federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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320. Employer entity payments for unemployment benefits and workers compensation.—The employer entity recognizes a liability and an expense for Federal employees who are laid-off or injured on the job and are entitled under law to unemployment benefits or workers compensation, respectively.<sup>71</sup> The payment to the former or current employee is made by the unemployment trust fund (Department of Labor) in the case of unemployment benefits and by the special benefits fund (Department of Labor) in the case of workers compensation. Unemployment benefits are reimbursed by the former employer entity; and workers compensation costs are mostly charged back to the employer entity.
321. Since the costs are recognized by the employer entity and its payment to the unemployment trust fund or the special benefits fund reimburses these funds for the costs they incur, the amounts these funds receive from the employer entity are exchange revenues.
322. Interest on Treasury securities held by revolving funds.—A revolving fund conducts a cycle of business-type operations in which the expenses are incurred to produce goods and services that generate revenue, and the revenue, in turn, finances expenses. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since their holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on the funds' securities is related to the funds' cost of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue earned from their sales of goods and services, for which the funds incurred costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net cost of operations. For this reason, interest earned by revolving funds should normally be classified as exchange revenue.
323. The source of balances for some revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.
324. Interest on Treasury securities held by trust revolving funds.—A trust revolving fund is a revolving fund that is also classified by law as a trust fund. Like other revolving funds, it earns exchange revenue, which is an offset to its gross cost. For example, the revenue that the Employees Health Benefit fund earns from contributions by Federal employees, annuitants, employer entities, and the Office of Personnel Management (OPM) is an offset to the insurance premiums that it pays to private firms. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the

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<sup>71</sup>See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 96 and para. 181, footnote 70.



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revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services. Furthermore, the source of the invested balances is predominantly revenue earned from the sales of services, for which they incurred costs of operations when the revenue was earned. The interest they receive should therefore be classified in the same way as the interest received by other revolving funds, which is exchange revenue.

325. The source of balances for some trust revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.
326. Interest on uninvested funds received by direct loan and guaranteed loan financing accounts.—A guaranteed loan financing account holds uninvested balances as reserves against its loan guarantee liabilities and earns interest on these balances that adds to its resources to pay these liabilities. A direct loan financing account may hold uninvested balances to bridge transactions that are integral to its operations, such as when it borrows from Treasury to disburse direct loans prior to the time of disbursement; it earns interest on these balances to reflect the time value of money and thereby finance the interest it pays on its debt to Treasury. Thus, in both cases, the interest received by the financing account is earned through exchange transactions with Treasury and is an offset to the financing account's related costs of operations. The interest is therefore an exchange revenue of the financing account.
327. Interest received by Treasury.—Accounts or funds (including direct loan and guaranteed loan financing accounts) may be authorized to borrow from the Treasury or from the Federal Financing Bank (an entity within Treasury) or other sources. The interest that the entity pays on its borrowings is a cost to the entity and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the entity borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the entity is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.

#### Exchange transactions—intragovernmental: gains and losses

328. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.
329. Retirement of debt securities prior to maturity: revolving funds and trust revolving funds.—Treasury securities held by revolving funds and trust revolving funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other

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Treasury securities held by these funds may also be callable or redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For revolving funds and trust revolving funds, as explained elsewhere, the interest is normally but not always an exchange revenue.

330. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the revolving fund or trust revolving fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.

