Federal Accounting Standards Advisory Board

December 21, 2005

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Comes, Executive Director

Subject: Application of the Liability Definition[1] – Tab F

At the October 6, 2005, board meeting, staff presented the following three potential liability classification options:

1. Option 1 – Maintain Current SFFAS 5 Liability Classes
2. Option 2 – Develop New Liability Classes by Transaction Type
3. Option 3 – Develop New Liability Classes by Relationship Type

Staff stated that after considering the advantages and disadvantages to selecting each option and the degree of flexibility, effectiveness, and feasibility that might potentially result from choosing each of the options, the staff recommended that you select option 2.

After a brief discussion, Mr. Mosso took a poll to determine your preferences for the three options. You overwhelmingly selected option 1 as your preference; however, several of you noted that even though you were selecting option 1, you recognize that option 1 may still require some revision or enhancements to what is contained in SFFAS 5. Staff agreed to provide you with a revised list of liability classes based on option 1 with the different transaction types in option 2 incorporated.

The staff objective for the January meeting is to obtain your approval of the revised project plan, which incorporates classes of liabilities as well as community involvement. Staff has also included an excerpt from the previous project plan at Appendix 1; an excerpt from FASAB SFFAS 5, *Accounting for Liabilities of the Federal Government* at Appendix 2; a discussion of selected issues regarding the exchange/nonexchange distinction at Appendix 3; a discussion of the obligating event versus settlement event at Appendix 4; GASB's view on nonexchange transactions at Appendix 5; and a glossary of selected terms relevant to the liability application discussion at Appendix 6.

Please contact me at 202-512-7377 or by e-mail at ranaganj@fasab.gov with any questions or comments.

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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I. Primary Objective

The first sub-objective for Operating Performance states that Federal financial reporting should provide information that helps the reader to determine the costs of providing specific programs and activities and the composition of, and changes in, these costs.[1] The second and third sub-objectives for Stewardship state that federal financial reporting should provide information that helps the reader to determine whether the government's financial position improved or deteriorated over the period and whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.[2]

However, current FASAB standards do not present recognition, measurement, display, and/or disclosure guidance for activities of the government that do not specifically meet the criteria for liabilities recognized or disclosed under SFFAS 5, *Accounting for Liabilities of the Federal Government*; SFFAS 12, *Recognition of Contingent Liabilities from Litigation*; or SFFAS 17, *Accounting for Social Insurance.* Although the standards do not preclude preparers from applying the liability definition to other transactions than those specifically addressed, it seems that few have attempted to do so.

The purpose of this project is to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements,[3] and all related disclosures for obligations[4] of the federal government that could potentially result in a net outflow of resources. Some such obligations may not currently be recognized as liabilities on the balance sheet while others may be recognized based on "due and payable" concepts. The focus of this project would be on both (1) how to recognize, measure, and display obligations that meet the revised definition of a liability and (2) how (and whether) to disclose information about obligations that do not meet the revised definition of a liability. This project would draw on the work completed by the elements phase of the Conceptual Framework and the Social Insurance[5] projects currently underway by FASAB staff, as appropriate.

II. Background

This project was formally introduced in April 2004. It has naturally evolved from the Social Insurance Liability Project due to the need to concurrently review other commitments undertaken by the Federal Government that may be more accurately portrayed with additional liability recognition, disclosure, and/or display requirements beyond due and payable. Fact sheets for Medicaid, Food Stamps, Temporary Assistance for Needy Families, and Supplemental Security Income were provided for the Board's information in conjunction with the Social Insurance Liability Project presentation. Staff also presented the Board with in-depth analyses of potential obligating events for the following four programs: Supplemental Security Income, Milk Income Loss Contract, Feed Grains Direct and Counter-Cyclical, and the Corporation for National and Community Service's Service Award Liability.

[1] FASAB SFFAC No. 1, *Objectives of Federal Financial Reporting*, par. 14
[2] FASAB SFFAC No. 1, *Objectives of Federal Financial Reporting*, pars. 136 and 139
[3] The scope of this project suggests that we should not preclude the development of new elements or statements if needed to adequately meet reporting objectives. However, staff does not suggest that this option be explored until existing (but evolving) element definitions and statements have been thoroughly considered.
[4] The term "obligation" is used in its everyday or generic sense (duty, responsibility, etc), not as it is used in federal budgetary accounting. Alternative wording is being considered as part of the elements project.
[5] The Social Insurance project addresses recognition and measurement and display of liability and expense for Old-age, Survivors and Disability Insurance; Medicare Hospital Insurance; Medicare Supplementary Medical Insurance; Railroad Retirement Benefits; Black Lung Benefits; and Unemployment Insurance for the general public.

II. Project Scope

This project would address all significant obligations of the federal government that could potentially result in a net outflow of resources other than those obligations already being addressed by staff for the Social Insurance Liability Project. The project would focus on (1) obligations arising from transactions between individuals and the government and (2) assumption of risk through unique federal activities such as treaties or government sponsored enterprises. Significant government obligations include Medicaid, Food Stamps, Supplemental Security Income (SSI), Temporary Assistance for Needy Families (TANF), Veterans benefits, treaties, contractual agreements, and Government Sponsored Enterprises.

IV. Project Approach[6]

There is broad and general agreement among FASAB Board members that establishing liability classes[7] would result in a more consistent application of the liability definition without the need for step-by-step rules on how to apply the definition to each government program as it comes into being. It is important to note, however, that the use of liability classes should not result in separate definition, recognition and measurement criteria for each class. Rather, the use of liability classes and sub-classes should allow grouping and discussion of common events and relationships within a class that would be relevant to consistently applying liability definition, recognition, and measurement criteria.

At the October 6, 2005, board meeting, the members voted to maintain the four broad classes that FASAB used to establish principle recognition points in SFFAS 5, *Accounting for Liabilities of the Federal Government*. Staff has slightly revised the definition of each of the classes as indicated by the use of underlining below:[8]

1. **Exchange Transactions** – an exchange transaction arises when each party to the transaction directly sacrifices value and directly receives similar value in return. There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., the federal government purchase of goods or services at market value[9] from a vendor);

2. **Nonexchange Transactions** – a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising similar value in return or one party to a transaction gives or promises value without directly receiving similar value in return. There is no reciprocal or two-way flow of resources or of promises to provide resources of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals);

3. **Government-related Events** – government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place

[6] The previously approved project approach is included at Appendix 1.
[7] A class is "a group, set, or kind sharing common attributes" (characteristics) as defined by Merriam-Webster Online at www.webster.com.
[8] The original definitions are included at Appendix 2.
[9] Market value is defined as the price as determined dynamically by buyers and sellers in an open market.

on federal property (e.g., accidental damage to nonfederal property caused by federal operations); and,

4. **Government-acknowledged Events** – government-acknowledged events are nontransaction-based events that are not the result of federal operations and do not directly involve the federal government but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

The underlined additions above were made (1) to apply the word "direct" more consistently (see discussion of Issue 1 in Appendix 3) and (2) for clarification purposes.

At the October 6, 2005, board meeting, several board members indicated that they would like to see how the transaction types in staff's Option 2 could be "mapped" to the liability classes in Option 1. The following listing presents this mapping:

1. Exchange Transactions

   a. Employee and Veteran Benefit Payments – Examples would be federal employee pension and other retirement benefits, military pension and other retirement benefits, other post-employment benefits, FECA, and Veterans disability compensation.[10]
   b. Capital Leases – Leases that transfer substantially all the benefits and risks of ownership to the lessee.
   c. Federal Debt – Includes Treasury debt to federal agencies, federal agency debt to the Treasury, and federal debt to the public.
   d. Accounts Payable for Goods and Services – Includes goods and services purchased through any means, including contracts, purchase orders, blanket purchase agreements, credit cards, intragovernmental agreements, etc.
   e. Other

2. Nonexchange Transactions

   a. General Fund Benefit Payments – Benefit payments that are financed by general revenues. Examples would be Temporary Assistance to Needy Families, Medicaid, Food Stamps, and Supplemental Security Income.
   b. Insurance and Guarantees – Examples would include Pension Benefit Guaranty Corporation, Federal Crop Insurance Corporation, Overseas Private Investment Corporation, Federal Deposit Insurance Corporation, Loan Guarantees, the Milk Income Loss Contract Program, the Feed Grains Direct and Counter-Cyclical Payment Program, and other stand-ready obligations.
   c. Grants and Award Programs – Government grants and awards can be provided under many different scenarios. Some can be provided without any significant requirements (e.g., formula-type grants to states based on population), while others may require specific activities to occur before the funds are available (e.g., the Corporation for National and Community Service's Service Award Program).
   d. Social Insurance – Includes Social Security, Medicare, and Railroad Retirement (see discussion of Issue 2 in Appendix 3).

