



**December 2, 2020**

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Through: Monica R. Valentine, Executive Director

Subj: **Technical Clarifications of Existing Standards-Debt Cancellation—Tab B<sup>1</sup>**

MEMBER ACTIONS REQUESTED:

- Respond to staff questions (p.10) by December 8<sup>th</sup>

**MEETING OBJECTIVES**

1. Provide the Board an update on the debt cancellation issue that was last presented at the June 2020 Board meeting.
2. Assess whether the Board wants to move forward with the Interpretation or defer the issue as part of the Reexamination Project.

**PHASE**

This project is in the development phase. The Board is considering an interpretation exposure draft.

**BRIEFING MATERIAL**

You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>. The briefing materials include the following:

**Attachment 1-** Staff Analysis (attached to the memorandum)

**Attachment 2-** Staff Draft Interpretation of Federal Financial Accounting Standards, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*

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

## BACKGROUND

At the October 2019 meeting, staff presented the debt cancellation issue related to paragraph 313 of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. Most Board members agreed that the paragraph needed clarification and should be resolved with the lowest level of GAAP guidance necessary. At the December 2019 meeting, the Board reiterated their position and agreed that an interpretation should be used to clarify SFFAS 7 par. 313.

At the February 2020 Board meeting, the Board considered an initial draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*. Although most Board members were supportive of the interpretation, Treasury and OMB requested additional time to perform research. The Board generally agreed to delay further consideration pending research into prior debt cancellations and other historical circumstances, as indicated by OMB and Treasury. In addition, the Board requested staff to consult with the reporting entities affected by the recent debt cancellation and seek input to determine whether the draft Interpretation guidance would have resolved the issue.

In April 2020, staff provided the Board with an update with the results of the research performed by Treasury and OMB as well as the outreach performed by FASAB staff. Staff believed that neither the feedback obtained from the reporting entities affected by the debt cancellation nor the additional research regarding previous debt cancellations would impede the Board from moving forward on the project. Specifically, there was only one additional example debt cancellation example provided and Treasury and OMB acknowledged cancellations happen infrequently. Further, the audit firm that cited the material weakness had conveyed the draft interpretation guidance was consistent with current GAAP and would have resolved the issue.

At the June 2020 Board meeting, a majority of the members was supportive of the staff draft interpretation, but there were differing views among members. For example, one member did not believe guidance was necessary. Another member suggested that there could be a short-term and long-term solution approach. Specifically, the member believed the Board could arrive at short-term solution through a limited scope Interpretation and address other issues when the Board reassesses SFFAS 7 in the reexamination project. Staff expressed concern regarding this approach at the June 2020 Board meeting because staff did not believe it would resolve the issue presented. The Board agreed to consider the short-term proposal to issue the draft Interpretation through paragraph 9 if it will resolve the debt cancellation issue. Based on the Board's decision to consider the short-term proposal, Treasury and FASAB staff agreed to meet with the applicable parties to determine if the short-term proposal would resolve the issue.

## **NEXT STEPS**

The next steps will depend on discussions and determinations at the December 2020 Board meeting. If a majority of the Board prefers to move forward with the Interpretation, it would be exposed for comment. Alternatively, if members prefer to defer or no action, the issue would be revisited in the Reexamination project.

## **MEMBER FEEDBACK**

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at [batchelorm@fasab.gov](mailto:batchelorm@fasab.gov) with a cc to [valentinem@fasab.gov](mailto:valentinem@fasab.gov).

## Attachment 1- Staff Analysis

### *History of Project*

As explained in the background in the memo, the Board agreed paragraph 313 of SFFAS 7 regarding debt cancellation needed clarification in 2019. At the February 2020 Board meeting, the Board considered an initial draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*. Although most Board members were supportive of the interpretation, Treasury and OMB requested additional time to perform research. The Board also requested staff to consult with the reporting entities affected by the recent debt cancellation to determine whether the draft Interpretation guidance would have resolved the issues.

