DEBT CANCELLATION:

AN INTERPRETATION OF SFFAS 7, PARAGRAPH 313

Interpretation of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by July 23, 2021

May 25, 2021

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- Mission statement
- Documents for comment
- Statements of Federal Financial Accounting Standards and Concepts
- FASAB newsletters

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May 25, 2021

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or "the Board") requests your comments on the exposure draft of a proposed Interpretation titled *Debt Cancellation: An Interpretation of SFFAS 7, Paragraph 313*. Specific questions for your consideration appear on page 7, but you are welcome to comment on any aspect of this proposal. If you do not agree with specific matters or proposals, your responses will be most helpful to the Board if you explain the reasons for your positions and any alternatives you propose.

Responses are requested by July 23, 2021.

All comments received by FASAB are considered public information. Those comments will be posted to FASAB's website and will be included in the project's public record.

Please provide your comments by email to fasab@fasab.gov. We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at 202-512-7350 to determine if your comments were received. If you are unable to email your responses, please call (202) 512-7350 to make alternate arrangements.

FASAB's rules of procedure provide that the Board may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft.

FASAB will publish notice of the date and location of any public hearing on this document in the Federal Register and in its newsletter.

Sincerely,

George A Scott

George A. Scott

Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

Issues were raised during audits related to the accounting treatment for debt cancellation that led to the need for review and clarification of paragraph 313 of Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. SFFAS 7, paragraph 313 provides:

> 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.

Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the statement of changes in net position (SCNP).

When considering paragraph 313 of SFFAS 7 and SFFAC 2 together, this proposed Interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity that should be reported on the SCNP. This proposed Interpretation would also clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item[1] "gain" or "loss" be displayed on the SCNP.

In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered. As noted in paragraph 313 of SFFAS 7, the cancellation of debt requires an Act of Congress. Each debt cancellation is governed by the particular language used in the enacted legislation canceling the debt. This proposed Interpretation would not provide guidance on budgetary accounting, which is issued by central agencies.[2]

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This proposal would facilitate consistent accounting and reporting of debt cancellation on the SCNP. Proper classification is essential to constructing financial statements that meet the federal financial reporting objectives as they have been described in SFFAC 2.

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[1] While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately or be included with other items due to materiality.
[2] "Central agencies" refers to the Department of the Treasury (Treasury), the Office of Management and Budget (OMB), and the Government Accountability Office (GAO).

MATERIALITY

The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial.[3] A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

[3] Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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QUESTIONS FOR RESPONDENTS

The Federal Accounting Standards Advisory Board (FASAB or "the Board") encourages you to become familiar with all proposals in the Interpretation before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Interpretation. Because FASAB may modify the proposals before a final Interpretation is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have regarding implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at https://www.fasab.gov/documents-for-comment/. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please contact 202-512-7350.

All responses are requested by July 23, 2021.

Q1. Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 313 provides:

> 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.

Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the statement of changes in net position (SCNP).

This proposed Interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity and should be reported on the SCNP. This proposed Interpretation would also clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item[4] "gain" or "loss" be displayed on the SCNP. In addition, reporting entity management is responsible

[4] While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately or be included with other items due to materiality.

for determining the most appropriate line item presentation and display and related disclosures, such as information about the debt cancelation. Refer to paragraphs 2-8 and A6-A18.

a. **Do you agree or disagree with the guidance? Please provide the rationale for your answer.**

Q2. **Paragraph 3 of the proposed Interpretation refers to "other financing sources" as defined by SFFAS 7. Under SFFAS 7, financing sources are divided into three categories: exchange revenue, nonexchange revenue, and "other." As discussed in paragraph A22, FASAB coordinated with the Office of Management and Budget (OMB) and determined that certain changes to the form and content requirements provided for the statement of changes in net position (SCNP) in OMB Circular A-136 would ensure clarity and consistency with generally accepted accounting principles (GAAP). Specifically, eliminating the sub-categories "Budgetary Financing Sources" and "Other Financing Sources (Nonexchange)" presented under the Cumulative Results on the SCNP would simplify the presentation and thereby enhance the clarity. In the next update to the *FASAB Handbook of Accounting Standards and Other Pronouncements, as Amended,* FASAB plans to make similar changes to non-authoritative illustrative financial statements presented in SFFAS 27 and SFFAS 43. Refer to paragraphs 9 and A22.**

a. **Is there a need for additional clarity or consistency with respect to the definition or use of the term "other financing sources" in FASAB documents or other guidance?**