[10] Some believe that Veterans' benefits arise from exchange transactions. However, SFFAS No. 5 provides an exception to full accrual accounting for health care benefits. This is a controversial exception in light of legislation intended to enhance veterans' access to health care. The Board agreed to take up this issue in connection with this broad project on obligations.

e. Environmental and Disposal –Includes actions that are taken to comply with the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA, or Superfund), and subsequent amendments; Safe Drinking Water Act; and Toxic Substances Control Act.

f. Other

3. Government-related Events

a. Environmental and Disposal (e.g., hazardous waste resulting from government operations or the disposal of assets)

b. Damage to nonfederal property caused by federal operations (e.g., military aircraft crashes into private office building)

c. Damage to federal property resulting from federal operations or natural disasters (e.g., damage to the National Finance Center in New Orleans caused by Hurricane Katrina)

d. Treaties

e. Other

4. Government-acknowledged Events

a. Environmental and Disposal (e.g., toxic waste damage to nonfederal property caused by nonfederal entities).

b. Damage to nonfederal property caused by natural disasters (e.g., damage to an apartment building in New Orleans caused by Hurricane Katrina)

c. Other

Staff Note: The classes and sub-classes above are based on the usual practice of the federal government but are not without exception. For example, in the unlikely event that the federal government was to enter into a capital lease that transferred substantial benefits to the federal government for significantly less than fair market value, the transaction would be more appropriately classified as a nonexchange transaction. In addition, there may be some insurance programs that are closer to exchange transactions if the value of the premiums received more closely matches the value of the risk assumed. However, many federal insurance programs were established to assume risks that private sector entities are unable or unwilling to assume (at least at prices that beneficiaries of the program can afford or want to pay) or to subsidize the provision of insurance to achieve social objectives. The four classes allow grouping and discussion of common events and relationships within a class that would be relevant to applying the liability definition. The “Other” sub-class is included as a placeholder for additional sub-classes that may arise as a result of the task force involvement discussed below.

Does the Board agree with these proposed classes and sub-classes?

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If the board members approve the above liability classes, staff proposes the five tasks below. These tasks are not mutually exclusive and need not be completed sequentially. They are currently prioritized according to staff's assessment of the perceived need for additional guidance in each area. In practice, it may be necessary for staff to work on multiple tasks simultaneously to achieve the greatest results.

<u>Task One – Test the four Classes and Sub-classes of Liabilities</u>
Staff would engage the federal financial management community in testing the completeness and suitability of the four classes and sub-classes of liabilities. Staff would accomplish Task One through the use of a task force. Engaging the community for Task One would help ensure completeness of the population of liabilities to be considered and raise potential issues as early as possible. Staff proposes that the task force address the following areas:

- Determine whether the four classes from SFFAS 5 are generally working;
- Describe relevant relationships/key events;
- Enhance the list of sub-classes and determine if each is operationally distinct; and,
- Test completeness and usefulness of classes, sub-classes, and relationships against knowledge of current practice.

(Staff does not anticipate that assistance from the task force would be required for Tasks Two through Five).

<u>Task Two – Government-Acknowledged Events</u>

- Develop principles for determining when an obligating event has occurred for government-acknowledged events and related recognition criteria.
- Prepare standards for each sub-class and issue an exposure draft.

<u>Task Three – Nonexchange Transactions</u>

- Develop principles for determining when an obligating event has occurred for nonexchange transactions and related recognition criteria.
- Prepare standards for each sub-class and issue an exposure draft.

<u>Task Four – Government-Related Transactions</u>

- Develop principles for determining when an obligating event has occurred for government-related events and related recognition criteria.
- Prepare standards for each sub-class and issue an exposure draft.

<u>Task Five – Exchange Transactions</u>

- Develop principles for determining when an obligating event has occurred for exchange transaction and recognition criteria.
- Prepare standards for each sub-class and issue an exposure draft.

Does the Board agree with this approach?

The appendices that follow this paper are provided as follows:

- **Appendix 1** provides an excerpt from the September 23, 2004 project plan as a convenience to board members who would like to recall the previously approved project approach.

- **Appendix 2** provides as excerpt from SFFAS 5 as a convenience to board members who would like to recall the definition of a liability and discussion of events and transactions contained in the current FASAB standards.

- **Appendix 3** contains a discussion of two issues that staff debated while updating the project plan: (1) the inconsistency between the SFFAS 5 definitions of exchange and nonexchange, and (2) the classification of social insurance as an exchange or nonexchange transaction.

- **Appendix 4** contains a discussion of the notion of the obligating event and the settlement event as an area that may be developed further in future staff papers.

- **Appendix 5** contains excerpts from GASB standards and is provided for informational purposes only. However, staff found it very helpful to read the approach taken by GASB in the area of nonexchange transactions and provides the excerpts here as a convenience to board members. It is interesting to note that, while GASB created two sub-classes of nonexchange transactions in Statement 33 (see par. 7c. and 7d. in Appendix 5), the two sub-classes are grouped together for purposes of liability recognition (see par. 21 in Appendix 5).

- **Appendix 6** contains a glossary of terms that may be used during the discussion of this project. The terms exchange transaction, nonexchange transaction, government-related event and government-acknowledged event have been updated to be consistent with the definitions recommended by staff in this paper. Changes are denoted by bolded and underlined text.

EXCERPT FROM SEPTEMBER 23, 2004 PROJECT PLAN:

IV. Project Approach

This project would cover a broad range of activities. Staff proposes that the first step in the project would be to gather additional information on the various kinds of programs of the government that result in significant obligations of some type. Staff would compile fact sheets on the various programs, develop a set of characteristics to be reviewed in line with what has been done in the Social Insurance liability project, and assign each program a broad category based on like characteristics. See appendix 3 [of the September 23, 2004 project plan] for the fact sheets compiled to date and discussed at the August 26th meeting in support of the Social Insurance Liability Project. Staff would not review all government programs, but rather a selection of programs that would be varied enough to effectively support the development of a principal-based standard.

Staff proposes that the following three phases be considered:[11]

> <u>Phase One – Benefits Provided to Individuals</u>
> This phase would address entitlement programs other than SI (Category I). Programs to be considered are veterans' benefits, Medicaid, Food Stamps, TANF, and SSI.
>
> <u>Phase Two – Government Sponsored Enterprises</u>
> This phase would explore the implied assumption of risk associated with Government Sponsored Enterprises, e.g., Fannie Mae and Freddie Mac (Category III) and any recognition or disclosure warranted for these activities.
>
> <u>Phase Three – Agreements that include broad assumption of risk</u>
> This phase would address treaties, contracts, and grants (Category II) that often include broad assumption of risk by the federal government.

Staff listed these phases in a logical sequence based on prior work of the Board, work currently underway in conjunction with the Social Insurance Liability Project, and input from the Board at the April 29th meeting. However, staff recognizes that this is not the only possible approach and would reorder these phases, as the Board deems necessary.

For each of the above three phases, this project would present for the Board's review:

(1) The current FASAB liability definition and its application to the category under review;
(2) Relevant applications of definitions established by other standard-setters;[12]
(3) Alternative obligating events (e.g., past events which create present obligations);
(4) Alternative measures for each major category of obligations;
(5) Alternative displays for the balance sheet, statement of net cost, and/or other statements;
(6) Alternative disclosures; and
(7) Associated issues.

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[11] This is a draft proposal of phases based on information gathered during the Social Insurance and liabilities projects and may be revised as a result of research completed during the information gathering stage of this project. Staff would present the Board with the results of the information gathering stage and proposed categories before proceeding with additional phases.

[12] For example, the International Federation of Accountants, Public Sector Committee, Invitation to Comment, "Accounting for Social Policies of Governments," January 2004 proposes three options for different recognition points as related to social obligations. This methodology would be reviewed as part of staff work on this project.

Excerpt from SFFAS 5, paragraphs 19 – 32

Definition and General Principle for Recognition of a Liability

19. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize[13] probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.[14]

Events and Transactions

20. The existence of a past event (which includes transactions) is essential for liability recognition. An event is a happening of financial consequence to an entity.[15] An event may be an internal event that occurs within an entity, such as transforming raw materials into a product. An event may also be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, a theft, vandalism, an injury caused by negligence, or an accident.

21. As the term is used in this Statement, a **transaction** involves the transfer of something of value. Transactions may be either exchange transactions or nonexchange transactions. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting.

22. Exchange Transactions – an **exchange transaction** arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.[16]

23. An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs. The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.

24. A **nonexchange transaction** arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services[17] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers for service

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[13] SFFAS 5, Footnote 16: Recognition means reporting a dollar amount on the face of the basic financial statements.

[14] SFFAS 5, Footnote 17: This document uses the term "nonexchange transaction" in a way similar to FASB's "nonreciprocal transfer." That is, it implies a one-way flow of resources, services, or promises between two parties. "Transaction" in the phrase "nonexchange transaction" does not include reclassification, closing, and similar "internal" entries to the accounting records, though some accountants use the term in that broader sense. "Probable" means more likely than not. "Measurable" means reasonably estimable.

[15] SFFAS 5, Footnote 18: "Consequence" is defined as something of importance or significance.