In April 2020, staff provided the Board with a written update regarding the debt cancellation issue since it was not on meeting agenda. In summary, the memo explained that neither the feedback obtained from the reporting entities affected by the recent debt cancellation nor the additional research provided by Treasury and OMB regarding previous debt cancellations would impede or prevent the Board from moving forward on the project. There was only one additional example debt cancellation example provided. Treasury and OMB acknowledged debt cancellations happen infrequently. Further, the audit firm that cited the material weakness conveyed the draft interpretation guidance was consistent with current GAAP and it would have resolved the issue.

At the June 2020 Board meeting, a majority of the Board was supportive of the updated draft interpretation. However, the Treasury representative suggested that there could be short-term and long-term solutions approach. Specifically, the Board could arrive at short-term solutions through a limited scope Interpretation and address other issues when the Board reassesses SFFAS 7 in the reexamination project. Staff expressed concern regarding this approach at the June 2020 Board meeting because staff did not believe it would resolve the issue presented.

The Board agreed to Treasury's short-term proposal to issue the draft Interpretation through paragraph 9 if it would resolve the debt cancellation issue. Treasury and FASAB staff agreed to meet with all parties—DHS, Treasury deputy chief financial officer, and auditors—to ensure the draft Interpretation through paragraph 9 would fully resolve the debt cancellation issue that existed.

### *Discussion on Shorter Interpretation as Proposed by Treasury*

Treasury and FASAB staff met with DHS, DHS-OIG and their IPA on October 8, 2020 (via teleconference) to discuss the draft and assess whether the Treasury proposed limited-scope Interpretation would address the issues raised.

DHS, DHS-OIG and their IPA confirmed that the shorter interpretation as proposed by Treasury (through paragraph 9) would not resolve the issue that caused the material weakness that was reported during the 2018 audit. The parties commented the interpretation draft in its entirety was necessary. The IPA audit firm that cited the material weakness during the 2018 conveyed the full draft interpretation (through paragraph 11) because it clarified debt cancellation should be classified as an ‘other financing source’ on the Statement of Changes in Net Position (SCNP).

During the meeting, Treasury representatives asked if the proposed guidance would change current reporting practices because the draft interpretation states that all debt cancellation should be considered an ‘other financing source’ whether an appropriation was received or not. Treasury posed the question because it appeared that any appropriation received would be reported as a budgetary financing source on the SCNP. Based on staff’s research and the discussions thus far, debt cancellations have been infrequent or rare, and therefore very few ‘current practices’ are available to consider in this area. It was suggested that FASAB staff research the issue further and/or follow-up with OMB. (Please see next section for FASAB staff follow-up on this issue.)

**Question for the Board: 1. Does the Board have any questions regarding the meeting with the DHS representatives?**

*All Debt Cancellations Classified as an “Other Financing Source”*

As noted above, FASAB staff was asked to research further whether the draft guidance might have an unintended change on current reporting practices. Specifically, paragraph 11 of the draft interpretation states “As such, all debt cancellation should be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.”

As you may recall, much of the interpretation is based on paragraph 212 and footnote 43 of SFFAS 7:

212. Appropriations, including permanent indefinite appropriations, are the most widely used form of budget authority. When obligated by orders for, or receipt or provision of, goods, services, or benefits, they are reflected as obligations incurred. <sup>FN 43</sup> When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.

<sup>FN43</sup> Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered budget authority.

During the October 8 meeting, Treasury asked if current reporting practices might change with the draft interpretation. Treasury suggested that any appropriation received would be reported as a budgetary financing source on the SCNP. While staff does not dispute that typical transactions (such as those underlying appropriations) would be reported as a budgetary financing source—debt cancellations are rare.

As noted above, debt cancellations have been infrequent or rare, and therefore very few 'current practices' are available to consider in this area. During our meeting, one auditor noted that they did not foresee any unintended or negative consequences resulting from the draft interpretation guidance.

As you may recall, OMB was to perform historical research about the accuracy of footnote 43 after February 2020 Board meeting because they had raised a concern. However, as indicated in staff's April 2020 update to the Board, OMB did not provide any information or research to indicate a change was necessary to footnote 43.