#### Other financing sources—intragovernmental

331. Appropriations.—Appropriations—a form of budget authority—permit an entity to incur obligations and make payments and thus are a means of financing the entity's cost. They are not otherwise related to the entity's cost and therefore are not an offset to its gross cost in determining its net cost of operations. They are not earned by the entity's activities, demanded by the entity, or donated to the entity. Therefore, appropriations provide an other financing source instead of a revenue.
332. More precisely, "appropriations used" is recognized as an other financing source in determining the entity's operating results when the entity receives goods and services or provides benefits, grants, or other transfer payments. To avoid double counting, appropriations used are **not** recognized for the appropriation of earmarked revenues or other financing sources, which are already counted in determining the entity's operating results. Appropriations that have been made available for apportionment but have not been used are recognized as "unexpended appropriations" in the entity's capital.
333. Cost subsidies: difference between internal sales price (reimbursement) and full cost.—One entity may receive goods or services from another entity without paying the full cost of the goods or services or without paying any cost at all. Other Federal accounting standards may require the receiving entity to recognize the full cost as an expense (or, if appropriate, as an asset). In these cases the difference between full cost and the internal sales price or reimbursement (sometimes called a "transfer price") is an imputed cost to the receiving entity.<sup>72</sup>

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<sup>72</sup>See SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, para. 105-115.

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334. The financing of the imputed cost is also imputed to the receiving entity. Imputed financing is necessary so that the imputed cost does not reduce the entity's operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the receiving entity does not earn the amount imputed or demand its payment.
335. Cost subsidies: difference between the service cost of pensions (and other retirement benefits), less the employee contributions, if any, and the employer entity contributions.—The service cost of pensions (and other retirement benefits) to the employer entity, less the employee contributions, if any, is recognized as a cost to the employer entity. The difference between the employer entity's cost and its contributions, if any, is imputed to the employer entity as part of its recognized cost. For pensions, the cost recognized by the employer entity is more than its contribution for employees who are covered by the Civil Service Retirement System and several minor systems (in a few of which the employer entity does not make any contributions toward the service cost). For retirement health care benefits, neither the employees nor the employer entity make any contributions while the employee is working.<sup>73</sup> Therefore, the entire service cost is recognized as a cost to the employer entity and imputed to it.
336. The financing of the imputed cost is also imputed to the employer entity.<sup>74</sup> The imputed financing is necessary so that the imputed cost does not reduce the employer entity's operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the employer entity does not earn the amount imputed or demand its payment.<sup>75</sup>
337. (This transaction differs from the immediately preceding transaction, in which an entity does not pay the full cost of the goods or services it receives from another entity. In the present case, the employer entity acquires the services of the employees itself, but another entity pays part of their cost.)
338. Contribution by the General Fund to the SMI trust fund.—The General Fund makes a contribution to the SMI (Supplementary Medical Insurance) trust fund. This appropriated payment is separate from the transfer of earmarked premiums and is not a transfer of

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<sup>73</sup>Retired employees do pay premiums, however, and the service cost to the employer entity is defined net of the actuarial present value of those future premiums.

<sup>74</sup>The employer entity's own contribution, if any, is generally financed by an appropriation but could be financed by earned revenue or other sources.

<sup>75</sup>For further discussion of the accounting standards for pensions and other retirement benefits for federal employees, see SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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earmarked taxes or other income. It does not arise from an exchange transaction, because SMI does not sacrifice any value to the General Fund in exchange for the payment, and the General Fund does not receive anything of value from SMI. Instead, the payment constitutes a General Fund subsidy of the SMI trust fund. Since the payment is not demanded or earned, it is an other financing source to SMI rather than a revenue.