[16] SFFAS 5, Footnote 19: Executory contracts where goods and services have not been received are not generally recognized as liabilities in financial accounting, although they are generally recognized as obligations in governmental budgetary accounting.

[17] SFFAS 5, Footnote 20: Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).

25. Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

26. An **event** is defined as a happening of financial consequence to an entity. For federal financial reporting, some events may be other than transaction based and these events may be classified in one of two categories: (1) government-related events or (2) government-acknowledged events.

27. **Government-related events** are nontransaction-based events that involve interaction between the federal government and its environment. The event may be beyond the control of the federal entity. In general, a liability is recognized in connection with government-related events on the same basis as those that arise in exchange transactions. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably.[18]

28. Government-related events include:

    (1) cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations, that are in effect as of the Balance Sheet date, to clean up (i.e., remove, contain, or dispose of);[19]

    (2) accidental damage to nonfederal property caused by federal operations; and

    (3) other damage to federal property caused by such factors as federal operations or natural forces.[20]

29. Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.

30. **Government-acknowledged events** are those nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event. The federal government has broad responsibility to provide for the public's general welfare. The federal government has established programs to fulfill many of the general needs of the public and often assumes responsibilities for which it has no prior legal obligation.

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[18] SFFAS 5, Footnote 21: The vast majority of claims against the United States Government stemming from tortious government conduct are adjudicated under the Federal Tort Claims Act (FTCA), which provides for both administrative and judicial resolution. Administrative awards under the established threshold are paid from agency appropriations. Administrative awards in excess of the established threshold are paid from the judgment appropriation. Court judgments and compromise settlements by the Department of Justice are paid from the judgment appropriation regardless of amount. This Act means that, for certain types of events it is not necessary for the government to acknowledge financial responsibility separately for each individual event as is the case for events described in paragraph 30.

[19] SFFAS 5, Footnote 22: See SFFAS No. 6, Accounting for Property, Plant, and Equipment, for a detailed discussion of cleanup cost.

[20] SFFAS 5, Footnote 23: The subjects of valuing assets and of measuring asset impairments--thus measuring the loss to be recognized--are beyond the scope of this Statement. See SFFAS No. 6, Accounting for Property, Plant, and Equipment, for a discussion on the impairment or loss of federal property.

31. Consequently, costs from many events, such as toxic waste damage caused by nonfederal entities and natural disasters, may ultimately become the responsibility of the federal government. But these costs do not meet the definition of a “liability” until, and to the extent that, the government formally acknowledges financial responsibility for the cost from the event and an exchange or nonexchange transaction has occurred. In other words, the federal entity should recognize the liability and expense when both of the following two criteria have been met (1) the Congress has appropriated or authorized (i.e., through authorization legislation) resources and (2) an exchange occurs (e.g., when a contractor performs repairs) or nonexchange amounts are unpaid as of the reporting date (e.g., direct payments to disaster victims), whichever applies.

32. The following example illustrates the liability recognition of government-acknowledged events. A tornado damages a U.S. town and the Congress appropriates funds in response to the disaster. This event is of financial consequence to the federal government because the federal government chooses to provide disaster relief to the town. Transactions resulting from this appropriation, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or nonexchange transactions. In the case of exchange transactions, amounts payable for goods and services provided to federal entities are recognized when the goods are delivered or the work is done. In the case of nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the federal entity’s reporting date, whether or not such amounts have been reported to the federal entity.

Issue 1: Definitions in SFFAS 5 for exchange and nonexchange are inconsistent.

SFFAS 5, par. 22

> An **exchange transaction** arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.[21]

SFFAS 5, par. 24

> A **nonexchange transaction** arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. . . [underline added for emphasis]

Glossary (SFFAS 5 and Codification)

> **Exchange Transaction -** A transaction that arises when each party to the transaction sacrifices value and receives value in return.
>
> **Nonexchange Transaction -** A transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return.

As evidenced by the excerpts from SFFAS 5 above, the only place that the word “directly” appears in any of the definitions is in par. 24 with respect to a nonexchange transaction. This word can have significant meaning in considering whether a transaction is exchange or nonexchange. If the exchange need not be direct, a wide variety of programs could be considered to be exchange programs. Since the Board wishes to keep the distinction between exchange and nonexchange, the Board should decide whether it believes the exchange needs to be direct. If so, the standard and definitions should be amended to be consistent.

Staff Recommendation

Staff recommends that the exchange and nonexchange transaction definitions be amended to be consistent and require that exchange transactions be direct and of similar value.

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

Issue 2: Social Insurance as Exchange or Nonexchange Transaction

The issue of whether social insurance is an exchange or nonexchange transaction has been a long-debated in the twelve-year history of FASAB liability deliberations. The draft liability definition proposed by Penny Wardlow and tentatively agreed to by the board does not make a distinction between exchange and nonexchange transactions. Further, the Board considered application of the liability definition to social insurance programs and reached tentative conclusions regarding the obligating event without reference to a unique framework for "non-exchange transactions." However, as part of this project, the board voted to continue to use the distinction to help establish the obligating events necessary for recognition. Staff is raising the question of classification since it is a necessary step in presenting a comprehensive list of sub-classes for the four classes. To inform your discussion, staff is presenting a chronological history on the matter below, followed by the methodology used by staff in classifying social insurance as a nonexchange transaction.

SFFAS 5, *Accounting for Liabilities of the Federal Government*, Appendix A, Basis for Conclusions, issued on December 20, 1995, contained the following "Conclusion on Social Insurance:"

> 134. The recognition, measurement and display of obligations for social insurance programs presented the Board with significant theoretical and practical problems. From the theoretical perspective, the Board considered whether social insurance programs resulted in exchange or nonexchange transactions, or whether they contained both exchange and nonexchange features. The Board also considered the problems of articulation between the operating statement and the Balance Sheet, specifically whether the process of reporting a year-to-year change in a Balance Sheet liability might affect the usefulness of an operating statement measure of performance. Finally, the Board considered the difficulty of determining an appropriate measure of the obligation assumed, whether such a measure were to be presented on the face of the Balance Sheet or in the notes.
>
> 135. In the exposure draft Accounting for Liabilities of the Federal Government, the majority of the Board concluded that social insurance programs were entitlement programs developed to carry out the sovereign responsibilities of the government, financed primarily by compulsory earmarked taxes. The Board favored characterizing social insurance obligations as nonexchange transactions, and limiting recognition of a liability to any unpaid amounts due as of the reporting date. A significant majority of the respondents, however, agreed with an alternative view, which expressed the notion that social insurance programs contained both exchange and nonexchange features, and that there was a need for recognizing a liability at least equal to the present value of future payments due to recipients currently eligible for benefits.
>
> 136. Upon reconsideration of the issues, the Board concluded that the most appropriate approach from both the Balance Sheet and Statement of Net Cost perspectives would be: (1) to include a line item entitled "social insurance obligations" in a separate section of the Balance Sheet following the liability section and before the equity section; (2) to make note disclosure of supplementary data resulting from several approaches for measuring the obligation, and (3) to report the annual financial outflows of current financial resources on the Statement of Net Cost. The Board also decided that, given the sensitivity and magnitude of social insurance, this new position should receive additional exposure, to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been

presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and consolidated in Supplementary Stewardship Reporting.

SFFAS 8, *Supplementary Stewardship Reporting*, Appendix A, Basis for Conclusions, issued on June 11, 1996, contained the following conclusion on "Social Insurance:"

116. Consideration of guidance for the recognition, measurement and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The Board notes the strength of feelings of respondents and commentators, some of whom believe a liability should be recognized for amounts that will be paid in future periods to or on behalf of current or future program beneficiaries and others who believe that there is no obligation associated with these programs that meets the definition of a liability, other than amounts due and payable at the end of an accounting period; additionally, some favor disclosure of projected data relating to the magnitude of the present value of future net benefit payments at a particular date while others favor cash flow information for a long period of time. The Board notes too the magnitude and complexity of these programs and the extreme sensitivity of projections relating to the programs to assumptions whose range of possibilities is large. More importantly, the Board notes that social insurance programs are presently being studied and discussed frequently and seriously within government and by the public; a report and recommendations are expected shortly from the 1994-95 Quadrennial Advisory Council on Social Security. The prospects of significant changes to the programs are reasonably high. [SFFAS 17]

117. After deliberating the issue, the Board has concluded that additional investigation and further deliberation is required and has directed the FASAB staff to continue to research social insurance issues focusing especially on: identifying the characteristics of programs which should cause them to be subject to the guidance provided in a Statement on Social Insurance; the appropriate display of information in the financial statements; the identification of additional information, if any, which should be required for social insurance programs; the means for measurement of financial data included in such additional information; and, the desirability of nonfinancial indicators (ratios of data to GDP or "covered payroll") to describe the status of programs or the implications of potential changes to or needs of the programs. The Board has instructed the staff to be mindful of all current developments in structuring its research and its recommendations.

