

**Executive Office of the President  
Office of Management and Budget**

**ACCOUNTING FOR SELECTED ASSETS AND LIABILITIES**

**STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS  
NUMBER 1**

**March 30, 1993**

\*\*\*\*\*

**CONTENTS**

PREFACE Paragraph numbers a-e

**INTRODUCTION**

Objective	Paragraphs 1-4
Approach	Paragraphs 5-9
Scope	Paragraphs 10-11
Materiality	Paragraphs 12-13
Applicability	Paragraph 14
Effective date	Paragraph 15

**RECOMMENDED STANDARDS**

Explanation	Paragraphs 16-17
General Standards	Paragraphs 18-26
Specific Standards	
Cash	Paragraphs 27-30
Fund Balance with Treasury	Paragraphs 31-39
Accounts Receivable	Paragraphs 40-52
Interest Receivable	Paragraphs 53-56
Advances and Prepayments	Paragraphs 57-61
Investments in Treasury Securities	Paragraphs 62-73
Accounts Payable	Paragraphs 74-80
Interest Payable	Paragraphs 81-82
Other Current Liabilities	Paragraphs 83-86

**APPENDICES**

Appendix A: Basis of the Board's Conclusions	Paragraphs 87-161
Appendix B: Illustration of the Interest Method for Amortization	
Appendix C: Glossary	

\*\*\*\*\*

## PREFACE

a In this Statement, the Board recommends accounting standards for selected assets and liabilities. The assets are cash, fund balance with Treasury, accounts receivable, interest receivable, advances and prepayments, and investments in Treasury securities. The liabilities are accounts payable, interest payable, and other current liabilities.

b The Board's focus in this Statement is on setting accounting standards for the individual federal entity, the level at which financial statements are often prepared. A federal entity, as the term is used in this document, is a unit within the federal government, such as a department, agency, bureau, or program. An entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts. The standards proposed in this Statement are applicable to federal entities performing either governmental or commercial-type functions and to the federal government as a whole, unless otherwise noted.

c The recommended standards distinguish between intragovernmental and governmental assets and liabilities. An entity may have intragovernmental assets and liabilities that arise from transactions among entities within the federal government. Intragovernmental assets represent claims of an entity of the federal government against other federal entities. Intragovernmental liabilities are amounts that a federal entity owes to other federal entities. An entity may also have governmental assets and liabilities that arise from transactions with entities outside the federal government. Governmental assets are claims of the federal government or an entity within the federal government against nonfederal entities. Governmental liabilities are amounts that the federal government or an entity within the federal government owes to nonfederal entities.

d The standards recommended in this Statement were previously proposed in the Exposure Draft, Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities, November 18, 1991. Comments were

received from sixty-nine organizations and individuals. Comments also were presented to the Board at a public hearing on February 28, 1992. The Board considered the comments and incorporated changes, as appropriate. Substantive comments and changes adopted are discussed in Appendix A, Basis of the Board's Conclusions.

e The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

\*\*\*\*\*

## INTRODUCTION

### OBJECTIVE

1 In this Statement, the Board recommends accounting standards for selected assets and liabilities of the federal government and its entities. The standards apply to both governmental and commercial-type functions of the federal government.

2 The selected assets and liabilities are among the fundamental elements of federal accounting and financial reporting. By recommending these standards in the Board's first Statement, the Board's objective is to provide definitive accounting and reporting guidance to federal agencies in these fundamental areas at the earliest stage of the Board's consideration and development of federal accounting standards.

3 In a separate project, the Board is identifying users' needs and federal accounting and reporting objectives. Although the Board's deliberation on objectives has not been finalized, there is a general consensus that one overall objective for accounting and financial reporting is to assure accountability of federal government entities. The Board believes that issuing these selected standards will help in fostering that overall objective.

4 Specifically, the recommended standards would assist users of financial statements in:

- assessing the efficiency and effectiveness of the government's management of its assets and

liabilities, and

- determining whether the government's financial position improved or deteriorated over the reporting period.

## APPROACH

5 The Board's initial approach to developing accounting standards was to review the existing accounting standards prescribed by the General Accounting Office (GAO) in its "Policy and Procedures Manual for the Guidance of Federal Agencies," Title 2 Accounting, (Title 2). The purpose of the review was to determine whether some of the Title 2 standards, with any necessary modifications, could be recommended by the Board to the principals of the Joint Financial Management Improvement Program (JFMIP).

6 Although the Title 2 standards had not been fully implemented by federal agencies, they represented a starting point for further analysis. The Title 2 standards were reviewed in light of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the same time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and objectives of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

7 These selected assets and liabilities involve less complex issues than other assets and liabilities to be considered by the Board in the future. The Board also believes that the selected assets and liabilities are so basic to financial reporting that they will not conflict with any conceptual framework that the Board may develop.[Footnote 1.]

[Footnote 1: The Board is also addressing other assets and liabilities. It has issued a proposed standard for direct loans and loan guarantees (see Exposure Drafts entitled Accounting for Direct Loans and Loan Guarantees, September 15, 1992, and Accounting for Inventory and Related Property, December 1992).]

8 The standards on the selected assets and liabilities were proposed in the Board's first Exposure Draft issued in September 1991, entitled Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities. A total of 69 respondents submitted their comments to the Board on the Exposure Draft. A public hearing on the Exposure Draft was held on February 28, 1992.

9 In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and objectives of federal financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, "Basis of the Board's Conclusions."

#### SCOPE

10 The selected assets addressed in this Statement are:

- Cash
- Fund Balance with Treasury
- Accounts Receivable
- Interest Receivable
- Advances and Prepayments
- Investments in Treasury Securities

11 The selected liabilities addressed in this Statement are:

- Accounts Payable
- Interest Payable
- Other Current Liabilities

#### MATERIALITY

12 Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

13 The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the

judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

## APPLICABILITY

14 The accounting standards recommended in this Statement are applicable to the federal government and its departments and agencies in the executive branch that fall within the definition of executive agency as defined in 31 U.S.C. 102 and 3501.

## EFFECTIVE DATE

15 The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

## EXPLANATION

16 The Board's focus in this Statement is on setting accounting standards for the individual federal entity level of reporting. In this Statement, the standards are also applicable to financial reporting by the U.S. government as a whole, except for those standards related to intragovernmental assets and liabilities, which are defined in the general standards and noted in specific standards.

17 The word entity refers to a unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements will be prepared. The word entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements are prepared in accordance with OMB guidance on the form and content of financial statements.

## GENERAL STANDARDS

Intragovernmental vs. Governmental Assets and Liabilities

INTRAGOVERNMENTAL ASSETS AND LIABILITIES 18 arise from transactions among federal entities. Intragovernmental

assets are claims of a federal entity against other federal entities. Intragovernmental liabilities are claims against the entity by other federal entities.

19 Among the assets covered by this Statement, intragovernmental assets include an entity's fund balance with Treasury, investments in Treasury securities, accounts and interest receivable from federal entities, and advances and prepayments to federal entities.

20 Intragovernmental liabilities include accounts and interest payable to federal entities and other current liabilities due to federal entities, such as receipt of federal advances and prepayments.

GOVERNMENTAL ASSETS AND LIABILITIES 21 arise from transactions of the federal government or an entity of the federal government with nonfederal entities. Governmental assets are claims of the federal government or an entity within the federal government against nonfederal entities. Governmental liabilities are amounts that the federal government or an entity within the federal government owes to nonfederal entities. The term nonfederal entities encompasses domestic and foreign persons and organizations outside the U.S. government. The term public is also used in this Statement to represent nonfederal entities.

22 Among the assets covered by this Statement, governmental assets that would be reported by a federal entity include cash, accounts and interest receivable from nonfederal entities, and advances and prepayments made to nonfederal entities.

23 Governmental liabilities include accounts and interest payable to nonfederal entities, other liabilities due to nonfederal entities, and advances and prepayments received from nonfederal entities.

24 Intragovernmental assets and liabilities should be reported separately from governmental assets and liabilities. This requirement applies to all of the selected assets and liabilities addressed in this document.