339. Examples of other payments of a similar nature (and also classified as other financing sources) are the payment by the General Fund to the social security trust funds for military service credits and for certain uninsured persons at least 72 years old; and the payment by the General Fund to the Railroad Retirement Board for the vested dual benefit payments received by certain retirees under both the railroad retirement and the social security systems. The quinquennial military service credit adjustment paid between the General Fund and the social security trust funds is likewise an other financing source to the social security trust funds but one that may be either positive or negative.
340. Transfer by CCC to Federal Crop Insurance Corporation.—The Commodity Credit Corporation (CCC) makes transfers to the Federal Crop Insurance Corporation (FCIC), which it finances by an appropriation. This payment does not arise from an exchange transaction, because FCIC does not sacrifice anything of value to CCC, and CCC does not receive anything of value from FCIC. It differs from the contribution to SMI primarily in that it is paid by another program entity (the CCC) rather than directly by the General Fund. Since the payment is not demanded or earned, it is an other financing source to FCIC rather than a revenue.
341. Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds.—The Railroad Retirement Board pays benefits equivalent to the amounts that would have been paid if railroad workers had been covered under Social Security since its inception, plus additional amounts unique to that program. The railroad retirement program is partly financed by an annual financial interchange that takes place between the Railroad Social Security Equivalent Benefit Account (a trust fund) and the trust funds for old-age and survivors insurance, disability insurance, and hospital insurance (OASDHI). The interchange is designed to place each of the OASDHI trust funds in the same position as it would have been if railroad employment had been covered under Social Security since its inception.
342. The amount of the payment reflects the difference between (a) the benefits that the OASDHI trust funds would have paid to railroad workers and their families if railroad employment had been covered by OASDHI and (b) the payroll taxes that the OASDHI trust funds would have received if railroad employment had been covered by OASDHI. If benefits would have exceeded taxes, the OASDHI trust funds make a payment to the Railroad Social Security Equivalent Benefit Account; if benefits would have been less, the OASDHI trust funds receive a payment. Currently OASI and DI make payments to that Account, and HI receives

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payment. The interchange differs from the examples in the previous cases primarily in that (a) the payment is between two trust funds and (b) the payment may be made in either direction.

343. The financial interchange does not arise from an exchange transaction, because it is a reallocation of resources among funds, all of which are financed primarily from nonexchange revenue. Furthermore, the nature of this reallocation is such that the transferring entity does not receive anything of value and the recipient entity does not sacrifice anything of value. Therefore, the recipient entity recognizes the transfer-in as an other financing source, and the transferring entity recognizes the transfer-out as a negative financing source.
344. Transfer of cash and other capitalized assets without reimbursement.—Cash and other capitalized assets may be transferred without reimbursement from one Government entity to another. Cash may include exchange revenue that is recognized by the transferring entity in determining its net cost of operations but is required to be transferred to the General Fund or another entity; other capitalized assets may include general property, plant, and equipment. The receiving entity does not sacrifice anything of value, and the transferring entity does not acquire anything of value. Therefore, the transfer is not an exchange transaction. The receiving entity recognizes the transfer-in as an other financing source; the transferring entity recognizes the transfer-out as a negative financing source. The amount recorded by both entities is the transferring entity's book value of the asset.
345. Transfer of property, plant, and equipment without reimbursement: types that are expensed.—Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.
346. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

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## Revaluations

347. Revaluation of capitalized property, plant, and equipment.—Capitalized property, plant, and equipment (PP&E) may be removed from the general PP&E accounts if it no longer provides service in the operations of the entity because it has suffered damage, become obsolete in advance of expectations, or is identified as excess. It is recorded as an asset at

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its expected net realizable value. Any difference between the book value and the expected net realizable value is recognized as a gain or loss in determining the net cost of operations, because the revaluation results from the entity's operations. The expected net realizable value is adjusted at the end of each period, and any further revaluation is also recognized as a gain or loss in determining the net cost of operations.<sup>76</sup>

348. Since the revaluation does not affect obligations incurred but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.
349. Revaluation of inventory and related property.—Inventory and related property may be revalued for such reasons as determination that the property is excess, obsolete, or unserviceable; that stockpile materials have decayed or been damaged; that a loss is estimated on commodity purchase agreements; or that a change has occurred in the net realizable value of commodities valued at the lower of cost or net realizable value. The amount of revaluation is recognized as a loss or a gain in determining the net cost of operations, because it results from the entity's operations. Assets are correspondingly reduced or increased.<sup>77</sup>
350. Since the revaluation does not affect obligations incurred, but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.