Q3. **Do you believe that the proposed Interpretation clarifies ambiguity regarding debt cancellation and would resolve any existing or anticipated issues? If not, please provide detail about other specific clarifications required regarding debt cancellations. Please also provide any other comments and other suggestions on the Interpretation. Please provide the rationale for your answer.**

PROPOSED INTERPRETATION

SCOPE

1. This Interpretation applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

INTERPRETATION

2. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 313 provides:

   > 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."

3. As provided in paragraph 32 of SFFAS 7, "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." In addition, paragraph 63 of SFFAS 7 also states, "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."

4. Paragraph 313 is part of Appendix B: Guidance for the Classification of Transactions. As noted, the appendix provides authoritative guidance for the classification of major transactions. The introduction of Appendix B provides the following:

   > 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.

5. SFFAS 7, Appendix B includes cancellation of debt under Intragovernmental Transactions: Nonexchange transactions—intragovernmental: gains and losses.

6. Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the statement of changes in net position (SCNP).

7. When considering SFFAS 7, paragraph 313 and SFFAC 2 together, this proposed Interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity that should be reported on the SCNP.

8. Paragraph 313 of SFFAS 7 provides, “As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.” This proposed Interpretation would clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item[5] “gain” or “loss” be displayed on the SCNP. Rather, the proposed Interpretation requires that debt cancellation activity be included on the SCNP. Reporting entity management is responsible for determining the most appropriate line item presentation and display[6] and related disclosures, such as contextual information about the debt cancelation (for example, the statutory authority cancelling the debt or the reason for the debt), if appropriate.

9. In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered. As noted in paragraph 313 of SFFAS 7, the cancellation of debt requires an Act of Congress. Each debt cancellation is governed by the particular language used in the enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency for the purposes of cancelling the debt or it may cancel the debt without providing an appropriation. This Interpretation does not provide guidance on budgetary accounting, which is issued by central agencies.

EFFECTIVE DATE

10. The requirements of this Interpretation are effective upon issuance.

The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial. Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

[5] While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately or be included with other items due to materiality.

[6] OMB prescribes form and content in OMB Circular A-136, *Financial Reporting Requirements,* based on the requirements and guidance contained in FASAB standards but also may provide more specific detailed instructions. See the Basis for Conclusions paragraphs A21-A22 for additional discussion.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Interpretation. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Interpretation—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, 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 or other pronouncement for the rationale for each amendment.

BACKGROUND

A1. The Federal Accounting Standards Advisory Board (FASAB or "the Board") was asked to review paragraph 313 of SFFAS 7, which pertains to debt cancellation, to determine if it needs to be revised. Specifically, issues were raised during audits related to the proper accounting treatment of a cancellation of debt that affected several reporting entities.

Debt Cancellation Example

A2. The request for guidance was based on an issue where an agency borrowed from the Department of the Treasury (Treasury) resulting in a payable/receivable relationship. Congress canceled debt through legislation and relieved the agency of liability.

A3. Each debt cancellation is governed by the particular language used in the enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency for the purposes of cancelling the debt or it may simply cancel the debt without providing an appropriation. In this particular example, the debt was canceled without providing an appropriation.

A4. Treasury's Bureau of the Fiscal Service (Fiscal Service) is responsible for prescribing the accounting posting logic for the agencies through the Treasury Financial Manual. Fiscal Service is also responsible for ensuring proper application of intragovernmental eliminations at the government-wide financial reporting level. The Office of Management and Budget (OMB) and Treasury determined the posting logic for the debt cancellation scenario described in this proposed Interpretation. Treasury and OMB concurred that a negative surplus warrant should be used. Per the Fiscal Service guidance, which Treasury and OMB agreed upon, the agency was required to show an increase to Fund Balance with Treasury (FBWT) and a subsequent decrease to FBWT representing debt repayment to implement the cancellation. The posting logic resulted in the agency reporting what appeared like an appropriation provided by the legislation by recording the debt cancellation as a budgetary financing source on its SCNP.