Entity Assets vs. <R>Non-entity Assets

ENTITY ASSETS 25 are those assets which the reporting

entity has authority to use in its operations. "Non-entity assets" are those assets that are held by an entity but are not available to the entity. An example of non-entity assets are customs duty receivables that the Customs Service collects for the U.S. government but has no authority to spend. A similar example is federal income tax receivable that the Internal Revenue Service collects for the U.S. government.

26 Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements. Non-entity assets reported in an entity's financial statements should be segregated from entity assets. An amount equal to non-entity assets should be recognized as a liability (due to Treasury or other entities) in the entity's financial statements.

## SPECIFIC STANDARDS

### Cash

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

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

**ENTITY CASH.** 28 Entity cash is the amount of cash that the reporting entity holds and is authorized by law to spend.

**NON-ENTITY CASH.** 29 Non-entity cash is cash that a federal entity collects and holds on behalf of the U.S. government or other entities. In some circumstances, the entity deposits cash in its accounts in a fiduciary capacity for the U.S. Treasury or other entities. Non-entity cash should be reported separately from entity cash.

Restricted cash. 30 Cash may be restricted. Restrictions are usually imposed on cash deposits by law, regulation, or agreement. Non-entity cash is always restricted cash. Entity cash may be restricted for specific purposes. Such cash may be in escrow or other special accounts. Financial reports should disclose the reasons and nature of restrictions.

#### Fund Balance with Treasury

31 A federal entity's fund balance with the Treasury is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund balance with Treasury is an intragovernmental item. From the reporting entity's perspective, a fund balance with Treasury is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability.

32 A federal entity's fund balance with Treasury includes clearing account balances and the dollar equivalent of foreign currency account balances. Foreign currency account balances should be translated into U.S. dollars at exchange rates determined by the Treasury and effective at the financial reporting date. A federal entity's fund balance with Treasury <R>also includes balances for direct loan and loan guarantee activities held in the credit reform program, financing, and liquidating accounts.

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

34 An entity's fund balance with Treasury does not include contract authority or unused authority to borrow. Contract authority is a statutory authority under which

contracts or other obligations may be entered into prior to receiving an appropriation for the payment of obligations. The later enacted appropriation provides cash to liquidate obligations. [Footnote 2] Thus, contract authority merely permits a federal entity to incur certain obligations but does not, in itself, add funds to the agency's accounts with Treasury.

[Footnote 2: Source of definition: OMB Circular A-34.]

35 Authority to borrow is a statutory authority that permits a federal agency to incur obligations and make payments for specific purposes out of borrowed funds. Authority to borrow adds funds to an agency's accounts with Treasury only after the agency actually uses the authority to borrow a specific amount of funds. Thus, authority to borrow is included in an entity's <R>fund balance with Treasury only to the extent that funds are actually borrowed under the authority.

36 An entity's fund balance with Treasury is reduced by (a) disbursements made to pay liabilities or to purchase assets, goods, and services, (b) investments in U.S. securities (securities issued by Treasury or other federal government agencies), (c) cancellation of expired appropriations; (d) transfers and reimbursements to other entities or to the Treasury, and (e) sequestration or rescission of appropriations.

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

38 The unobligated balance is the amount of funds available to an entity against which no claims have been recorded. Unobligated balances are generally available to a federal entity for specific purposes stipulated by law. Unobligated balances may also include balances in expired/canceled accounts that are available only for approved adjustments to prior obligations. Certain unobligated balances may be restricted to future use and are not apportioned for current use. Disclosure should be provided on such restrictions.

39 Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared.) Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year.

#### Accounts <R>Receivable

40 Accounts receivable arise from claims to cash or other assets. The accounting standard for accounts receivable is set forth below.

**RECOGNITION OF RECEIVABLES.** [Footnote 3] 41 A receivable should be recognized when a federal entity establishes a claim to cash or other assets against other entities, either based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due), or goods or services provided. If the exact amount is unknown, a reasonable estimate should be made.

[Footnote 3: The word recognition used in this document bears the same meaning as used by the Financial Accounting Standards Board (FASB) in its conceptual statements. It means 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. FASB Statement of Financial Accounting Concepts No. 5, par. 6.]

**SEPARATE REPORTING.** 42 Receivables from federal entities are intragovernmental receivables, and should be reported separately from receivables from nonfederal entities.

**ENTITY VS. NON-ENTITY RECEIVABLES.** 43 Receivables should be distinguished between entity receivables and non-entity receivables. "Entity receivables" are amounts

that a federal entity claims for payment from other federal or nonfederal entities and that the federal entity is authorized by law to include in its obligational authority or to offset its expenditures and liabilities upon collection.[Footnote 4] Non-entity receivables are amounts that the entity collects on behalf of the U.S. government or other entities, and the entity is not authorized to spend. [Footnote 5] > Receivables not available to an entity are non-entity assets and should be reported separately from receivables available to the entity.

[Footnote 4: An entity may have receivables that, once collected, can be used as offsets to the entity's budget authority and outlays only when authorized by Congress. Before receiving the authorization, however, those receivables are non-entity receivables.]

[Footnote 5: Governmental receipts include collections arising from the sovereign and regulatory powers unique to the federal government, e.g., income tax receipts, customs duties, court fines, certain license fees, etc. A federal entity may be responsible for collecting these receipts on behalf of the U.S. government, but is not authorized to use the monies collected to offset its expenditures.]

#### RECOGNITION OF LOSSES DUE TO UNCOLLECTIBLE AMOUNTS. 44

Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase *more likely than not* means more than a 50 percent chance of loss occurrence.

45 An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value.[Footnote 6] The allowance for uncollectible amounts should be reestimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct.

[Footnote 6: In the Board's Exposure Draft, *Accounting for Direct Loans And Loan Guarantees*, September 15, 1992, receivables are accounted for on a net present value basis.]

Measurement of losses. 46 Losses due to uncollectible amounts should be measured through a systematic methodology. The systematic methodology should be based on analysis of

both individual accounts and a group of accounts as a whole.

Individual account analysis. 47 Accounts that represent significant amounts should be individually analyzed to determine the loss allowance. Loss estimation for individual accounts should be based on (a) the debtor's ability to pay, (b) the debtor's payment record and willingness to pay, and (c) the probable recovery of amounts from secondary sources, including liens, garnishments, cross collections and other applicable collection tools.

48 The allowance for losses generally cannot be based solely on the results of individual account analysis. In many cases, information may not be available to make a reliable assessment of losses on an individual account basis or the nature of the receivables may not lend itself to individual account analysis. In these cases, potential losses should be assessed on a group basis.

Group analysis. 49 To determine the loss allowance on a group basis, receivables should be separated into groups of homogeneous accounts with similar risk characteristics.

50 The groups should reflect the operating environment. For example, accounts receivable can be grouped by: (a) debtor category (business firms, state and local governments, and individuals), (b) reasons that gave rise to the receivables (tax delinquencies, erroneous benefit payments, trade accounts based on goods and services sold, and transfers of defaulted loans to accounts receivable), or (c) geographic regions (foreign countries, and domestic regions). Within a group, receivables are further stratified by risk characteristics. Examples of risk factors are economic stability, payment history, alternative repayment sources, and aging of the receivables.

51 Statistical estimation by modeling or sampling is one appropriate method for estimating losses on groups of receivables. Statistical estimation should take into consideration factors that are essential for estimating the level of losses, including historical loss experience, recent economic events, current and forecast economic conditions, and inherent risks.

Disclosure. 52 Agencies should disclose the major categories of receivables by amount and type, the

methodology used to estimate the allowance for uncollectible amounts, and the total allowance.

#### Interest <R>Receivable

53 Interest receivable should be recognized for the amount of interest income earned but not received for an accounting period. Interest receivable should be recognized as it is earned on investments in interest-bearing securities. Interest also should be recognized on outstanding accounts receivable and other U.S. government claims against persons and entities in accordance with provisions in 31 U.S.C. 3717, Interest and Penalty Claims. (See also Federal Claims Collection Standards, 4 CFR Part 103, paragraph 102.13.)[Footnote 7]

[Footnote 7: Accounting for imputed interest, interest on long-term leases, interest on loans, and interest on amounts deposited in credit reform accounts will be addressed when the Board considers accounting standards in these areas.]