SFFAS 17, *Accounting for Social Insurance*, Appendix A, Basis for Conclusions, issued in August 1999, contained the following discussion on "Exchange and Nonexchange Transactions:"

60. During its consideration of social insurance and, before that, of liability accounting, the Board considered whether social insurance programs result in exchange or non-exchange transactions or whether they contained features of both. As described in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government, nonexchange transactions give rise to a different kind of obligation than exchange transactions under federal accounting principles.

61. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. However, for a nonexchange transaction, a liability is recognized for any unpaid amounts due and payable as of the reporting date, including estimates of claims incurred but not yet reported.

62. As defined in SFFAS No. 5, obligations become liabilities against the Federal Government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing the liability recognition point among various federal programs is whether a nonexchange transaction is involved. Although a high probability may exist that a grant, a subsidy, or an income transfer will be made or will continue to be made in future years, the recipients do not have as high an equitable claim to receive grants, subsidies, or transfers in the future as do those who exchange service for promises of future payments. The latter have a greater probability of being paid than the former. At the same time, many people feel that some social insurance benefits, Social Security in particular, also have similar “exchange” or “equitable” claims. They also believe that social insurance benefits have as great a probability of being paid as any other payments.

63. Whether on the balance sheet or elsewhere in the financial report, estimates of the future amounts required to continue present policies regarding such programs are relevant to certain decisions and should be disclosed or otherwise reported. In the context of the Board’s definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute a liability (SFFAS No. 5, pars. 129-131).

The current Social Insurance Liability and Elements projects began in August 2003. The Research into the Application of the Liability project began in April 2004. During 2004 and 2005, deliberations on the Social Insurance Liability, Elements, and Research into the Application of the Liability Definition projects turned to the distinction between exchange, nonexchange, and exchange-like on numerous occasions. The board was not comfortable with the term “exchange-like”; some members argued that the term was too arbitrary and would need to be considered on a case-by-case basis. Thus, the board opted not to pursue the use of the term “exchange-like.”

Over the last two years, the board has concluded that the distinction between exchange and nonexchange is not necessary for an obligation to meet the definition of a liability. In addition, the board has not focused on the relative strength of equitable claims (SFFAS 17, par. 62 presented above); rather the board has evaluated the obligation based on terms and conditions embodied in current law. In planning for further work on application of the liability definition, the board has concluded that the distinction between exchange and nonexchange is helpful in identifying obligating events for recognition. Furthermore, the board has concluded that the amount due and unpaid as of the reporting date (due and payable) is not the default recognition point for all nonexchange transactions. Nonetheless, no conclusion has been reached on whether social insurance is an exchange or nonexchange transaction.

Staff Recommendation

The summary section of SFFAS 17 states, "Social insurance programs have complex characteristics and thus require specialized accounting standards. These programs blend elements of exchange and nonexchange transactions and therefore do not completely fit traditional accounting notions of either annual governmental assistance programs (nonexchange transactions) or long-term pension programs (exchange transactions)." It is true that social insurance programs blend elements of both exchange and nonexchange transactions. This has been discussed in detail in prior briefing memos on the Social Insurance Liability Project. However, the distinction between exchange and nonexchange was more constricting when the board agreed that all nonexchange transactions would be recognized at the due and payable point. The board has agreed to abandon due and payable as the default recognition point for all nonexchange transactions. As a result, obligating events for nonexchange transactions must be identified based on the definition of liabilities and the explanatory text to be included in the concept statement. Thus, staff envisions establishing broad principles informed by the tentative decisions of the board on social insurance and the related discussions.

Staff recommends that the "nonexchange" category be applied broadly since that has been the historical practice. Staff believes individuals could differ on the "exchange" characteristics of other programs as well (e.g., subsidies to encourage milk production might be viewed as an exchange of government guarantees for participation in the industry). Therefore, introducing a special class (exchange-like) or over-emphasizing the effect of classification would be unproductive since the Board is applying the same definition to all transactions and events. The four classes instead allow grouping and discussion of common events and relationships within a class that would be relevant to applying the liability definition.

Obligating Event versus Settlement Event

Before discussing a proposed approach to operationalizing the application of the liability definition, staff found it helpful to consider the notion of the obligating event versus the settlement event. This brief discussion is presented for informational purposes only and is not intended to be complete. The notion that the distinction between the obligating event and the settlement event is central to identifying the obligating event from among many possible events leading to the provision of goods or services will be further developed in future staff papers. The examples below merely illustrate how one *might* distinguish between the two.

Obligating Event	Settlement Event
- Is a past or present event(s) - Heart of the liability definition	- Will occur in the future - Heart of measurement and recognition

Present Obligation*

* Present obligation exists when there has been an obligating event involving a second party with whom there is a mutual agreement or understanding as to when settlement of the obligation is to occur and the government has taken action that commits or binds itself under the agreement.

One example to illustrate the distinction between the two is in the case of pensions. The obligating event results from the establishment of a pension plan and performance of work consistent with the terms of the plan. The settlement event will occur in the future when the worker ages, retires and begins to draw down on the pension. The plan specifies when settlement will occur by indicating events that permit cash payments to begin and these events are “settlement” events. An estimate of the timing and amount of the settlement event(s) is used for recognition of the liability at the point there is a present obligation, which is when the obligating event occur

To further illustrate, it may be helpful to discuss the hypothetical case of two bequests made in a will. Bequest one provides that the deceased’s grandson will receive $100,000 upon reaching age 25. The estate has a present obligation that must be settled when the deceased’s grandson has his 25th birthday. Bequest two provides that the deceased’s granddaughter will receive $100,000 four years after registering for college. The estate will be obligated when the granddaughter first registers for college; registering is the obligating event. The settlement event is established as four years following the obligating event.

The foregoing hypothetical is simplified for purposes of illustration. In practice, the obligating and settlement events may occur simultaneously or be linked (e.g., settlement is 30 days after the obligating event occurs). For example, the bequest might have specified that the granddaughter receive $100,000 upon graduation from college instead of four years after registering for college.

Settlement events determine the timing of provisions of goods or services. When not linked to an obligating event, a key characteristic of settlement events is that the parties have no direct role in causing the settlement event to occur or not occur. That is, a settlement event may relate solely to the passage of time, acts of God or market results. While parties may have some control over the timing (for example, retirement may occur at the first possible date or later), the occurrence or non-occurrence of the event is generally not within their control. In reviewing the conditions or eligibility criteria for programs, staff will further develop the notion of obligating and settlement events.

Various Excerpts from GASBS 11, 33, and 34 Related to Nonexchange

GASBS 11, *Measurement Focus and Basis of Accounting – Governmental Fund Operating Statements*, par. 131[22]

131. Most revenues reported in governmental funds are not from exchange or "earnings" transactions; they are from taxes and other nonexchange transactions or events. Taxes and other nonexchange transactions involve a transfer of something of value between two or more entities, but there is no direct relationship between the value received and the value given. With taxes, for example, a government receives amounts from taxpayers and uses them to provide a variety of services. The taxpayers do not necessarily receive value in direct proportion to the taxes they pay, but they receive indirect value in having governmental programs and services available in their community. Private-sector accounting standards might refer to these transactions as nonreciprocal transfers, which FASB Concepts Statement No. 6, Elements of Financial Statements, defines as transactions "in which an entity incurs a liability or transfers an asset to another entity (or receives an asset or cancellation of a liability) without directly receiving (or giving) value in exchange" (paragraph 137). This Board believes the term nonexchange more accurately describes the indirect receiving and giving of value in the governmental environment.

GASBS 11, par. 206

206. Governmental fund operating expenditures arise from both exchange and nonexchange transactions. In an exchange transaction, each party to the transaction receives and sacrifices something of value. This Statement provides detailed recognition criteria for operating expenditures arising from certain exchange transactions, including the purchase of services, such as personal services, insurance, rent, and utilities. However, many governmental fund operating expenditures arise from transactions other than exchanges. These are transactions in which governments transfer resources to other governments and to citizens for legislatively approved programs, such as education, housing, and food. The Board is separately researching the issues on accrual-basis recognition of operating expenditures arising from nonexchange transactions.

GASBS 33, *Accounting and Financial Reporting for Nonexchange Transactions*

Preface

This Statement establishes accounting and financial reporting standards to guide state and local governments' decisions about when (in which fiscal year) to report the results of nonexchange transactions involving cash and other financial and capital resources. In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. The amount of a homeowner's property tax, for example, is not directly related to the value or amount of services to that taxpayer that are financed by property taxes. The absence of an equal exchange sometimes can make it difficult to decide when a transaction has occurred that should be recognized in the financial statements.