Based on the October 8, 2020 meeting, staff followed up with OMB again. This follow-up included asking their views on current practices and reconfirming the research that had been done after the February 2020 meeting regarding footnote 43 because it related to appropriations. OMB believes the wording of the footnote could be improved grammatically<sup>2</sup> so it is clearer but it is technically accurate. The causality that OMB staff is concerned about is not in question or an issue.

Therefore, staff does not recommend any further action regarding current practices or the wording of footnote 43 for purposes of the interpretation. Staff believes in the rare instances that a debt cancellation occurs GAAP guidance (especially with the additional interpretation if the Board agrees to move forward) would be clear regarding how they are to be reported.

**Question for the Board: 2. Does the Board agree with the staff recommendation that no further action is required regarding footnote 43 and change in current practices for purposes of the interpretation?**

### *Terminology Issue*

At the June 2020 Board meeting, a Board member suggested that staff review the terminology in the draft Interpretation. Specifically, it was suggested that there wasn't a clear difference between the terms "budget authority" and "budgetary financing sources." It was suggested that the two terms are often intermingled but, in reality, are two very different concepts and the Board may need to consider defining these terms in the reexamination of SFFAS 7 or in future pronouncements.

Based on staff's review of the FASAB Handbook, the term "budget authority" is used 96 times. In fact, it was used quite often in the first Concepts Statement.

Budget Authority is defined in the Appendix as follows:

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<sup>2</sup> OMB staff conveyed that they believe the term "hence" in footnote 43 could be inferred by some to mean "therefore" and the sentence could be written clearer or slightly more accurate. Although the sentence may be written poorly, when one breaks down each part it is factually correct.

The authority provided by Federal law to incur financial obligations that will result in immediate or future outlays. Specific forms of budget authority include:

- Appropriations -- which may be provided in appropriations acts or other laws and which permit obligations to be incurred and payments to be made;
- Borrowing authority -- which permits obligations to be incurred but requires funds to be borrowed to liquidate the obligation;
- Contract authority -- which permits obligations to be incurred but requires a subsequent appropriation or offsetting collections to liquidate the obligations; and
- Spending authority from offsetting collections -- which permits offsetting collections to be credited to an expenditure account and permits obligations and payments to be made using the offsetting collections (the offsetting collections credited to an account are deducted from gross budget authority of the account.)

Budget authority may be classified by period of availability (one year, multiple-year, or no year), by nature of the authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections). (OMB *Circular A-11, Preparation and Submission of Budget Estimates*, Executive Office of the President, Office of Management and Budget, hereafter cited as OMB *Circular A-11*; OMB, *The Budget System and Concepts*; and GAO, *A Glossary of Terms Used in the Federal Budget Process*, Exposure Draft, January 1993; hereafter referred to as GAO *Budget Glossary*.)

“Budget authority” is used 11 times in the draft interpretation—in paragraphs 10, A12, A13, A19, and A20. Staff notes that much of the references are excerpts from SFFAS 7 that was included in the Basis for Conclusions. Staff does not see an issue with how the term “budget authority” is used in the draft interpretation and it appears consistent with the definitions provided.

Based on staff’s review of the FASAB Handbook, the term “budgetary financing source” is used just 7 times. The term has only been used in two pronouncements (SFFAS 27 and SFFAS 43) when showing pro forma Illustrative Statement of Changes in Net Position (SCNP). FASAB does not define the term.

Staff believes that this term may be referenced in the two illustrations because OMB uses ‘budgetary financing sources’ in form and content. As noted, it has only been referenced in FASAB standards in pro forma illustrative statements, so it would be consistent with form and content requirements. Staff notes that this has been in A-136 and earlier versions. Staff contacted OMB to confirm, but they could not confirm the background on “budgetary financing source” or the background of how it was first used in the A-136.