54 No interest should be recognized on accounts receivable or investments that are determined to be uncollectible unless the interest is actually collected. Payments received from the debtor are required to be applied first to penalty and administrative cost charged, second to interest receivable, and third to outstanding debt principal, per Federal Claims Collection Standards, 4 C.F.R. 102.13(f).

55 However, until the interest payment requirement is officially waived by the government entity or the related debt is written off, interest accrued on uncollectible accounts receivable should be disclosed.

56 Interest receivable from federal entities should be accounted for and reported separately from interest receivable from the public.

#### Advances and Prepayments

57 Advances are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed

to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee.

58 Prepayments are payments made by a federal entity to cover certain periodic expenses before those expenses are incurred. Typical prepaid expenses are rents paid to a lessor at the beginning of a rental period. Progress payments made to a contractor based on a percentage of completion of the contract are not advances or prepayments.

59 Advances and prepayments should be recorded as assets. Advances and prepayments are reduced when goods or services are received, contract terms are met, progress is made under a contract, or prepaid expenses expire. A travel advance, for example, should be initially recorded as an asset and should be subsequently reduced when travel expenses are actually incurred. Amounts of advances and prepayments that are subject to refund (for example, a settled travel claim indicating the traveler owes part of the advance to the government) should be transferred to accounts receivable.

60 Advances and prepayments paid out by an entity are assets of the entity. On the other hand, advances and prepayments received by an entity are liabilities of the entity (see the recommended standard for other current liabilities). In financial reports of an entity, advances and prepayments the entity paid out (assets) should not be netted against advances and prepayments that the entity received (liabilities).

61 Advances and prepayments made to federal entities are intragovernmental items and should be accounted for and reported separately from those made to nonfederal entities.

#### Investments in Treasury Securities

Scope. 62 This standard applies to investment by federal entities in Treasury securities, including (a) nonmarketable par value Treasury securities, (b) market-based Treasury securities expected to be held to maturity, and (c) marketable Treasury securities expected to be held to maturity. This standard does not apply to investments by federal entities in securities (debt and

equity) and other financial instruments issued by other than the U.S. Treasury.

63 Nonmarketable par value Treasury securities are special series debt securities that the U.S. Treasury issues to federal entities at face value (par value). The securities are redeemed at face value on demand; thus investing entities recover the full amounts invested.

64 Market-based Treasury securities are debt securities that the U.S. Treasury issues to federal entities without statutorily determined interest rates. Although the securities are not marketable, their terms (prices and interest rates) mirror the terms of marketable Treasury securities.

65 Marketable Treasury securities, including Treasury bills, notes, and bonds, are initially offered by Treasury to the marketplace and can then be bought and sold on securities exchange markets. Their bid and ask prices are publicly quoted by the marketplace.

Treasury securities expected to be held to maturity.

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

Separate accounting and reporting for federal and nonfederal securities. 67 Investments of a federal entity in U.S. securities (securities issued by Treasury and federal agencies) are intragovernmental investments. These U.S. securities also represent intragovernmental liabilities of the Treasury Department or other federal entities that issue the securities. Investments in securities issued by the U.S. Treasury or other federal entities should be accounted for and reported separately from investments in securities issued by nonfederal entities.

Initial recording. 68 The three types of Treasury securities covered by this standard (nonmarketable par value Treasury securities, market-based Treasury securities expected to be held to maturity, and marketable Treasury securities expected to be held to maturity) should be recognized at their acquisition cost. If the acquisition is made in exchange for nonmonetary assets, the acquired securities should be recognized at the fair market value of either the securities acquired or the assets given up, whichever is more definitively determinable.

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

Valuation subsequent to acquisition. 70 Subsequent to their acquisition, investments in Treasury securities should be carried at their acquisition cost, adjusted for amortization, if appropriate, as explained below.

71 If an amount of premium or discount exists, the carrying amount of the investments should be adjusted in each reporting period to reflect the amortization of the premium or the discount. Premiums and discounts should be amortized over the life of the Treasury security using the interest method. Under the interest method, the effective interest rate (the actual interest yield on amounts invested) multiplied by the carrying amount of the Treasury security at the start of the accounting period equals the interest income recognized during the period (the carrying amount changes each period by the amount of the amortized discount or premium). The amount of amortization of discount or premium is the difference between the effective interest recognized for the period and the nominal interest for the period as stipulated in the Treasury security. (See Appendix B for an illustration of the interest method of amortization.)

Disclosure of market value. 72 For investments in market-based and marketable Treasury securities, the market

value of the investments should be disclosed. For purposes of determining a market value, investments should be grouped by type of security, such as marketable or market-based Treasury securities. The market value of investments in a group is calculated by the market price of securities of that group at the financial reporting date multiplied by the number of notes or bonds held at the financial reporting date.

Investment reclassification. 73 In rare instances, significant unforeseeable circumstances may cause a change in an entity's intent or ability to hold to maturity certain securities that are initially classified as expected to be held to maturity. In these circumstances, the affected securities should be reclassified as securities available for sale or early redemption (redemption before the security's maturity). Once a security is reclassified it is no longer subject to this standard.

#### Accounts Payable

74 Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities.

75 Accounts payable are not intended to include liabilities related to on-going continuous expenses such as employees' salary and benefits, which are covered by other current liabilities. (See recommended standard for Other Current Liabilities.)

76 Amounts owed for goods or services received from federal entities represent intragovernmental transactions and should be reported separately from amounts owed to the public.

77 When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated.

78 When a contractor provides the government with goods that are also suitable for sale to others, the

liability usually arises when the contractor physically delivers the goods and the government receives them and takes formal title. However, when a contractor builds or manufactures facilities or equipment to the government's specifications, formal acceptance of the products by the government is not the determining factor for accounting recognition. Constructive or de facto receipt occurs in each accounting period, in accordance with the following paragraph.

79 For facilities or equipment constructed or manufactured by contractors or grantees according to agreements or contract specifications, amounts recorded as payable should be based on an estimate of work completed under the contract or the agreement. The estimate of such amounts should be based primarily on the federal entity's engineering and management evaluation of actual performance progress and incurred costs.

80 The reporting entity should disclose accounts payable not covered by budgetary resources.

#### Interest Payable

81 Interest payable should be recorded for the amount of interest expense incurred and unpaid. Interest incurred results from borrowing funds from Treasury, Federal Financing Bank, other federal entities, or the public. Interest also should be recorded on late payment of bills by the federal entity (see provisions in 31 U.S.C. 3901 through 3907, Prompt Payment) and on refunds <R>(see provisions in 26 U.S.C. 6611). Interest payable of an entity on borrowed funds and unpaid bills should be recognized at the end of each period.

82 Interest payable to federal entities is an intragovernmental liability and should be accounted for separately from interest payable to the public.

#### Other Current<R> Liabilities

83 The term other current liabilities is used to report current liabilities that are not recognized in specific categories such as accounts payable; interest payable; debt owed to the public, Treasury, or other entities; and liabilities for loan guarantee losses. Other

current liabilities may include unpaid expenses that are accrued for the fiscal year for which the financial statements are prepared and are expected to be paid within the fiscal year following the reporting date.

84 Typical examples of other current liabilities to be recognized are: (a) accrued employees' wages, bonuses, and salaries for services rendered in the current fiscal year for which paychecks will be issued in the following year; (b) accrued entitlement benefits payable, such as Old Age Survivors Insurance (OASI) and Veterans Compensation and Pension benefits applicable to the current period but not yet paid, and (c) annuities for the current fiscal year administered by trust, pension, or insurance programs for which payment would be made in the following fiscal year. Such liabilities may be presented on the face of the financial reports as Other Current Liabilities or as one or more separate categories depending on the materiality of the amounts.

85 Federal entities may receive advances and prepayments from other entities for goods to be delivered or services to be performed. Before revenues are earned, the current portion of the advances and prepayments should be recorded as other current liabilities. After the revenue is earned (goods or services are delivered, or performance progress is made according to engineering evaluations), the entity should record the appropriate amount as a revenue or financing source and should reduce the liability accordingly. Other current liabilities due to federal entities are intragovernmental liabilities that should be reported separately from those due to employees and the public.