A5. However, the reporting entities disagreed on the proper entries. Specifically, the auditors of the agency that was relieved of the liability believed the cancellation of debt should be reported on the SCNP but recognized as nonexchange gain in accordance with SFFAS 7 because the legislation did not provide for an appropriation. The auditors did not agree with Fiscal Service's prescribed posting logic and identified this treatment as a material weakness. To avoid losing its unmodified opinions on its agency financial report and closing package audits, the agency made the correcting entry required by the auditors to reverse the posting logic and recognize a nonexchange gain on the SCNP.

GAAP Guidance

A6. SFFAS 7 paragraph 313 provides:

> 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.

A7. Paragraph 313 is part of Appendix B, Guidance for the Classification of Transactions in SFFAS 7. Appendix B provides authoritative guidance on classifying transactions. Specifically, the 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. Cancellation of debt is included under Intragovernmental Transactions: Nonexchange transactions—intragovernmental: gains and losses.

A8. Not only is the transaction labeled a nonexchange transaction per the Appendix B Table of Transactions in SFFAS 7, but paragraph 313 of SFFAS 7 clearly provides that debt cancellation is nonexchange activity by stating, "As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender." Understanding that debt cancellation is nonexchange activity is very important because it specifies reporting as prescribed in SFFAC 2.

A9. The Introduction of SFFAS 7, paragraphs 16-17 provides the following explanation regarding the difference between nonexchange and exchange revenue:

> 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 as they have been described in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.
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> 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.

A10. Paragraph 21 of SFFAS 7 provides further explanation regarding nonexchange revenue and why it should not be reported with net costs as follows:

> 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.

A11. SFFAC 2, paragraph 100 provides that nonexchange activity is reported on the SCNP. Therefore, previous Boards were clear that debt cancellation activity is nonexchange and should be reported on the SCNP.

A12. It should also be noted that paragraph 133 of SFFAS 7 states:

> 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.

A13. Further, the Board also discussed the relationship between revenues and gains in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements,* as follows:

> 55. Existing standards or established practice may indicate that certain increases and decreases in assets should be reported as gains and losses, rather than revenues and expenses. Use of the terms *gains* and *losses* generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature or their having resulted from peripheral or incidental activities of an entity.

56. The definitions of revenue and expense in this Statement include items that might be reported as gains and losses. Gains and losses are considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets. Whether certain kinds of revenues and expenses should be reported as gains and losses and, if so, under what circumstances, is beyond the scope of this Statement.

A14. SFFAS 7 also provides discussion of budgetary accounting as it pertains to meeting the objectives of federal financial reporting. For example, SFFAS 7, Introduction paragraphs 23-26 discuss the budgetary accounting perspective. SFFAS 7, paragraphs 77-82 discuss budgetary accounting and current disclosures. In addition, paragraphs 203-223 of the Basis for Conclusions provide further rationale and explanation of SFFAS 7 specific to budgetary principles, the budget process, and its link to proprietary accounting. (These paragraphs have been included at Appendix B - Excerpts from SFFAS 7 as a reference in this exposure draft and will be removed before the Interpretation is issued as final.)

Nonexchange Activity Reported on Statement of Changes in Net Position

A15. When considering SFFAS 7 and SFFAC 2 together, GAAP clearly provides that debt cancellation is nonexchange activity that should be reported on the SCNP. It is important to note that paragraph 313 of SFFAS 7 provides, “As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.”

A16. However, the Board recognizes that there could be uncertainty conceptually with respect to applying “gain” and “loss” to intragovernmental transactions. The Board believes the previous Board was clear in its intent by classifying debt cancellation as nonexchange. However, valid concerns were raised regarding the potential ambiguity of the terms “gain” and “loss” in the context of intragovernmental transactions, and therefore, the Board believed it important to clarify that ambiguity through this proposed Interpretation.