“Budgetary financing source” is used four times in the draft interpretation—in paragraphs 10, A4, and A19. Staff notes that paragraph A4 describes the Treasury posting logic and that it resulted in detail and that it resulted in the agency reporting the debt cancellation as a budgetary financing source on the SCNP. Paragraphs 10 and A19 references the term in a similar manner, by suggesting that they are the similar,

because they are linked in the sentence with an “or.” Staff suggests removing the phrase “or a budgetary financing source” in both paragraphs because this term is not defined in FASAB literature. FASAB staff notes the intent of including this phrase was to ensure that it was clear that the classification should not be a budgetary financing source on the SCNP for debt cancellation. Staff does not believe this is necessary to say because the guidance is clarified by providing how it is classified in paragraph 11. Specifically, paragraph 11 states:

11. As such, all debt cancellation should be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.

The edited par. 10 would be:

10. The Board provides further rationale and explanation of SFFAS 7 requirements in the basis for conclusions. As described in paragraphs 209-212 of SFFAS 7, appropriations are the most widely used form of budget authority that makes funds available to incur new obligations. SFFAS 7, footnote 43 provides: “Amounts appropriated to...repay debt are not available to incur new obligations and hence are not considered budget authority.” Likewise, debt cancellation activity would not be considered new budget authority ~~or a budgetary financing source.~~

Likewise, paragraph A19 states:

A19. Although the Board does not prescribe line items, paragraphs 209-212 of SFFAS 7 provides discussion about budgetary accounting and its linkage to accounting that is relevant to this topic that may assist users in making classification and display decisions. Footnote 43 to paragraph 212 provides: “Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered new budget authority.” Likewise, debt cancellation activity would not be considered new budget authority ~~or a budgetary financing source.~~ Therefore, debt cancellations would be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.

It should be noted that staff also reviewed GAO’s “A Glossary of Terms Used in the Federal Budget Process.” Similarly, the term budgetary financing source” is not defined. “Budget authority” is defined and very similar to FASAB’s definition. Staff also confirmed with OMB staff that budget authority is defined and used consistently.

Given the above, staff does not believe any additional changes (beyond the small edit to par. 10 and A19. above) are required to the Interpretation.

**Question for the Board: 3. Does the Board agree with the staff recommendation to edit paragraph 11 and A19 and that no further action is required?**

*Proceed with Interpretation or Defer to Reexamination of SFFAS 7*

As noted, at the June 2020 Board meeting, a majority of the Board was supportive of the staff draft interpretation. A common notion among members was that they were prepared to move forward with the draft Interpretation as long as it would not take up too much additional time. If it appeared that it would take up a lot more resources to finalize, then members would prefer to address it in the reexamination project due to the limited scope. If the Board would like to defer, the issue would be addressed when SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* is reviewed in its entirety.

Staff would like to confirm member's preference to move forward with the draft interpretation or defer and the issue to be addressed in the reexamination project. Staff has confirmed with the relevant parties that the draft interpretation will resolve the issue presented by the parties. Therefore, staff recommends exposing the Interpretation.

**Question for the Board: 4. Does the Board wish to move forward with the draft Interpretation? Alternatively, does the Board prefer to defer the issue until the Reexamination Project or not address?**

*IF the Board decides to proceed with the Draft Interpretation*

If the Board decides to proceed with the Draft Interpretation, staff has included a copy of an updated draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313* for members' consideration and review. The only technical change since the June 2020 meeting is marked on page 8 of this memo. Staff also updated the materiality language.

*(Please note that this document has **not** been reviewed by FASAB's communication specialist for grammar and consistency.)*

**Question for the Board: 5. Do members have any suggested edits or changes to the draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*?**

## QUESTIONS FOR THE BOARD

1. Does the Board have any questions regarding the meeting with the DHS representatives?
2. Does the Board agree with the staff recommendation that no further action is required regarding footnote 43 and change in current practices for purposes of the interpretation?
3. Does the Board agree with the staff recommendation to edit paragraph 11 and A19 and that no further action is required?
4. Does the Board wish to move forward with the draft Interpretation? Alternatively, does the Board prefer to defer the issue until the Reexamination Project or not address?
5. Do members have any suggested edits or changes to the draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*?