86 The reporting entity should disclose the amount of current liabilities not covered by budgetary resources.

\*\*\*\*\*

RECOMMENDED STANDARDS FOR  
FINANCIAL ACCOUNTING AND REPORTING

OBJECTIVE

In this Statement, the Board recommends accounting standards for selected assets and liabilities of the federal government and its entities. The standards apply to both

governmental and commercial-type functions of the federal government.

The selected assets and liabilities are among the fundamental elements of federal accounting and financial reporting. By recommending these standards in the Board's first Statement, the Board's objective is to provide definitive accounting and reporting guidance to federal agencies in these fundamental areas at the earliest stage of the Board's consideration and development of federal accounting standards.

In a separate project, the Board is identifying users' needs and federal accounting and reporting objectives. Although the Board's deliberation on objectives has not been finalized, there is a general consensus that one overall objective for accounting and financial reporting is to assure accountability of federal government entities. The Board believes that issuing these selected standards will help in fostering that overall objective.

Specifically, the recommended standards would assist users of financial statements in:

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

## APPROACH

The Board's initial approach to developing accounting standards was to review the existing accounting standards prescribed by the General Accounting Office (GAO) in its Policy and Procedures Manual for the Guidance of Federal Agencies, Title 2 Accounting, (Title 2). The purpose of the review was to determine whether some of the <MI>Title 2<M> standards, with any necessary modifications, could be recommended by the Board to the principals of the Joint Financial Management Improvement Program (JFMIP).

Although the Title 2 standards had not been fully implemented by federal agencies, they represented a starting

point for further analysis. The Title 2 standards were reviewed in light of the accounting and reporting requirements established in the Chief Financial Officers (CFOs) Act of 1990. At the same time, the Board considered current accounting practices of federal agencies. It also considered the findings from its project on user needs and objectives of federal financial reporting. As a result of the review, the Board decided that with certain modifications, accounting standards for selected assets and liabilities could be recommended to the JFMIP principals.

These selected assets and liabilities involve less complex issues than other assets and liabilities to be considered by the Board in the future. The Board also believes that the selected assets and liabilities are so basic to financial reporting that they will not conflict with any conceptual framework that the Board may develop. The Board is also addressing other assets and liabilities. It has issued a proposed standard for direct loans and loan guarantees (see Exposure Drafts entitled Accounting for Direct Loans and Loan Guarantees, September 15, 1992, and Accounting for Inventory and Related Property, December 1992).

The standards on the selected assets and liabilities were proposed in the Board's first Exposure Draft issued in September 1991, entitled Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities. A total of 69 respondents submitted their comments to the Board on the Exposure Draft. A public hearing on the Exposure Draft was held on February 28, 1992.

In preparing this Statement of recommended standards, the Board considered the respondents' comments. Based on the comments the Board received and its reevaluation in relation to the Board's current thinking on user needs and objectives of federal financial reporting, the Board made changes to the proposals contained in the Exposure Draft. The specific changes are discussed in Appendix A, Basis of the Board's Conclusions.

## SCOPE

The selected assets addressed in this Statement are:

Cash

Fund Balance with Treasury  
Accounts Receivable  
Interest Receivable  
Advances and Prepayments  
Investments in Treasury Securities

The selected liabilities addressed in this Statement are:

Accounts Payable  
Interest Payable  
Other Current Liabilities

#### MATERIALITY

Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

#### APPLICABILITY

The accounting standards recommended in this Statement are applicable to the federal government and its departments and agencies in the executive branch that fall within the definition of executive agency as defined in 31 U.S.C. 102 and 3501.

#### EFFECTIVE DATE

The FASAB recommends that, if the Principals approve the accounting standards recommended in this Statement, they become effective for fiscal years ending September 30, 1994, and thereafter.

\*\*\*\*\*

#### APPENDIX A: BASIS OF THE BOARD'S CONCLUSIONS

87 This Appendix provides a discussion on the substantive comments that the Board received from

respondents to Exposure Draft No. 1, "Financial Resources, Funded Liabilities, and Net Financial Resources of Federal Entities" (November 18, 1991) and from testimony at a public hearing on the Exposure Draft held February 28, 1992. The Appendix explains the basis of the Board's conclusions on issues raised by the respondents.

## BASIC CONCEPTS

Net financial resources. 88 In the Exposure Draft, the Board proposed the concept of net financial resources . The term net financial resources was referred to as an entity's total financial resources less its total funded liabilities (Exposure Draft, page 11). The Exposure Draft stated that the amount of net financial resources provides a general measure of an entity's financial sufficiency before new appropriations are provided. The Exposure Draft further stated that information on the components of an entity's net financial resources (obligated and unobligated balances of budget authority and other items) can provide additional insight into an entity's financial situation.

89 Many respondents do not see convincing evidence that the concept of net financial resources is useful. They point out that there are no concrete examples to illustrate how the information can be used. Some respondents also do not believe that the measure of net financial resources is well defined. They point out that one of the elements missing from the concept is the amount of unfunded liabilities. They state that without measuring unfunded liabilities, the measure of net financial resources is incomplete and can be misleading.

90 The Board has decided to postpone consideration of the net financial resources concept. The Board believes that the usefulness of the concept can be further explored after it completes its project on users' needs and objectives for financial accounting and reporting.

ENTITY FINANCIAL RESOURCES. 91 In the Exposure Draft, the Board discussed the concept of entity financial resources. The concept was defined as assets of a federal entity that consist of (a) the entity's cash and funds authorized and available for disbursement (excluding contract authority and unused authority to borrow), (b) resources of the entity that are expected to be converted

into cash to satisfy liabilities, and (c) conversion of cash into another form (for example prepayments) that would be consumed. Under this definition, the Exposure Draft identified as financial resources: cash, funds with Treasury, claims to cash (for example accounts receivable and loans receivable), claims to goods and services (for example advances and prepayments), inventories held for sale, and investments.

92 As indicated in the Exposure Draft, financial resources are a subset of assets that provide liquidity (cash and assets that can be converted to cash) to meet a federal entity's operational needs. The concept was considered useful because federal entities obtain resources from the budget to finance their operations and are held accountable for the use of the financial resources.

93 The Board has decided not to use the term financial resources in this document. However, a definition of the term financial resources and its usefulness will be further considered by the Board in its conceptual framework project. In the absence of the term, the items that would provide future economic benefits to the government and its entities are referred to as assets. The term asset as used in this document means an item that embodies a probable future economic benefit that can be obtained or controlled by the federal government or a reporting entity as a result of past transactions or events. (The definition of assets will be considered by the Board in the future.)

**FUNDED LIABILITIES.** 94 The Exposure Draft proposed the definition of funded liabilities as liabilities for which the federal entity has received budget authority to cover the related expenditure or expense.

95 The term funded liabilities would limit the recognition of liabilities to the extent that they are funded. The Board believes that the liabilities addressed in this document should be recognized when they are incurred, regardless of whether they are funded. The Board therefore decided not to use the term funded liabilities in this document. However, the Board recommends that disclosure be made for liabilities that are not covered by budgetary resources.

96 The word *liability* used in this document means a probable and measurable future outflow of resources arising from past transactions or events. <SFA comprehensive definition of liabilities is being considered by the Board in its project concerning liabilities in general.> However, this document addresses only those selected liabilities that routinely recur in normal operations and that are due within a fiscal year. These liabilities are accounts payable, interest payable, and other current liabilities. The category of other current liabilities includes salary and entitlement benefit expenses that are accrued and would be paid within a fiscal year.

## GENERAL STANDARDS

97 The recommended standards apply to reporting by the federal government and its entities for both governmental assets and liabilities and intragovernmental assets and liabilities reported at the entity level.