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## Transactions Not Recognized As Revenues, Gains, Or Other Financing Sources

351. Borrowing from the public.—Borrowing from the public is a means of financing the Government's outlays. However, it is not a net inflow of resources to the Treasury or other borrowing entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.
352. Borrowing from Treasury, the Federal Financing Bank, or other Government accounts.—An entity may be provided the authority to borrow from Treasury, the Federal Financing Bank, or other Government accounts. Intragovernmental borrowing is a means of financing the

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<sup>76</sup>SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 39.

<sup>77</sup>See SFFAS No. 3, *Accounting for Inventory and Related Property*, para. 29-30, 47-48, 54, 97, and 107.

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entity's outlays. However, it is not a net inflow of resources to the entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.

353. Disposition of revenue to other entities: custodial transfers.—Revenue, primarily nonexchange revenue, may be collected by an entity acting on behalf of the General Fund or another entity within the Government on whose behalf it was collected. The collecting entity accounts for the disposition of revenue as part of its custodial activity. These custodial transfers, by definition, do not affect the collecting entity's net cost of operations or operating results, nor are they part of the reconciliation between its obligations and net cost of operations. (The receiving entity recognizes the revenue as nonexchange or exchange revenue, depending on its nature, according to the applicable revenue standards.)
354. Sales of different types of Government assets.—The sale of Government assets (other than forfeited property) is an exchange transaction, because each party receives and sacrifices something of value. As a general rule, any difference between the sales proceeds and book value is recognized as a gain or loss when the asset is sold. The remainder of the transaction does not provide a net inflow of resources, so no gain, revenue, or other financing source is recognized. If the sales proceeds equal book value, there is no gain or loss, because the exchange of one asset for another of equal recorded value is not a net inflow of resources.
355. This general rule applies to property, plant, and equipment, receivables (other than direct loans), foreclosed property associated with pre-1992 direct loans and loan guarantees, and miscellaneous assets. It does not apply to inventory, nor does it apply to forfeited property (as explained in the previous section on nonexchange revenue). It also does not apply to the sale of direct loans and the sale of foreclosed property associated with post-1991 direct loans and loan guarantees. The latter transactions are discussed in subsequent paragraphs.
356. Acquisition of property, plant, and equipment through exchange.—The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).<sup>78</sup>

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<sup>78</sup>See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 32.

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357. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss. If the cost of the PP&E acquired equals the book value of the PP&E surrendered, there is no gain or loss (nor a revenue or other financing source), because the exchange of one asset for another of equal value does not provide a net inflow of resources. Therefore, the amount of the transaction equal to the book value of the PP&E surrendered is not recognized as a gain, a revenue, or an other financing source.
358. Transfer of property, plant, and equipment without reimbursement: types that are expensed.—Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.
359. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.
360. If multi-use heritage assets are transferred and some cost was recognized for them on the books of the transferring entity, that cost is recognized as a transfer-out (a negative other financing source) of capitalized assets. No amount is recognized by the entity that receives the asset.<sup>79</sup>
361. Donation of property, plant, and equipment: types that are expensed.—The acquisition cost of stewardship property, plant, and equipment (PP&E) is recognized as a cost when incurred. Such PP&E consists of Federal mission PP&E, heritage assets, and stewardship land. When such PP&E is donated to the Government, however, no amount is recognized as a cost.<sup>80</sup> Since the donation of such PP&E does not affect the net cost or net position of the recipient entity, it is not a revenue, a gain, or an other financing source.
362. Negative subsidies on post-1991 direct loans and loan guarantees.—A negative subsidy means that the direct loans or loan guarantees are estimated to make a profit, apart from administrative costs (which are excluded from the subsidy calculation by law). The amount of the subsidy cost is recognized as an expense when the direct loan or guaranteed loan is disbursed. A negative subsidy is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.<sup>81</sup>

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<sup>79</sup>SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, para. 61 and 72.

<sup>80</sup>Ibid.