Most governments receive a large proportion of their revenues through nonexchange transactions, including income, sales, and property taxes; intergovernmental grants, entitlements, and other financial assistance; and private donations. Many governments also provide financial assistance to other

[22] GASBS 11 is indefinitely deferred by GASB Statement 17 to periods beginning approximately two years after an implementation standard is issued. According to paragraph 5 of GASBS 17, "Early application is not permitted because of the need for simultaneous implementation with GASB pronouncements on financial reporting, capital reporting, pension accounting, and the types of nonrecurring projects and activities that have long-term economic benefit and for which debt meets the definition of general long-term capital debt. The new effective date and transition requirements for this Statement will be established by a future Statement on financial reporting."

governmental and nongovernmental entities. Because of this, governments' decisions about when to include nonexchange transactions in the financial statements can have important effects on reported operating results and financial position and on users' ability to compare information across governments and over time. These effects may in turn influence decisions by governments and other resource providers about future revenue-raising and resource-allocation needs.

Until now, and despite the importance of nonexchange transactions, governmental accounting and financial reporting standards have included only limited guidance on when to report them. As a result, different governments have used different criteria in making reporting decisions. This Statement establishes more uniform recognition criteria to promote greater consistency and comparability in financial reporting.

A summary of the new standards follows this preface. The summary and the one-page chart in Appendix C describe the classes of nonexchange transactions and give an overview of the recognition criteria for each class. The authoritative standards are presented in paragraphs 3 through 31. The 25 mini-cases in Appendix D are nonauthoritative illustrations that will help governments identify nonexchange transactions and apply the appropriate standards. The reasons for the Board's conclusions on the major issues are discussed in the Basis for Conclusions (Appendix B). Finally, Appendix E summarizes how the new standards will be incorporated into the GASB's Codification of Governmental Accounting and Financial Reporting Standards.

The GASB is responsible for developing standards of state and local governmental accounting and financial reporting that will (a) result in useful information for users of financial reports and (b) guide and educate the public, including issuers, auditors, and users of those financial reports. The GASB has an open decision-making process and encourages broad public participation. The research and due-process procedures that we followed in developing this Statement are summarized in the Background (Appendix A).

Summary

This Statement establishes accounting and financial reporting standards for nonexchange transactions involving financial or capital resources (for example, most taxes, grants, and private donations). In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. The principal issue addressed in this Statement is the timing of recognition of nonexchange transactions—that is, when should governments recognize them in the financial statements?

Classes of Nonexchange Transactions

This Statement identifies four classes of nonexchange transactions based on shared characteristics that affect the timing of recognition:

1. Derived tax revenues, which result from assessments imposed on exchange transactions (for example, income taxes, sales taxes, and other assessments on earnings or consumption)
2. Imposed nonexchange revenues, which result from assessments imposed on nongovernmental entities, including individuals, other than assessments on exchange transactions (for example, property taxes and fines)
3. Government-mandated nonexchange transactions, which occur when a government at one level provides resources to a government at another level and requires the recipient to use the resources for a specific purpose (for example, federal programs that state or local governments are mandated to perform)
4. Voluntary nonexchange transactions, which result from legislative or contractual agreements, other than exchanges, entered into willingly by the parties to the agreement (for example, certain grants and private donations).

Time Requirements and Purpose Restrictions

This Statement distinguishes between two kinds of stipulations on the use of resources: time requirements and purpose restrictions. Different standards apply for each kind of stipulation.

- Time requirements specify (a) the period when resources are required to be used (sold, disbursed, or consumed) or when use may begin (for example, operating or capital grants for a specific period) or (b) that the resources are required to be maintained intact in perpetuity or until a specified date or event has occurred (for example, permanent endowments, term endowments, and similar agreements). Time requirements affect the timing of recognition of nonexchange transactions.
- Purpose restrictions specify the purpose for which resources are required to be used. Purpose restrictions should not affect when a nonexchange transaction is recognized. However, governments that receive resources with purpose restrictions should report resulting net assets, equity, or fund balance as restricted (or a reservation of fund balance for governmental funds).

Recognition Standards

The timing of recognition of, respectively, assets, liabilities, and expenses/expenditures resulting from nonexchange transactions should be the same whether the accrual or the modified accrual (current financial resources) basis of accounting is required. However, for revenue recognition to occur on the modified accrual basis, the criteria established in this Statement for accrual-basis recognition should have been met and the revenues should be available. "Available" means that the government has collected the revenues in the current period or expects to collect them soon enough after the end of the period to use them to pay liabilities of the current period. Also, this Statement continues the guidance in NCGA Interpretation 3, Revenue Recognition—Property Taxes, as amended, for recognizing property taxes on the modified accrual basis of accounting.

The timing of recognition for each class of nonexchange transactions is outlined below. (The accrual basis of accounting is assumed, except where indicated for revenue recognition.)

- Derived tax revenues

  – Assets—when the underlying exchange transaction occurs or resources are received, whichever is first.
  – Revenues—when the underlying exchange transaction occurs. (On the modified accrual basis of accounting, revenues should be recognized when the underlying exchange has occurred and the resources are available.) Resources received before the underlying exchange has occurred should be reported as deferred revenues (liabilities).

- Imposed nonexchange revenues

  – Assets—when the government has an enforceable legal claim to the resources or resources are received, whichever is first.
  – Revenues—in the period when use of the resources is required or first permitted by time requirements (for example, for property taxes, the period for which they are levied), or at the same time as the assets if the government has not established time requirements. Resources received or recognized as receivable before the time requirements are met should be reported as deferred revenues. (For property taxes on the modified accrual basis, governments should apply NCGA Interpretation 3, as amended.)

- Government-mandated and voluntary nonexchange transactions

  – Assets (recipients) and liabilities (providers)—when all applicable eligibility requirements are met or resources are received, whichever is first. Eligibility requirements are established by the provider and may stipulate the qualifying characteristics of recipients, time requirements, allowable costs, and other contingencies.

– Revenues (recipients) and expenses/expenditures (providers)—when all applicable eligibility requirements are met. (On the modified accrual basis, revenues should be recognized when all applicable eligibility requirements are met and the resources are available.) For transactions in which the provider requires the recipient to use (sell, disburse, or consume) the resources in or beginning in the following period, resources provided before that period should be recognized as advances (providers) and deferred revenues (recipients). For transactions, such as permanent or term endowments, in which the provider stipulates that resources should be maintained intact in perpetuity, for a specified number of years, or until a specific event has occurred, resources should be recognized as revenues when received and as expenses/expenditures when paid.

Other Provisions and Illustrations

This Statement also provides guidance on recognizing promises made by private donors, contraventions of provider stipulations, and nonexchange revenues administered or collected by another government. Appendix C includes a chart summarizing the classes of nonexchange transactions and recognition requirements. Appendix D includes cases to illustrate how nonexchange transactions should be classified and when they should be recognized in accordance with this Statement.

Effective Date

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2000. Earlier application is encouraged.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments, public benefit corporations and authorities, public employee retirement systems, utilities, hospitals and other healthcare providers, and colleges and universities. Paragraphs 3 and 4 discuss the applicability of this Statement.

INTRODUCTION

1. State and local governments engage in two kinds of transactions: (a) exchange and exchange-like transactions, in which each party receives and gives up essentially equal values, and (b) nonexchange transactions, in which a government gives (or receives) value without directly receiving (or giving) equal value in exchange.[23]

2. Accounting and financial reporting standards using the accrual basis of accounting generally have focused on exchange and exchange-like transactions. Little guidance exists on accrual-basis accounting for the nonexchange transactions of governments. Also, existing accounting and financial reporting standards for nonexchange transactions using the modified accrual basis of accounting are limited in scope and require clarification.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability

3. This Statement establishes accounting and financial reporting standards for the nonexchange transactions of state and local governments. It applies to all governments[24] that engage in

[23] GASBS 33, Footnote 1: In this Statement, the terms *transaction* and *transactions* refer only to *external* events in which something of value (benefit) passes between two or more parties. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.
[24] GASBS 33, Footnote 2: The terms *government*, *governments*, and *governmental* in this Statement do not include the federal government, unless otherwise indicated.

nonexchange transactions, including primary governments and component units in the same reporting entity, whether they are recipients of resources or providers of resources to others.

4. This Statement also refers to nongovernmental entities (including individuals) and the federal government as recipients or providers when they engage in nonexchange transactions with governments. However, the standards in this Statement do not apply to those entities.

5. This Statement applies to nonexchange transactions involving financial or capital resources; it does not apply to other resources, such as contributed services. Also, this Statement does not apply to food stamps and on-behalf payments for fringe benefits and salaries, which are addressed in GASB Statement No. 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance. This Statement does, however, apply to pass-through grants, as defined in Statement 24.[25]

6. This Statement supersedes American Institute of Certified Public Accountants Statement of Position 75-3, Accrual of Revenues and Expenditures by State and Local Governmental Units; paragraphs 1 through 14, 17, 19, and 20 of National Council on Governmental Accounting (NCGA) Statement 2, Grant, Entitlement, and Shared Revenue Accounting by State and Local Governments; paragraph 9 of NCGA Interpretation 3, Revenue Recognition—Property Taxes; paragraphs 14, 15, and 23 of GASB Statement No. 6, Accounting and Financial Reporting for Special Assessments; paragraphs 40 through 61 of GASB Statement No. 11, Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements; and GASB Statement No. 22, Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds.