98 An entity may have two categories of assets and liabilities—intragovernmental and governmental assets and liabilities. The difference between intragovernmental and governmental assets and liabilities is explained below:

- (1) Intragovernmental assets and liabilities. These assets and liabilities arise from intragovernmental transactions. For example, investments held by a federal entity in Treasury securities are reported by the entity as an asset. However, the Treasury securities also are liabilities of the Department of the Treasury. Thus, the securities represent intragovernmental assets and liabilities. Another example is fund balance with Treasury. An entity's fund balance with Treasury of an entity will be reported as an asset by the entity. However, it is not an asset of the federal government; rather, it is a commitment of the U.S. government to provide funds to a federal entity. (See discussion, which follows, on Fund balance with Treasury .)
- (2) Governmental assets and liabilities. These are assets and liabilities that arise from transactions of the federal government with nonfederal entities (persons and organizations outside the U.S. government, either foreign or domestic). For example, income taxes to be

collected from the public are reported on IRS financial statements as receivables. These receivables are assets of the federal government.

99 The recommended standards require that intragovernmental assets and liabilities be reported separately from governmental assets and liabilities.

100 Assets reported by an entity also are distinguished between entity and non-entity assets.

(1) Entity assets. Entity assets are assets that are available to an entity for its use. Entity assets include both intragovernmental and governmental assets. Supplies inventory held by an entity for consumption in its operations is an entity asset as well as a governmental asset. A receivable of a federal entity from another federal entity is an entity asset if the receiving entity has authority to use the amount collected.

(2) Non-entity assets. An entity may have assets under its custody and management that the entity is not authorized to use. In this Statement, these assets are called non-entity assets, as distinguished from entity assets that the entity is authorized to use in its operations. For example, customs duty receivables to be collected by the Customs Service is a non-entity asset that would be reported by the Customs Service.

101 The Board recommends that both entity assets and non-entity assets under an entity's custody or management be recognized in the entity's financial statements. Non-entity assets should be separately reported in an entity's financial statements.

102 The following exhibit, using receivables as an example, illustrates the relationship between entity and non-entity assets on one hand and intragovernmental and governmental assets on the other hand.

## ACCOUNTS RECEIVABLE

	Entity Assets	Non-entity assets
Intra-governmental Assets	Amounts receivable from a federal entity for goods or services delivered that will be available to the receiving entity to spend.	Amounts to be collected from a federal entity that will not be available to the receiving entity to spend.
Governmental Assets	Amounts receivable from a nonfederal entity for goods or services delivered that will be available to the receiving entity to spend.	Amounts (such as taxes) to be collected from a nonfederal entity that will not be available to the receiving entity to spend.

## SPECIFIC STANDARDS

### Cash

103 The Board has retained from the Exposure Draft the requirement for separate reporting of restricted and unrestricted cash. However, after considering comments on the Exposure Draft, the Board has modified the definition of restricted cash.

104 The Exposure Draft proposed that unrestricted cash include amounts in demand deposits. However, whether an amount of cash is restricted does not depend on where the cash is kept. For example, federal entities may hold cash in demand deposit accounts on behalf of Treasury. Since the entities have no authority to spend the cash, from the entities' perspective, these amounts of cash are restricted.

105 The recommended standard in this document redefines restricted cash as (1) amounts of cash that an entity holds on behalf of Treasury or other entities and does not have authority to spend, and (2) amounts of cash that are legally restricted to specific purposes.

## Fund Balance with Treasury

106 The recommended standard provides guidance on the composition of fund balance with Treasury. Events that cause an entity's fund balance to increase include receiving appropriations, allocations, transfers, receipts that the entity is authorized to spend (or to use to offset its expenditures) and borrowing from Treasury. An entity's fund balance is reduced by amounts disbursed to pay liabilities and expenditures, amounts invested in securities, amounts of appropriations canceled or rescinded, and amounts transferred to other agencies or to the Treasury.

107 With respect to fund balance with Treasury, the Board has considered the following issues:

### (1) IS FUND BALANCE WITH TREASURY AN ASSET?

108 The Board believes that from the perspective of a federal entity (such as a bureau, a program, or a fund), fund balance with Treasury is an asset. In fact, it is the most important source against which an entity can make expenditures and incur liabilities.

109 However, the Board recognizes that a fund balance with Treasury is an intragovernmental item. It represents a entity's authorized claim to the federal government's resources on one hand, and the government's commitment to supply resources to the entity on the other hand. The claims and commitments would not be reported when financial reports of individual entities are consolidated on a government-wide level. Thus, from the perspective of the federal government as a whole, fund balances with Treasury are not assets of the federal government.

### (2) HOW DOES FUND BALANCE WITH TREASURY RELATE TO BUDGETARY RESOURCES?

110 A fund balance is created by budget authority. An appropriation is the major form of budget authority that creates a fund balance with Treasury for an entity. Thus, the relationship between fund balance with Treasury and budget authority cannot be ignored.

111 However, an entity's fund balance with Treasury

does not necessarily equal its budgetary resources. The difference between these two concepts may be clarified by examining their definitions. A fund balance represents the sum of amounts that is actually available in an entity's accounts with Treasury. Budgetary resources on the other hand encompass all authorities for an entity to incur obligations. Some of the authorities do not in themselves provide funds to the entity. Contract authority, for example, allows an entity to incur obligations under a contract. However, it does not, in itself, provide funds to the entity's accounts with Treasury. An appropriation is necessary for the entity to have funds to liquidate obligations incurred under contract authority.

112 Authority to borrow does not in itself place funds into an entity's accounts with Treasury. In order to increase its fund balance with Treasury, an entity must actually borrow under its borrowing authority.

113 For these reasons, the recommended standard states that fund balance with Treasury does not include contract authority and unused authority to borrow.

### **(3) SHOULD THE FUND BALANCE EXCLUDE FUNDS DESIGNATED FOR SPECIAL PURPOSES?**

114 Some respondents to the Exposure Draft believe that the standard should identify funds held with Treasury that are not available to the entity's operations. For example, the Department of Energy collects fines levied under the Emergency Petroleum Allocation Act of 1973, deposits those funds in an escrow account with Treasury, and ultimately disburses those funds to injured parties or for other uses as directed by court decisions.

115 It is not unusual that funds in certain accounts are held and restricted to specific purposes. Amounts of trust funds, for example, are held for the specific purpose of making benefit payments to eligible recipients. The restriction on funds held for the Department of Energy to pay persons injured by oil pricing and allocation violations is another example. The Board believes that the fund balance of a reporting entity should include funds held in all accounts of the entity regardless of whether they are designated for specific purposes.

## Accounts Receivable

116 Respondents raised issues related to the recognition and measurement of losses due to uncollectible amounts. Before addressing the Board's actions in relation to respondents' comments, however, the terms recognition and measurement as used in this Statement are explained below:

117 Recognition means formally recording or incorporating an item into the records and financial statements as an asset, liability, expense, revenue, or similar element. For assets or liabilities, recognition encompasses subsequent changes to the amounts of assets and liabilities.

118 Measurement is the process of expressing an asset or liability in monetary units. Measuring an item requires selecting an appropriate measurement attribute such as historical cost, current market value, net realizable value, or present value of future cash flows.

119 In the proposed standard and the discussion of accounts receivable, the term recognition concerns the timing of recording an asset or the impairment of an asset in the financial records. The term measurement concerns the valuation basis and the dollar amount of the asset that should be reported.

120 Detailed discussions of respondents' comments and the Board's actions are provided in the following paragraphs.

121 Timing of receivable recognition. The Exposure Draft states that a receivable should be recorded when events (e.g., payment due dates) or transactions occur that entitle an entity to accrue revenue or receive a reimbursement or fund transfer. Some respondents questioned the use of payment due dates as a criterion for recognizing receivables. These respondents stated a receivable should be recognized when an entity is owed an amount or earns a revenue, and that due dates are irrelevant.

122 Some receivables result from exchange transactions. For example, receivables may result from goods

and services provided to other entities. However, claims to cash or other assets also result from the federal government's legal authority to levy taxes and impose duties, fees and fines. These receivables are not related to revenue-earning functions or exchange transactions, but are based on the federal government's authority to collect the payments and a party's liability to pay cash or provide other assets to cover the claims. For the accrual of taxes, the tax due date represents the date that the government demands payment. The payment due date is a definitive criterion for accruing taxes.