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363. Downward subsidy reestimates for post-1991 direct loans and loan guarantees.—A downward subsidy reestimate means that the subsidy cost of direct loans or loan guarantees is estimated to be less than had previously been estimated. The initial subsidy cost is recognized as an expense; a positive subsidy reestimate is recognized as an expense; and a downward subsidy reestimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.
364. Fees on post-1991 direct loans and loan guarantees.—The present value of estimated fees is included as an offset in calculating the subsidy cost of direct loans and loan guarantees, which is recognized as an expense when the loans are disbursed. The present value of estimated fees is likewise included as one component in calculating the value of loans receivable or loan guarantee liabilities. When cash is received in payment of fees, the loans receivable decrease by an equal amount (or the loan guarantee liabilities increase by an equal amount). The increase in one asset is offset by an equal decrease in another asset (or by an equal increase in liabilities). Therefore, fees are not recognized as a revenue, a gain, or an other financing source.<sup>82</sup>
365. Repayment of post-1991 direct loans.—The present value of estimated loan repayments is included in the calculation of the subsidy cost of direct loans, and this subsidy cost is recognized as an expense when the loans are disbursed. The present value of estimated loan repayments is likewise included in the value of the loans receivable. When cash is received for the repayment of loans, the loans receivable decrease by an equal amount. The increase in one asset is offset by an equal decrease in another asset. Therefore, cash inflow from the repayment is not recognized as a revenue, a gain, or an other financing source.<sup>83</sup>
366. Repayment of pre-1992 direct loans.—When pre-1992 direct loans are repaid in whole or in part, the entity exchanges one asset (loans receivable) for another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.<sup>84</sup>
367. Repayment of receivables: except direct loans.—When receivables other than direct loans are paid or repaid in whole or in part, the entity exchanges one asset (loans receivable) for

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<sup>81</sup>For standards on direct loans and loan guarantees, see SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*. The accounting for negative subsidy costs is symmetrical to the accounting for positive subsidy costs.

<sup>82</sup>The fee component of the subsidy cost is required to be disclosed separately.

<sup>83</sup>If the actual repayment is different from the previous estimate, the present value of the difference between cash inflows and outflows over the term of the loan—calculated as of the date of disbursement—is reestimated and is recognized as a subsidy expense or a reduction in subsidy expense.

<sup>84</sup>If the loan is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

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another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.<sup>85</sup>

368. Sales of direct loans.—The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990 regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.<sup>86</sup> Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.<sup>87</sup> The amount of cash inflow equal to book value is not a net inflow of resources to the entity, because it is an exchange of one asset for another of equal recorded value. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.

369. Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees.—The net present value of the cash flow from the estimated sales of foreclosed property is included in calculating the subsidy cost of post-1991 direct loans and loan guarantees. This subsidy cost is recognized as an expense when the loans are disbursed. When property is foreclosed, the property is recognized as an asset at the net present value of its estimated net cash flows. When the foreclosed property is sold, any difference between the sales proceeds and the book value (i.e., the net present value as of the time of sale) requires a reestimate of the subsidy expense, which is recognized as a subsidy expense or a reduction in subsidy expense. The amount of cash flow equal to book value is an exchange of one asset for another of equal recorded value and therefore is not recognized as a gain, a revenue, or an other financing source.<sup>88</sup>

370. [Paragraph 370 was rescinded by SFFAS 31, paragraph 34.]

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<sup>85</sup>If the receivable is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

<sup>86</sup>This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is disbursed and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

<sup>87</sup>SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, para. 53-55 and Appendix B, Part II(B).

<sup>88</sup>See SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, para. 57-60 and Appendix B, Part III(E); and SFFAS No. 3, *Accounting for Inventory and Related Property*, para. 79-91 and 154-158.

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**Appendix C: Glossary**

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

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## List of Abbreviations

See Consolidated List of Acronyms in “Appendix F: Consolidated List of Abbreviations.”