A17. This Interpretation clarifies that paragraph 313 of SFFAS 7 should not be interpreted to require that a line item “gain” or “loss” be displayed on the SCNP, only that debt cancellation activity be included on the SCNP.

A18. While in certain standards the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately due to materiality or may need to be included with other items for presentation. Instead, most standards allow reporting entities flexibility in determining the best presentation. The Board did not prescribe specific line items for display in paragraph 313 of SFFAS 7. Reporting entity management is responsible for determining the most appropriate presentation and display. Much judgment and consideration of materiality is required and would be specific to each reporting entity.

A19. In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered. As noted in paragraph 313 of SFFAS 7, the cancellation of debt requires an Act of Congress. Each debt cancellation is governed by the particular language used in the enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency for the purposes of cancelling the debt or it may simply cancel the debt without providing an appropriation.

A20. As noted, this Interpretation does not provide guidance on budgetary accounting. Central agencies provide guidance on budgetary accounting[7] for debt cancellation based upon language provided in the legislation canceling the debt and based upon budget concepts. For example, OMB Circular A-11, *Preparation, Submission, and Execution of the Budget,* provides instructions on budget execution, including guidance on the apportionment and reapportionment process, a report on budget execution and budgetary resources (SF 133), and a checklist for fund control regulations. In addition, the Treasury Financial Manual is Fiscal Service's official publication of policies, procedures, and instructions concerning financial management in the federal government.

OMB A-136 Form and Content

A21. OMB specifies the form and content of agency financial statements, pursuant to its authority under the Chief Financial Officers Act of 1990, as amended (31 U.S.C. § 3515(d)) through issuance of Bulletins and Circulars. OMB prescribes form and content in OMB Circular A-136, *Financial Reporting Requirements*, based on the requirements and guidance contained in FASAB standards but also may provide more specific detailed instructions.

A22. As part of the research on this project, FASAB coordinated with OMB and determined that certain changes to the form and content requirements provided for the SCNP in A-136 would ensure clarity and consistency with GAAP. Specifically, eliminating the sub-categories "Budgetary Financing Sources" and "Other Financing Sources (Nonexchange)" presented under the Cumulative Results on the SCNP would simplify the presentation and thereby enhance the clarity.

Disclosures

A23. The Board considered whether this proposed Interpretation should clarify disclosures. The Board believed it important to remind users that management is responsible for reporting, presentation, and display. Therefore, this would include consideration of additional disclosures. The reporting entity may believe it relevant to provide readers information about debt cancellation and the impact[8] of the debt cancellation.

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[7] See paragraphs 23-26 and paragraphs 77-82 of SFFAS 7 for discussion about budgetary information and the budgetary accounting perspective. In addition, paragraphs 203-223 of the Basis for Conclusions provides further rationale and explanation of SFFAS 7 specific to budgetary principles, the budget process and its link to proprietary accounting.

[8] For example, if a cancellation of debt is for a business-type activity, and it prevents the reporting entity from having to increase future charges for goods or services the reporting entity should disclose this. In addition, a summary of the impact of the cancellation on the reporting entity, the lender, and current and future users of the goods or services could be provided.

APPENDIX B: EXCERPTS FROM SFFAS 7

This appendix provides relevant excerpts related to budgetary accounting to assist users during the exposure draft comment period and will be removed.

SFFAS 7, Introduction paragraphs 23-26 provide a detailed discussion about the budgetary perspective.

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

purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

SFFAS 7 paragraphs 77-82 also provide discussion about budgetary accounting:

77. The budget is the primary financial planning and control tool of the government. For this reason, and because of the importance of this information to users of federal financial information, the following material budgetary information should be presented by reporting entities whose financing comes wholly or partially from the budget:

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

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

(c) outlays.

78. Recognition and measurement of budgetary resources should be based on budget concepts and definitions contained in OMB Circulars A-11 and A-34. In addition, the reporting entity should provide this information for each of its major budget accounts as supplementary information. Small budget accounts may be aggregated.