123 The Board, therefore, recommends that a receivable be recognized when a claim to cash or other assets is established based either on goods or services provided or the government's legal authority to levy and collect. The Board is not recommending a revenue recognition standard at this time.

124 Loss recognition. In the Exposure Draft, it was proposed that a loss be recognized when it is more likely than not that a receivable has been impaired. The phrase more likely than not means a greater than 50 percent probability of occurrence.

125 Several respondents questioned why the Board used the more likely than not criterion for loss recognition instead of the probable criterion used in the private sector under generally accepted accounting principles (GAAP).[Footnote]

[Footnote: FASB Statement of Standards No.5, Accounting for Contingencies. ]

126 The Board may refer to the pronouncements and statements issued by other standard setting bodies in deliberating accounting standards for the federal government. However, the Board is not bound by these pronouncements and statements, especially when accounting standards promulgated for other sectors are not relevant to the federal government.

127 In the case of loss recognition on receivables, the Board believes that there should be a definitive guideline for recognizing government credit losses. The word probable is subject to broad interpretation (often being

interpreted as meaning a virtual certainty of occurrence) and could allow for belated recognition of losses.

128 The Board proposed the more stringent criterion of more likely than not, which requires the recognition of losses when there is more than a 50 percent chance that some receivables will not be collected. In recommending the more likely than not criterion, the Board's intent is to achieve unbiased, consistent, and reliable loss recognition in federal government accounting.

129 The more likely than not criterion can be applied to both individual accounts and groups of accounts. Both significant individual accounts receivable (e.g., unusually large refunds due from contractors, medicaid reimbursements from third parties, substantial tax delinquencies, or other large claims) and groups of small accounts should be analyzed and losses recognized if it is more likely than not that some or all of the amounts owed will not be collected.

130 When applying the loss recognition criterion, the Board believes it is appropriate to recognize the nature of federal receivables. Many of the federal government's receivables, unlike trade accounts of private firms or loans made by banks, are not created through credit screening procedures. These receivables arise because of activities such as fines from regulatory violations, refunds from erroneous benefit payments, reimbursements, and overdue taxes and duties. In these circumstances, historical experience and economic factors indicate that the receivables frequently are not fully collectible. These receivables meet the loss recognition test because of their inherent risk. Therefore, an appropriate amount of allowance for losses should be recognized at their inception.

131 Loss measurement. Because of the large volume of federal transactions, accounts receivable generally exist in large groups. Some groups may consist of several hundred thousand accounts. In such cases, losses on uncollectible amounts should be assessed on a group basis using statistical sampling techniques. Statistical sampling should be supplemented by historical trend experience, adjusted for current conditions.

132 On the other hand, some government receivables

arise from transactions of significant amounts. These receivables should be individually analyzed to assess losses due to risks specifically attributable to the individual accounts. The assessment of impairment of individual accounts may not always provide a valid basis to estimate the impairment of the entire group. Often, losses may exist for the group that are not currently identifiable on an individual basis. The Board believes that the federal government's receivables are generally subject to losses due to inherent risks. Therefore, allowances for receivables should be viewed in the context of the overall risk of the receivables being assessed.

133 Based on the above considerations, the recommended standard provides that, for reporting purposes, losses on accounts receivable should be determined by evaluating accounts on both a group and an individual basis.

#### Interest Receivable

134 In the Exposure Draft, the proposed standard requires that interest be recognized on a receivable until the receivable is repaid or written off. At the same time, the proposed standard requires that an allowance for uncollectible interest be provided. The intent of the proposed standard is to establish the debtor's liability for the accrued interest.

135 Some respondents expressed concern that there is usually a lengthy period from the time a receivable is determined to be uncollectible until it is written off. It would be burdensome to recognize interest on the uncollectible receivable and, at the same time, offset the amount of interest recognized by an allowance for uncollectible interest.

136 The initial intent of this procedure was to maintain a correct amount of the debtor's liability. This purpose can be achieved by record-keeping procedures rather than financial reporting. Therefore, for financial reporting, the Board has concurred that (a) interest receivable should be recognized only on collectible accounts, and (b) interest receivable on uncollectible accounts should be recognized only when it is actually received.

## Advances and Prepayments

137 There were no comments on the substance of the recommended accounting standard for advances and prepayments since the standard does not contain significant changes from the current accounting practice within federal government agencies. Some respondents requested that the Board clarify that prepayments do not include progress payments made on long-term contracts. Since progress payments are made based upon percentage of completion of a contract, the Board concluded that progress payments are not advances or prepayments.

138 Comments were also received questioning whether advances and prepayments should be included within the definition of financial resources (as proposed in the Exposure Draft) since advances and prepayments are not usually converted to cash or budget authority available for use by the entity.

139 The Board recognizes that, as in the case of inventories held for consumption, advances and prepayments convert into goods and services, but do not convert into cash. However, since the term financial resources is not used in this Statement, the issue is now moot. Advances and prepayments normally benefit current operations and, therefore, are normally considered current assets.

## Investments in Treasury Securities

140 The recommended standard applies to investments in Treasury securities, including (1) nonmarketable par value Treasury securities, (2) market-based Treasury securities held to maturity, and (3) marketable Treasury securities held to maturity.

141 In the future, the Board will address investments that are not covered by this standard. In the interim, federal entities should continue their current accounting practices for those investments not covered by this standard.

142 Federal entities, particularly the Social Security and the retirement trust funds, invest available funds in excess of their current needs in special Treasury securities issued in the government account series. The terms of the

Treasury securities are usually designed to meet the cash needs of government accounts. The vast majority of the investments are in nonmarketable Treasury securities issued exclusively to federal agencies. Most of them are par value securities, and some are market-based securities whose prices and interest rates reflect market terms. Thus, although the scope of the recommended standard is limited, it covers more than 90 percent of federal entities' investments.

143 A few federal entities are permitted to buy and sell marketable Treasury securities on the open market. Some federal entities which conduct business with the public or provide insurance to the private sector may acquire marketable Treasury securities as a part of a rescue and takeover transaction. This standard applies to marketable Treasury securities only to the extent that they are expected to be held to maturity.

144 In the Exposure Draft, the Board proposed that investments in par value nonmarketable Treasury securities be reported at cost. The Board also proposed that marketable securities and market-based Treasury securities be reported at market value as of the reporting date.

145 A number of respondents, however, expressed concern with the recognition of increases and decreases in assets based on market value, and the recognition of associated gains or losses. These respondents believe these are unrealized gains and losses which do not represent actual increases or decreases in assets. Some respondents also indicated that market value fluctuations generally do not affect an entity's investments in securities intended to be held to their maturity.

146 In this Statement, the Board continues to use the cost based valuation for nonmarketable par value Treasury securities. The cost basis is appropriate for this type of security because the invested amounts will be fully recovered at redemption.

147 The Board also recommends the cost or amortized cost basis for the valuation of market-based Treasury securities and marketable Treasury securities that are to be held to maturity. The Board believes that the cost basis is appropriate because the invested amounts can be fully

recovered when the Treasury securities mature. During the time periods when the securities are outstanding, the market prices of the securities may fluctuate due to interest rate changes or other temporary causes. However, so long as the securities are not to be sold to the market, the investing entity would not be affected by such market price fluctuations. For this reason, the Board decided to recommend the cost based approach rather than market value approach for marketable Treasury securities expected to be held to maturity.

148 The Board considered the valuation issues related to securities not covered by this standard. The Board has concluded that the use of a fair value approach pertains to a broad conceptual issue that needs to be addressed in its conceptual framework. Until the Board reaches decisions on the conceptual framework, it is premature to recommend a valuation basis for securities beyond those covered by this standard.

149 The Board believes that the criteria for classifying an investment as expected to be held to maturity should be based on the intent and ability of the investing entity to hold the security to its maturity. Intent and ability differ from a mere absence of an intent to sell the security. An evaluation of whether an entity has the intent and ability to hold its investments should be based on the entity's current and projected financial condition and its recent pattern in buying, selling, and managing Treasury securities. A security should not be classified as expected to be held to maturity if for cash needs or other investment management reasons the investing entity is not able to hold the security to its maturity.