Characteristics and Classes of Nonexchange Transactions

7. In a nonexchange transaction, a government (including the federal government, as a provider) either gives value (benefit) to another party without directly receiving equal value in exchange or receives value (benefit) from another party without directly giving equal value in exchange. This Statement groups nonexchange transactions of governments into four classes, based on their principal characteristics:

    a. Derived tax revenues result from assessments imposed by governments on exchange transactions. Examples include taxes on personal income, corporate income, and retail sales of goods and services. The principal characteristics of these transactions are (1) the assessing government imposes the provision of resources on the provider (the entity that acquires the income, goods, or services) and (2) the government's assessment is on an exchange transaction, such as the exchange of an employee's services for a wage or salary or the exchange of motor fuel for the market price of the fuel. Enabling legislation[26] sometimes requires a particular source of derived tax revenues to be used for a specific purpose or purposes. For example, revenues resulting from a motor fuel tax may be required to be used for road and street repairs. Stipulations concerning the purpose for which resources are required to be used are referred to in this Statement as purpose restrictions and are discussed in paragraph 14.
    b. Imposed nonexchange revenues result from assessments by governments on nongovernmental entities, including individuals, other than assessments on exchange transactions. Examples include property (ad valorem) taxes; fines and penalties; and property forfeitures, such as seizures and escheats. The principal characteristic of these transactions is that the required transmittal of resources to the assessing government is imposed by that government on an act committed or omitted by the provider (such as property ownership or the contravention of a law or regulation) that is not an exchange transaction. Enabling legislation sometimes places purpose restrictions on the use of the

[25] GASBS 33, Footnote 3: This Statement does not apply to the use of resources resulting from grants or other nonexchange transactions when that use is an exchange transaction (for example, the use of grant monies to purchase goods or services).
[26] GASBS 33, Footnote 4: Enabling legislation authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers).

resources. Alternatively, or in addition to purpose restrictions, the government may specify the period when the resources are required to be used or when use may begin. For example, property taxes generally are required to be used in or beginning in a particular period—the period for which the taxes are levied—which may not be the same period that payment is due or the period when the government has a right to place a lien on the property. Stipulations concerning the time period when resources are required to be used or when use may begin are referred to in this Statement as time requirements and are discussed in paragraphs 12 and 13.

c. Government-mandated nonexchange transactions occur when a government (including the federal government) at one level provides resources to a government at another level and requires that government to use them for a specific purpose or purposes established in the provider's enabling legislation.[27] That is, the provider establishes purpose restrictions and also may establish time requirements. Examples of government-mandated nonexchange transactions include federal programs that state or local governments are mandated to perform, and state programs that local governments are mandated to perform. The principal characteristics of these transactions are (1) a provider government (including the federal government) mandates that a recipient government perform a particular program or facilitate its performance by another government or by a nongovernmental entity (secondary recipient) and (2) fulfillment of certain requirements is essential for a transaction (other than the provision of cash or other assets in advance) to occur. These essential requirements may include time requirements and are referred to in this Statement as eligibility requirements. Eligibility requirements are discussed in paragraphs 19 and 20.

d. Voluntary nonexchange transactions result from legislative or contractual agreements,[28] other than exchanges, entered into willingly by two or more parties. Examples of voluntary nonexchange transactions include certain grants, certain entitlements, and donations by nongovernmental entities, including individuals (private donations). Both parties to a voluntary nonexchange transaction may be governments (including the federal government, as a provider), or one party may be a nongovernmental entity, including an individual. Frequently, the provider establishes purpose restrictions and eligibility requirements. In many cases, the provider may require the return of the resources if the purpose restrictions or eligibility requirements are contravened after recognition of the transaction. The principal characteristics of voluntary nonexchange transactions are (1) they are not imposed on the provider or the recipient and (2) fulfillment of eligibility requirements is essential for a transaction (other than the provision of cash or other assets in advance) to occur.

Standards Based on Characteristics of Transactions

8. Accounting and financial reporting of nonexchange transactions should be appropriate for their class and characteristics (derived tax revenues, imposed nonexchange revenues, government-mandated nonexchange transactions, or voluntary nonexchange transactions), as described in paragraph 7. Therefore, application of the standards in this Statement requires analysis of the substance of a transaction, rather than attention only to its label.

9. A transaction's label often indicates its substance and, therefore, the class of nonexchange transaction to which it belongs. However, in practice, the same label, such as "tax" or "grant," may be given to transactions that have different characteristics and should be accounted for differently. For example, property taxes and income taxes are classified differently in paragraph 7 because they have different characteristics that affect how they should be reported. Also, different labels may be given in practice to transactions that, from an accounting and financial reporting perspective, have the same characteristics and should be reported in the same way. For

[27] GASBS 33, Footnote 5: Unfunded mandates are not transactions (no value passes from one party to another); therefore, this Statement does not apply to them.

[28] GASBS 33, Footnote 6: Contractual agreements include oral as well as written contracts, provided that they are verifiable.

example, some transactions called "grants" have the same characteristics as other transactions called "contributions" or "donations."

10. In addition, labels commonly used for exchange and exchange-like transactions, such as "fees" and "charges," sometimes are applied to nonexchange transactions, so that these labels do not always indicate that an exchange has occurred. Also, some transactions have characteristics of both exchange and nonexchange transactions. For example, a for-profit organization may provide resources to a public university for research that may result in commercial applications. The award may be referred to as a "grant." However, if the for-profit organization retains the right of first refusal to benefit from the research results, the award may be an exchange or exchange-like transaction. Alternatively, the characteristics of the award may indicate that part of the transaction should be accounted for as an exchange transaction and part as a nonexchange transaction.

Accounting and Financial Reporting

11. All standards in this Statement apply whether the accrual basis or the modified accrual basis of accounting is required, except for the revenue recognition standards. (When the modified accrual basis of accounting is required or when the reporting government is a public college or university, the requirements of this Statement for the recognition of expenses should be interpreted as requirements for the recognition of expenditures.) For revenue recognition, the standards in paragraphs 16 through 28 apply when the accrual basis of accounting is required and the standards in paragraphs 29 and 30 apply when the modified accrual basis of accounting is required. On either basis of accounting, recognition of nonexchange transactions in the financial statements is required unless the transactions are not measurable (reasonably estimable) or are not probable[29] of collection. Transactions that are not recognizable because they are not measurable should be disclosed.

Time Requirements and Purpose Restrictions

12. As indicated in paragraph 7, enabling legislation or providers of resources in nonexchange transactions frequently stipulate time requirements, purpose restrictions, or both. Time requirements specify the period or periods when resources are required to be used or when use may begin. (For example, a provider may stipulate that the resources it provides are to be disbursed during a specific fiscal year or over a specified number of years, or cannot be disbursed until after a certain date or event has occurred, if ever.) Purpose restrictions specify the purpose or purposes for which the resources are required to be used. (For example, a provider may specify that its resources are to be expended for road and street repairs or, in the case of an endowment, that the principal is required to be held in income-producing investments.)

13. This Statement establishes different standards for time requirements than for purpose restrictions. Time requirements affect the timing of recognition of nonexchange transactions. Also, the effect on the timing of recognition is different, depending on whether a nonexchange transaction is (a) an imposed nonexchange revenue transaction[30] (discussed in paragraphs 17 and 18) or (b) a government-mandated or voluntary nonexchange transaction (discussed in paragraphs 19 through 25).

14. In contrast to time requirements, purpose restrictions do not affect the timing of recognition for any class of nonexchange transactions. Rather, recipients of resources with purpose restrictions should report resulting net assets (or equity or fund balance, as appropriate) as restricted until the

[29] GASBS 33, Footnote 7: In this Statement, the term *probable* has the meaning assigned in paragraph 3a of Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies* – that is, “[t]he future event or events are likely to occur.”

[30] GASBS 33, Footnote 8: Derived tax revenues generally do not have time requirements. However, if they apply, asset and revenue recognition should be consistent with the requirements for imposed nonexchange revenue transactions.

resources are used for the specified purpose or for as long as the provider requires the resources to be maintained intact (for example, endowment principal).[31]

Reimbursements

15. Governments (including the federal government) frequently engage in award programs commonly referred to as "reimbursement-type" or "expenditure-driven" grant programs. These programs may be either government-mandated or voluntary nonexchange transactions, depending on their characteristics. In either case, the provider stipulates that a recipient cannot qualify for resources without first incurring allowable costs under the provider's program. That kind of stipulation is not a purpose restriction as defined in this Statement. Rather, it is considered an eligibility requirement (discussed in paragraphs 19 and 20) and affects the timing of recognition. That is, there is no award—the provider has no liability and the recipient has no asset (receivable)—until the recipient has met the provider's requirements by incurring costs in accordance with the provider's program. (Cash and other assets provided in advance should be reported as advances [assets] by providers and as deferred revenues [liabilities] by recipients until allowable costs have been incurred and any other eligibility requirements have been met.)