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 [Footnote Omitted] and net outlays by the entity during the reporting period. The reconciliation should reference the reported “net outlays” [Footnote Omitted] and related adjustments as defined by Office of Management and Budget (OMB) Circular A-11: *Preparation, Submission, and Execution of the Budget*.

81. The net cost of operations should be adjusted by

a) components of net cost that are not part of net outlays (e.g., depreciation and amortization expenses of assets previously capitalized, change in asset/liabilities);

b) components of net outlays that are not part of net cost (e.g., acquisition of capital assets); and

c) other temporary timing differences (e.g., prior period adjustments due to correction of errors).

82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between net outlays and the accrual basis 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.

SFFAS 7, Basis for Conclusions paragraphs 203-223 discusses the link between the budgetary process and accounting, as included below:

203. The standards for other financing sources and budgetary resources should satisfy several of the objectives of financial reporting such as: (1) explaining the relationship of budgetary resources obligated to the net cost of operations, (2) showing how budgetary resources were used and the status of budgetary resources at the end of the period, and (3) indicating the effect on the net results of operations of the entity of all the financing sources used to finance the net cost of operations. However, financing from a financial accounting (proprietary) perspective is different than the budgetary accounting perspective.

204. The budget is the primary financial planning and control tool of the Government. Its objectives, such as planning resource allocation, authorizing and controlling obligations, planning cash disbursements, and raising revenue, differ from those of financial reporting where the focus is on net cost of the entity’s programs and activities and stewardship of its assets and liabilities. Differing objectives are responsible for some but not all of the many differences in these two financial management tools. Differences in standards for measuring and reporting budgetary and financial information, coupled with unreliable data, have caused financial statements to be under-utilized by Government managers, the budget community, and others who might benefit from financial information.

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 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. [Footnote 43] 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.

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

213. From the budgetary perspective, appropriations include dedicated tax receipts, such as Social Security taxes and Highway Trust Fund excise taxes. From a proprietary perspective, on the other hand, unexpended appropriations do not include dedicated tax receipts, because these receipts are accounted for as nonexchange revenue. Therefore, appropriations used do not include dedicated tax receipts, thus avoiding double counting of these amounts as financing sources.

214. The accounting treatment for recognizing "appropriations used" as a financing source parallels the budgetary accounting for expended appropriations. Expended appropriations are recognized when goods and services ordered have been delivered, when benefits are payable to recipients, or when funds available under a grant agreement are payable, and there is an available appropriation to pay these amounts. Under this standard, this is also the time when "appropriations used" is recognized as a financing source in the proprietary accounts.

215. Thus, at the time a liability is established which will be paid by an available appropriation, appropriations are considered used. Liabilities should be established in accordance with SFFAS No. 5. Under that standard, a liability can be established in several ways, and the type of transaction that has occurred governs when a liability has occurred. For example, grants can be provided under different transactions. Some can be provided without any required exchange of service with the federal government, while others may require specific activities to occur before the funds are available.

216. Providing funds from an appropriation does not necessarily cause the recognition of a financing source if that payment is an advance. For example, an entity may advance funds to a grantee under the grant agreement. This should not cause recognition of a financing source. The recognition of appropriations used would not occur until the grantee meets the requirements that allow it to use the funds in accordance with the grant agreement.

217. The focus on net cost rather than on matching financing with expenses as incurred provided an opportunity to simplify the accounting for appropriations and to eliminate one of the differences between financial and budgetary accounting. Reporting entities will no longer have to defer recognition of appropriations used nor accrue appropriations before they become available.

- Recognition was previously deferred for appropriations used to finance capitalized transactions, such as the purchase of a fixed asset or the making of a loan under pre-credit reform programs which have not converted their accounts to a present value basis. The use of financing was previously recognized at the same time and rate that depreciation of the asset's cost was recognized as an expense or that bad debts expense was recognized on pre-credit reform receivables which had not been converted to present values.

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

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.[Footnote Omitted] 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 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.

APPENDIX C: ABBREVIATIONS

FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
SCNP	Statement of Changes in Net Position
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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