150 At each financial reporting date, the appropriateness of this classification should be reassessed. In rare instances, an entity's originally stated intent or ability to hold a security to maturity may change due to significant unforeseen changes in the entity's cash needs or in other circumstances. When this occurs, securities initially classified as expected to be held to maturity should be reclassified to securities available for sale or early redemption.

Accounts Payable

151 Accounts payable are set up to record an entity's liability for goods and services received or work progress made by a contractor for which payment has not been made.

152 Some respondents questioned the timing of recognizing a liability in accounts payable. A federal entity, under budgetary accounting, records an obligation when the entity places a purchase order or signs a contract. The term obligations incurred is defined as amounts of orders placed, contracts awarded, services received, and similar transactions that will require payment in the same or future periods. Such amounts include outlays for which obligations have not been previously recorded. Such amounts also include adjustments for (a) differences between amounts recorded as obligations and actual outlays to liquidate those obligations, (b) cancellations of obligations, and (c) refunds arising during the reporting period for recovery of erroneous payments or due to accounting adjustments. However, adjustments to obligations incurred in prior years are reported separately as recoveries of prior year obligations. (For legal basis of obligations incurred, see 31 U.S.C. 200 and OMB Circular A-34.) See also JFMIP Report, Project on Standardization of Basic Financial Information Requirements of Central Agencies, (October, 1991) p. 24. An obligation, once incurred, reduces an entity's resources available for obligation. Budgetary accounting entries are required to record the amounts obligated and to reduce the available budget authority. For financial reporting purposes, liabilities are recognized when goods and services are received or are recognized based on an estimate of work completed under a contract or agreement.

153 Some federal entities believe it is appropriate to recognize a liability in accounts payable when a purchase order is placed. The theory of this practice is that the purchase order represents a use of the entity's budgetary resources and that recognizing the liability would correctly reduce the entity's available budgetary resources.

154 Proponents for this practice also argue that, in many cases, goods produced under government contracts bear unique specifications for government needs and, as a result, cannot be sold to other customers. Thus, they argue that it is virtually certain that the government has incurred a liability toward the contractor.

155 The Board recognizes that there is a need to reconcile budget execution results and financial effects. In budgetary accounting, when a purchase order is placed, an obligation is recorded to ensure budgetary control. However, recognition of the claim from a financial accounting standpoint does not occur until goods are delivered, work progress is actually made by a contractor, or services are performed since these events generally trigger a cash outlay that liquidates the obligation. The Board does not believe that recognizing a liability prior to a actual receipt or constructive receipt of goods or services should be adopted as a financial accounting standard. It also does not believe that it is appropriate to erase the distinction between recording obligations for budget purposes and recognizing a liability for financial accounting purposes.

156 Some respondents question whether a liability should be recognized for multi-year contracts that are to be financed through appropriations over a number of years. As has been discussed earlier, when a contract is entered, an obligation is recognized in budgetary accounting. However, until goods or services are received or work progress is made, the Board does not believe that an obligation should be recognized as a liability. When goods or services are received or work progress is made under either a short or long-term contract, a liability for unpaid amounts should be recognized.

#### Interest Payable

157 There were no substantial comments on the recommended accounting standard for interest payable. The recommended standard does not differ from the current accounting practice within federal government agencies.

#### Other Current Liabilities

158 The recommended standard covers the current liabilities that are not specifically defined in other standards. Current liabilities specifically defined in this Statement are accounts payable and interest payable. Accounts payable and interest payable represent liabilities arising from discrete transactions. The Board also plans to issue statements to define other specific liabilities such as liabilities incurred under a loan guarantee contract and

borrowings from other entities.

159 Other current liabilities generally are related to on-going and continuous expenses, which are typically recognized throughout each accounting period rather than on an individual transaction basis. A typical example is the liability for employees salary that is accrued at the end of a fiscal year but is not paid.

160 The Exposure Draft indicated that a liability was considered funded if the related expense was incurred under budget authority. Some respondents suggested that the term budget authority be changed to budgetary resources . They argued that budgetary resources encompass not only new budget authority, but also other resources available to incur liabilities for specified purposes in a given year.

161 The Board agrees that a liability (or a portion of the liability) should be considered funded from the reporting entity's perspective if it is covered by available budgetary resources. However, the recommended standard takes the position that a liability should be recognized when it is incurred, regardless of whether it is covered by available budgetary resources. The recommended standard also requires that disclosure should be made for liabilities that are not covered by available budgetary resources.

\*\*\*\*\*

## APPENDIX B:

### ILLUSTRATION OF THE INTEREST METHOD FOR INVESTMENT DISCOUNT AND PREMIUM

This Appendix provides an illustration of the interest method for amortizing a discount or premium of an investment in a marketable or a market-based Treasury security, such as a Treasury bond. The interest method is required in the recommended standard for investments. Before explaining the interest method itself, the concept of discount and premium will be explained.

#### Bond Discount and Premium

The price of a bond equals the present value of the bond's net future cash flows, including principal and interest payments, discounted to the time of its issuance. The discount rate is referred to as the effective interest

rate. Since the effective interest rate usually equals the market interest rate, it may differ from the stated interest rate (the coupon rate) of the bond. The difference between the effective interest rate of a bond and its stated interest rate causes the bond price to be different from its face amount.

A Treasury bond may be purchased at a price higher or lower than the bond's face amount (par amount). The difference between the purchase price and the face amount is a discount if the price is lower than the face amount; or a premium if the price is higher than the face amount. The investor initially records the bond at its face amount and records the discount or the premium in a valuation allowance account. Thus, the carrying amount of the bond equals its face amount minus or plus the discount or the premium. The discount or the premium is amortized over the life of the bond, so that the bond would be redeemed at its face amount at its maturity.

#### The Interest Method [Footnote 10]

Under the interest method of amortization, an amount of interest equal to the carrying amount of the investment times the effective interest rate, is calculated for each accounting period. This calculated interest is the effective interest of the investment (referred to as effective yield in some literature). The amount of effective interest is compared with the stated interest of the investment. (The stated interest is the interest that is payable to the investor according to the stated interest rate.) The difference between the effective interest and the stated interest is the amount by which the discount or the premium should be amortized (i.e., reduced) for the accounting period.

[Footnote 10 :The interest method of amortization is described in several FASB statements and APB Opinions. For example, see paragraph 18, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, and paragraph 16 of APB Opinion No. 12, Omnibus Opinion.]

#### EXAMPLES [Footnote 11]

In the first example, which shows the amortization of a

discount, Treasury bonds with the face amount of \$100,000 were purchased by a federal entity on the bonds' issuance date, January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is \$96,007, with a discount of \$3,993, which reflects an effective interest rate of 8 percent.

[Footnote 11: The examples are adapted from Glenn A. Welsch and Charles T. Zlatkovich, *Intermediate Accounting*, 8th ed. (Boston: Richard D. Irwin, Inc., 1989), p. 656.]

In Table 1 below, the annual discount amortization is in column 4, which equals column 3 minus column 2.

TABLE 1: DISCOUNT AMORTIZATION

DATE	BONDS		DISCOUNT AMORTIZA- TION	UNAMOR- TIZED BALANCE	CARRYING AMOUNT
	STATED INTEREST 7%	EFFECTIVE INTEREST 8%			
1/1/92				\$3,993	\$96,007
12/31/92	\$7,000	\$7,681	\$681	3,312	96,688
12/31/93	7,000	7,735	735	5,577	97,423
12/31/94	7,000	7,794	794	1,783	98,217
12/31/95	7,000	7,857	857	926	99,074
12/31/96	7,000	7,926	926	0	100,000

In the second example, which is the amortization of a premium, Treasury bonds with the face amount of \$100,000 were purchased by a federal entity on the bonds' issuance date, January 1, 1992. The bonds' stated interest rate is 7 percent, and interest is payable at the end of each year. The bonds will mature in 5 years, on December 31, 1996. The cost of the investment is \$104,212, with a premium of \$4,212, which reflects an effective interest rate of 6 percent.

In Table 2 below, the annual premium amortization is in column 4, which equals column 2 minus column 3.