Derived Tax Revenue Transactions

16. Governments should recognize assets from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. Revenues should be recognized, net of estimated refunds and estimated uncollectible amounts, in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred. Resources received in advance should be reported as deferred revenues (liabilities) until the period of the exchange.

Imposed Nonexchange Revenue Transactions

17. Governments should recognize assets from imposed nonexchange revenue transactions in the period when an enforceable legal claim to the assets arises or when the resources are received, whichever occurs first. For property (ad valorem) taxes, the date when an enforceable legal claim to taxable property arises generally is specified in the enabling legislation. Many governments refer to this date as the "lien date," even though a lien is not formally placed on the property at that date. Some governments, however, use a different term, such as the "assessment date." (For some governments, the enforceable legal claim does not arise until the period after the period for which the taxes are levied. Those governments should recognize property taxes receivable in the same period that revenues are recognized in accordance with paragraph 18.)

18. Governments should recognize revenues from property taxes, net of estimated refunds and estimated uncollectible amounts, in the period for which the taxes are levied, even if the enforceable legal claim arises or the due date for payment occurs in a different period. All other imposed nonexchange revenues should be recognized in the same period that the assets are recognized unless the enabling legislation includes time requirements. If so, revenues should be recognized in the period when the resources are required to be used or when use is first permitted. (Resources received or recognized as receivable before that period should be reported as deferred revenues.)

Government-Mandated Nonexchange Transactions and Voluntary Nonexchange Transactions

19. Providers of resources in government-mandated or voluntary nonexchange transactions frequently establish eligibility requirements. Eligibility requirements are conditions established by enabling legislation or the provider that are required to be met before a transaction (other than the provision of cash or other assets in advance) can occur. That is, until those requirements are met,

[31] GASBS 33, Footnote 9: For a governmental fund, recipients should report a reservation of fund balance. Accounting for contraventions of purpose restrictions is discussed in paragraph 26.

the provider does not have a liability, the recipient does not have a receivable, and the recognition of expenses or revenues for resources transmitted in advance should be deferred.

Eligibility Requirements

20. Eligibility requirements for government-mandated and voluntary nonexchange transactions comprise one or more of the following:

    a. Required characteristics of recipients. The recipient (and secondary recipients, if applicable) has the characteristics specified by the provider. (For example, under a certain federal program, recipients are required to be states and secondary recipients are required to be school districts.)
    b. Time requirements. Time requirements specified by enabling legislation or the provider have been met. (The period when the resources are required to be used [sold, disbursed, or consumed] or when use is first permitted has begun, or the resources are being maintained intact, as specified by the provider.)
    c. Reimbursements. The provider offers resources on a reimbursement ("expenditure-driven") basis and the recipient has incurred allowable costs under the applicable program.
    d. Contingencies (applies only to voluntary nonexchange transactions). The provider's offer of resources is contingent upon a specified action of the recipient and that action has occurred. (For example, the recipient is required to raise a specific amount of resources from third parties or to dedicate its own resources for a specified purpose and has complied with those requirements.)

Recognition Requirements

21. Providers should recognize liabilities (or a decrease in assets) and expenses from government-mandated or voluntary nonexchange transactions, and recipients should recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all applicable eligibility requirements, including time requirements, are met. Resources transmitted before the eligibility requirements are met should be reported as advances by the provider and as deferred revenues by recipients,[32] except as indicated in paragraph 22 for recipients of certain resources transmitted in advance.

22. In some kinds of government-mandated and voluntary nonexchange transactions, a provider transmits cash or other assets with the stipulation (time requirement) that the resources cannot be sold, disbursed, or consumed until after a specified number of years have passed or a specific event has occurred, if ever. In the interim, the provider requires or permits the recipient to benefit from the resources—for example, by investing or exhibiting them. Examples of these transactions include permanently nonexpendable additions to endowments and other trusts; term endowments; and contributions of works of art, historical treasures, and similar assets to capitalized collections.[33] For these kinds of transactions, the recipient should recognize revenues when the resources are received, provided that all eligibility requirements have been met.[34] Resulting net assets (or equity or fund balance, as appropriate) should be reported as restricted for as long as the provider's purpose restrictions or time requirements remain in effect.[35]

[32] GASBS 33, Footnote 10: Recognitions of assets and revenues should not be delayed pending completion of purely routine requirements, such as the filing of claims for allowable costs under a reimbursement program (paragraph 20c) or the filing of progress reports with the provider.
[33] GASBS 33, Footnote 11: Governments should not capitalize contributed collection items if the collection has not been capitalized. The Board will address the issue of capitalization of collections in one or more Statements resulting from its financial reporting model projects.
[34] GASBS 33, Footnote 12: For transactions that meet the criteria of this paragraph, the time requirement is met as soon as the recipient begins to honor the provider’s stipulation not to sell, disburse, or consume the resources and continues to be met for as long as the recipient honors that stipulation.
[35] GASBS 33, Footnote 13: For a governmental fund, recipients should report a reservation of fund balance.

23. The transactions covered by paragraph 22 should be distinguished from those in which, for administrative or practical reasons, a government receives cash or other assets in the period immediately before the period that the provider specifies as the period when sale, disbursement, or consumption of resources is required or may begin. Although the recipient may benefit from the short-term investment of these resources, the benefit is incidental and not a primary purpose of the provider. Recipients should recognize these transactions as required by paragraph 21.

24. Sometimes a provider in a government-mandated or voluntary nonexchange transaction does not specify time requirements. When that is the case, the entire award should be recognized as a liability and an expense by the provider, and as a receivable and a revenue (net of estimated uncollectible amounts) by the recipients, in the period when all applicable eligibility requirements are met (applicable period). When the provider is a government (including the federal government), the applicable period for both the provider and the recipients is the provider's fiscal year and begins on the first day of that year (when, for example, the relevant appropriation becomes effective).[36] The entire award should be recognized at that time. However, if a provider government has a biennial budgetary process, each year of the biennium should be considered a separate applicable period. In those circumstances, the provider and the recipients should allocate one-half of the resources appropriated for the biennium to each applicable period, unless the provider specifies a different allocation.

25. Promises of cash or other assets that nongovernmental entities, including individuals, voluntarily make to governments may be referred to in practice as "pledges," "promises to give," or "promised donations" or by some other term. Promised assets may include permanently nonexpendable additions to endowments and other trusts; term endowments; contributions of works of art and similar assets to capitalized collections; or other kinds of capital or financial assets, with or without purpose restrictions or time requirements. As required by paragraph 21, recipients of promises from nongovernmental entities to provide cash or other assets should recognize receivables and revenues (net of estimated uncollectible amounts) when all eligibility requirements are met,[37] provided that the promise is verifiable and the resources are measurable and probable of collection.

Subsequent Contravention of Eligibility Requirements or Purpose Restrictions

26. After a nonexchange transaction has been recognized in the financial statements, it may become apparent that (a) the eligibility requirements are no longer met (the transaction was recognized as a government-mandated or voluntary nonexchange transaction) or (b) the recipient will not comply with the purpose restrictions within the specified time limit. In these circumstances, if it is probable that the provider will not provide the resources or will require the recipient to return all or part of the resources already received, the recipient should recognize a decrease in assets (or an increase in liabilities) and an expense, and the provider should recognize a decrease in liabilities (or an increase in assets) and a revenue, for the amount that the provider is expected to cancel or reclaim.

Nonexchange Revenues Administered or Collected by Another Government

27. Sometimes, a government collects derived tax revenues or imposed nonexchange revenues on behalf of the government (recipient) that imposed the revenue source. For example, a state may administer and collect a local option sales tax at the same time that the state collects the state sales tax; the state subsequently remits the appropriate amount of the collections to the participating local government recipients. Because those recipients impose the tax or other revenue source, they should have or can reasonably estimate the accrual-basis information

[36] GASBS 33, Footnote 14: For secondary recipients, the fiscal year of the immediate provider, rather than the originating provider, applies. For example, the state government's fiscal year would apply for a local government receiving federal resources via the state government.
[37] GASBS 33, Footnote 15: See footnote 12. For transactions that meet the criteria of paragraph 22, the recipient does not begin to meet time requirements until the cash or other assets are received.

necessary to comply with the requirements of this Statement for derived tax revenues or imposed nonexchange revenues.

28. On the other hand, a government may share its own derived tax revenues or imposed nonexchange revenues with other governments. For example, a state may share a portion of the revenues resulting from its sales tax with local governments. The recipient governments should comply with the requirements of this Statement for derived tax revenues or imposed nonexchange revenues, as appropriate. However, because they do not impose the tax or other revenue source, they may neither have nor be able to reasonably estimate the accrual-basis information necessary for compliance, and they may be unable to obtain sufficient information in a timely manner from the administering or collecting government. If so, the recipient governments should recognize revenues for the period equal to cash received during the period. Cash received after the end of the period also should be recognized as revenues of the period (less amounts recognized as revenues in the previous period) if reliable information is consistently available to identify the amounts applicable to the current period.

Revenue Recognition Using the Modified Accrual Basis of Accounting

29. This Statement does not change the requirements of NCGA Statement 1, Governmental Accounting and Financial Reporting Principles, as amended, and subsequent NCGA and GASB pronouncements for revenue recognition using the modified accrual basis of accounting, except as indicated in paragraph 6 of this Statement. Therefore, revenues from nonexchange transactions should be recognized "in the accounting period when they become available and measurable."[38]

30. When the modified accrual basis of accounting is used, revenues resulting from nonexchange transactions should be recognized as follows:

    a. Derived tax revenues. Recipients should recognize revenues in the period when the underlying exchange transaction has occurred and the resources are available.
    b. Imposed nonexchange revenues—property taxes. Recipients should recognize revenues in accordance with NCGA Interpretation 3, as amended.
    c. Imposed nonexchange revenues—other than property taxes. Recipients should recognize revenues in the period when an enforceable legal claim has arisen and the resources are available.
    d. Government-mandated nonexchange transactions and voluntary nonexchange transactions. Recipients should recognize revenues in the period when all applicable eligibility requirements have been met and the resources are available.

    If the circumstances described in paragraph 26 apply, providers that require the return of resources should recognize revenues in the period when the returned resources are available.

EFFECTIVE DATE AND TRANSITION

31. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2000. Earlier application is encouraged.[39] In the first period that this Statement is

[38] GASBS 33, Footnote 16: NCGA Statement 1, paragraph 62. GASB Interpretation No. 5, *Property Tax Revenue Recognition in Governmental Funds*, paragraph 4, states that the term *available* means “collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period.” With respect to property taxes only, NCGA Interpretation 3, paragraph 8, as amended, states that “such time thereafter shall not exceed 60 days.” Measurability and probability of collection are discussed in paragraph 11 of this Statement.

[39] GASBS 33, Footnote 17: The provisions of this Statement for accrual-basis revenue recognition cannot become effective for governmental activities until one or more Statements requiring accrual-basis accounting for those activities become effective. Under the existing financial reporting models, the modified accrual provisions of this Statement should be used for governmental funds and expendable trust funds, and the accrual provisions should be

applied, accounting changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated.[40] Prior-period adjustments and restatement of the financial statements are not required for promises of private donations. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net assets (or equity or fund balance, as appropriate) for the earliest period restated (generally the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

GASBS 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, par. 16

16. The statement of net assets and the statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place.[41] Revenues, expenses, gains, losses, assets, and liabilities resulting from nonexchange transactions should be recognized in accordance with the requirements of Statement 33.

GASBS34, Par. 369

369. The ED proposed that program revenues be reported in two categories—charges for services, and program-specific grants and contributions. Charges for services include revenues attributable to a specific program because they result from exchange or exchange-like transactions or other events, such as charges to customers. Charges for services reduce the net cost of the program to be financed from general revenues.

GASBS34, Par. 370

370. Program-specific grants and contributions include grants and other financial assistance directly attributable to specific programs. These categories differ from charges for services in two ways:

a. Program-specific grants and contributions are not "generated by" the program, in the same sense as charges for services.
b. The grantor generally is not the beneficiary of the goods, services, or privileges provided; that is, there is not a direct relationship between the resource provider and the benefit recipient, as in an exchange or exchange-like transaction. Generally, the grant recipient provides the program or service to help achieve some objective of the grantor, either directly or indirectly. The grantor helps pay the costs of the program and therefore reduces the net cost of a program that the government is required to finance from taxes and other general revenues.

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used for proprietary funds; nonexpendable, pension, and investment trust funds; colleges and universities; and entities that use proprietary fund accounting.

[40] GASBS 33, Footnote 18: This Statement requires governments to recognize capital contributions to proprietary funds and to other governmental entities that use proprietary fund accounting as *revenues*, not contributed capital. However, governments should not restate contributed capital arising from periods prior to implementation of this Statement until the Board issues one or more Statements requiring restatement of those prior-period balances.

[41] GASBS 34, Footnote 11: In this Statement, the terms *transaction* and *transactions* refer only to *external* events in which something of value (benefit) passes between two or more parties. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

Accrual Accounting	Records the effects on a reporting entity of transactions and other events and circumstances in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. Accrual accounting is concerned with an entity's acquiring of goods and services and using them to produce and distribute other goods and services. It recognizes that the buying, producing, selling, distributing, and other operations of an entity during a period, as well as other events that affect entity performance, often do not coincide with the cash receipts and payments of the period. Compare with cash accounting.
Actuarial Liability	A liability based on statistical calculations and actuarial assumptions (actuarial assumptions are conditions used to resolve uncertainties in the absence of information concerning future events affecting insurance, pension expenses, etc.).
Basic Financial Statements	As used in SFFAS 7, the basic financial statements are those on which an auditor would normally be engaged to express an opinion. The term "basic" does not necessarily mean that other financial information not covered by the auditor's opinion is less important to users than that contained in the basic statements; it merely connotes the expected nature of the auditor's review of, and association with, the information. The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the "principal financial statements." The Form and Content of these statements are determined by OMB.
Budgetary Accounting	Budgetary accounting is the system that measures and controls the use of resources according to the purposes for which budget authority was enacted; and that records receipts and other collections by source. It tracks the use of each appropriation for specified purposes in separate budget accounts through the various stages of budget execution from appropriation to apportionment and allotment to obligation and eventual outlay. This system is used by the Congress and the Executive Branch to set priorities, to allocate resources among alternative uses, to finance these resources, and to assess the economic implications of federal financial activity at an aggregate level. Budgetary accounting is used to comply with the Constitutional requirement that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations Made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public money shall be published from time to time."
Cash Accounting	A system of accounting in which revenues are recorded when received in cash and expenses or expenditures are recorded when cash is disbursed.
Contingency	An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.
Current Liabilities	Amounts owed by a federal entity for which the financial statements are prepared, and which need to be paid within the fiscal year following the reporting date.

Disclosure	Reporting information in notes or narrative regarded as an integral part of the basic financial statement.
Entitlement Period	The period (such as, monthly) for which benefits become due.
Entitlement Program	A program in which the federal government becomes automatically obligated to provide benefits to members of a specific group who meet the requirements established by law.
Event	A happening of consequence to an entity. It may be an internal event that occurs within an entity, such as the transforming of raw materials into a product. Or it may be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, theft, vandalism, a tort caused by negligence, or an accident.
Exchange Transaction	A transaction that arises when each party to the transaction **directly** sacrifices value and **directly** receives **similar** value in return. **There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., the federal government purchase of goods or services at market value from a vendor).**
Executory Contract	A contract which has not been performed by all parties to it.
Expected Value	A statistical measurement attribute that is the sum of the products of each potential outcome multiplied by the probability of that potential outcome.
Expense	Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period.
Government-acknowledged Events	Nontransaction-based events that **are not the result of federal operations and do not directly involve the federal government but** are "of financial consequence" to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).
Government-related Events	Nontransaction-based events that **are of financial consequence to the federal government because they** involve **direct** interaction between **the** federal **government** and **its** environment**, either through the conduct of federal operations or because the events take place on federal property** (e.g., accidental damage to nonfederal property caused by federal operations).
Liability	A federal liability is a present obligation to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

Loan Guarantee	Any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender but does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (OMB Circular A-11)
Loan Guarantee Commitment	A binding agreement by a federal agency to make a loan guarantee when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement. (OMB Circular A-11)
Measurable	Can be determined with reasonable certainty or is reasonably estimable.
Nonexchange Transaction	A transaction that arises when one party to a transaction receives value without **directly** giving or promising **similar** value in return or one party to a transaction gives or promises value without **directly** receiving **similar** value in return. **There is no reciprocal or two-way flow of resources or of promises to provide resources of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).**
Obligation (or Budgetary Obligation)	Following the enactment of budget authority and the completion of required apportionment action, Government agencies incur obligations to make payments. Obligations are binding agreements that will result in outlays immediately or in the future. Obligations include, for example: current liabilities for salaries, wages, and interest; contracts for the purchase of supplies and equipment, construction, and the acquisition of office space, buildings, and land; and other arrangements requiring the payment of money.
Other Postemployment Benefits (OPEB)	Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans.
Other Retirement Benefits (ORB)	Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.
Present Obligation	An existing duty or responsibility to act in a certain way.
Present Value	The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest.
Probable	That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Reasonably Possible	The chance of the future confirming event or events occurring is more than remote but less than probable.
Recognition	The process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item.
Recognize	To determine the amount, timing, classification, and other conditions precedent to the acceptance and entry of a transaction. Hence, to give expression on the books of account; said of transactions.
Record	To give expression to a transaction on (or in) the books of account; to enter.
Remote	The chance of the future event or events occurring is slight.
Transaction	A particular kind of external event involving the transfer of something of value concerning two or more entities. The transfer may be a two-way or one-way flow of resources or of promises to provide resources.