TABLE 2: PREMIUM AMORTIZATION

DATE	STATED INTEREST 7%	EFFECTIVE INTEREST 6%	PREMIUM AMORTI-ZATION	UNAMOR-TIZED BALANCE	BONDS CARRYING AMOUNT
1/1/92				\$4,212	\$104,212
12/31/92	\$7,000	\$6,253	\$747	3,465	103,465
12/31/93	7,000	6,208	792	2,673	102,673
12/31/94	7,000	6,160	840	1,833	101,833
12/31/95	7,000	6,110	890	943	100,943
12/31/96	7,000	6,057	943	0	100,000

\*\*\*\*\*

APPENDIX C: GLOSSARY

This glossary provides definitions of many terms used in this Statement. The definitions may be modified or superseded when relevant terms are considered or defined by the FASAB in future projects.

**ALLOCATIONS:** The amount of obligational authority transferred from one agency, bureau, or account that is set aside in a transfer appropriation account to carry out the purpose of the parent appropriation or fund. (JFMIP, Project on Standardization of Basic Financial Information Requirements of Central Agencies, dated October 1991, hereafter cited as JFMIP Standardization Project)

**AMORTIZATION:** The gradual extinguishment of any amount over a period of time through a systematic allocation of the amount over a number of consecutive accounting periods such as the retirement of a debt by serial payments to a sinking fund. (Kohler's Dictionary).

**APPROPRIATION:** In most cases, appropriations are a form of budget authority provided by law that permits federal agencies to incur obligations and make payments out of the Treasury for specified purposes. An appropriation usually follows enactment of authorizing legislation. An appropriation act is the most common means of providing budget authority, but in some cases the authorizing legislation itself provides the budget authority.

**ASSETS:** Tangible or intangible items owned by the federal

government which would have probable economic benefits that can be obtained or controlled by a federal government entity. (Adapted from FASB Concepts Statement No. 6 and Kohler's Dictionary.)

**AUTHORITY TO BORROW:** Authority to borrow is a subset of budget authority. (See budget authority.)

**BUDGET AUTHORITY:** The term budget authority means the authority provided by Federal law to incur financial obligations, as follows:

- provisions of law that make funds available for obligation and expenditure (other than borrowing authority), including the authority to obligate and expend the proceeds of offsetting receipts and collections;
- borrowing authority (authority to borrow), which means authority granted to a Federal entity to borrow and obligate and expend the borrowed funds, including through the issuance of promissory notes or other monetary credits;
- contract authority, which means the making of funds available for obligation but not for expenditure [Statutory authority under which contracts or other obligations may be entered into prior to an appropriation for the payment of such obligations. The later appropriation provides cash to liquidate such obligations. See OMB Circular A-34.], and
- offsetting receipts and collections as negative budget authority, and the reduction thereof as positive budget authority. (Omnibus Budget Reconciliation Act of 1990 (Pub. L. 101-508), Sec. 13211): Budget authority may be classified by period of availability (1-year, multiple-year, and no-year), by nature of authority (current or permanent), by the manner of determining amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections).

**BUDGETARY RESOURCES:** Those amounts available to enter into obligations for specified purposes in a given year. They include: (1) new budget authority, (2) offsetting

collections credited to an appropriation or fund account, (3) recoveries of unexpired budget authority through downward adjustments of prior year obligations, <R>and, (4) unobligated balances of such resources at the beginning of the year or transferred in during the year. (JFMIP Standardization Project)

**COLLECTIONS:** Amounts received by the federal government during the fiscal year. Collections are classified as follows:

- Budget receipts or off-budget receipts are collections from the public based on the government's exercise of its sovereign powers, including collections from participants in compulsory social insurance programs.
  
- Offsetting collections are collections from government accounts (intragovernmental transactions) or from the public that are offset against budget authority and outlays rather than reflected as receipts in computing the budget and off-budget totals. They are classified as (a) offsetting receipts (i.e., amounts deposited to receipt accounts), and (b) collections credited to appropriation or fund accounts. The distinction between these two major categories is that collections credited to appropriation or fund accounts are offset within the account that contains the associated disbursements (outlays), whereas offsetting receipts are in accounts separate from the associated disbursements. Offsetting collections are deducted from gross disbursements in calculating net outlays. (Based on A Glossary Of Terms Used in the Federal Budget Process; and Related Accounting, Economic, and Tax Terms, Third Edition, General Accounting Office, March 1981, hereafter referred to as the Budget Glossary.)

**CONTRACT AUTHORITY:** Contract authority is a subset of budget authority. (See budget authority.)

**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.

**DIRECT LOAN:** A disbursement of funds by the government to a

nonfederal borrower under a contract that requires the repayment of such funds within certain time, with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB Circular No. A-11.)

**ENTITY:** A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with OMB annual guidance on Form and Content of Financial Statements.

**EXPENSE:** Outflows or other using up of assets or incurrence of liabilities (or a combination of both) during a period of 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. (Adapted from Kohler's Dictionary and FASB Concepts Statement No. 6.)

**EXPIRED APPROPRIATIONS (ACCOUNTS):** Appropriation accounts in which the balances are no longer available for incurring new obligations because the time available for incurring such obligations has expired. (JFMIP Standardization Project)

**FEDERAL ENTITIES (UNITS, COMPONENTS):** See entity.

**INTEREST METHOD:** For purposes of this Statement, the method used to amortize a bond discount or premium using the effective interest rate (the discount rate) of the bond. The amortized amount equals the effective interest amount minus the stated interest amount. (See Appendix B.)

**LIABILITY:** A probable and measurable future outflow of resources arising from past transactions or events.

**MARKET-BASED TREASURY SECURITIES:** Treasury securities issued to governmental accounts that are not traded on any securities exchange but mirror the prices of marketable securities with similar terms. (See Treasury Financial Manual 2-4100, Federal Agencies' Financial Reports, Exhibit No. 3.)

**MARKET VALUE:** For investments in marketable securities, the term refers to the value of such securities determined by prices quoted on securities exchange markets multiplied by the number of bonds or shares held in an investment portfolio.

**MARKETABLE TREASURY SECURITIES:** Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

**NET REALIZABLE VALUE (NRV):** The estimated amount that can be recovered from disposing of an item.

**OBLIGATED BALANCES:** The net amount of obligations in a given account for which payment has not yet been made. (JFMIP Standardization Project) **Obligations:** Amounts of orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payments during the same or a future period. (JFMIP Standardization Project)

**OFFSETTING RECEIPTS:** Offsetting receipts are a subset of offsetting collections. (See collections.)

**REAPPROPRIATION:** Enacted legislation that continues the availability of unexpended funds that expired or would otherwise expire. (JFMIP Standardization Project)

**RECOGNITION (OR RECOGNIZE):** The term recognition, as used in this Statement, bears the same meaning as used by FASB in its conceptual statements. Recognition is 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. (FASB Statement of Financial Accounting Concepts No. 5, para. 6)

**REIMBURSEMENTS:** Sums received as payment or advance payment for goods or services furnished either to the public or to

another federal government account. If authorized by law, these sums are credited directly to specific appropriation and fund accounts. These amounts are deducted from the total obligations incurred (and outlays) in determining net obligations (and outlays) for such accounts. (Budget Glossary) Reimbursements are offsetting collections. (See offsetting collections.)

**TRANSFERS BETWEEN APPROPRIATION/FUND ACCOUNTS:** Occur when all or part of the budget authority in one account is transferred to another account when such transfers are specifically authorized by law. The nature of the transfer determines whether the transaction is treated as an expenditure transfer or a non-expenditure transfer. (JFMIP Standardization Project)

**UNOBLIGATED BALANCES:** Balances of budgetary resources that have not yet been obligated. (JFMIP Standardization Project)

Unobligated balances expire (cease to be available for obligation) for:

- 1-year accounts at the end of the fiscal year;
- multiple-year accounts at the end of the period specified;
- no-year accounts only when they are 1) rescinded by law, 2) purpose is accomplished, or 3) when disbursements against the appropriation have not been made for 2 full consecutive years. (Budget Glossary).