Federal Accounting Standards Advisory Board

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**DEBT CANCELLATION:**  
AN INTERPRETATION OF SFFAS 7 PARAGRAPH 313

**Interpretation of Federal Financial Accounting Standards**

**Exposure Draft**

Written comments are requested by **TBD XX, 2020**

**TBD XX, 2020**

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## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

Additional background information and other items of interest are available at [www.fasab.gov](http://www.fasab.gov):

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

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TBD XX, 2020

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

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

Responses are requested by TBD XX, 2021.

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

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

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

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

Sincerely,

George A. Scott

Chair

## EXECUTIVE SUMMARY

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### WHAT IS THE BOARD PROPOSING?

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

“Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity’s operations and is not directly related to the entity’s costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”

SFFAC 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position (SCNP). When considering paragraph 313 of SFFAS 7 and SFFAC 2 together, this proposed interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity that should be reported on the SCNP.

This proposed Interpretation would also clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item “gain” or “loss” be displayed on the SCNP. Rather, this proposed interpretation would clarify that debt cancellation activity should be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.

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

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This proposal would facilitate consistent reporting of financing sources on the Statement of Changes in Net Position. Proper classification is essential to constructing financial statements that meet the federal financial reporting objectives as they have been described in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

### MATERIALITY

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The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial.<sup>1</sup> A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement.

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<sup>1</sup> Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

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## QUESTIONS FOR RESPONDENTS

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

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

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

All responses are requested by **TBD XX, 2020**.

Q1. SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraph 313 provides:

“Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity’s operations and is not directly related to the entity’s costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”

SFFAC 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position (SCNP).

This proposed interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity and should be reported on the SCNP. Refer to paragraphs **XX**

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

- Q2. Paragraph 313 of SFFAS 7 provides “As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.” SFFAS 7 basis for conclusions paragraphs 209-212 discusses the proprietary accounting linkage to budgetary accounting.

This proposed interpretation would clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item<sup>2</sup> “gain” or “loss” be displayed on the SCNP. Rather, the proposed interpretation provides that debt cancellation activity be classified as an “other financing source” on the SCNP, whether an appropriation was received or not. In addition, reporting entity management is responsible for determining the most appropriate line item presentation and display and related disclosures, such as information about the debt cancelation. Refer to paragraphs XX

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

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<sup>2</sup> While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately due to materiality or be included with other items due to materiality.

## PROPOSED INTERPRETATION

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### SCOPE

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

### INTERPRETATION

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

“Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity’s operations and is not directly related to the entity’s costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”
3. As provided in paragraph 32 of SFFAS 7 “Appendix B, “Guidance for the Classification of Transactions,” provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or “other financing sources.” In addition, paragraph 63 of SFFAS 7 also states that “The various types of nonexchange revenue are described in Appendix B: Guidance for the Classification of Transactions. Some of these are not specifically mentioned in this standard.”
4. Paragraph 313 is part of Appendix B, “Guidance for the Classification of Transactions.” As noted, the appendix provides authoritative guidance for the classification of major transactions. The introduction of Appendix B provides the following “It is intended that these classifications—together with the explanation of these classifications, interpreted in the light of the Standards, the Basis for Conclusions, and the Introduction—will provide guidance for classifying all the financing transactions of the Government, including those that are not specifically listed. It should be understood that while some classifications are unequivocal, others are the result of balancing different considerations.”
5. Cancellation of debt is included under Intragovernmental Transactions: Nonexchange transactions—intragovernmental: gains and losses.

6. SFFAC 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position.
7. When considering SFFAS 7 paragraph 313 and SFFAC 2 together, this proposed interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity that should be reported on the Statement of Changes in Net Position (SCNP).
8. Paragraph 313 of SFFAS 7 provides “As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.” This proposed interpretation would clarify that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item<sup>3</sup> “gain” or “loss” be displayed on the (SCNP). Rather, the proposed interpretation requires that debt cancellation activity be included on the (SCNP). Reporting entity management is responsible for determining the most appropriate line item presentation and display and related disclosures, such as information about the debt cancellation (e.g., the statutory authority cancelling the debt, the reason for the debt), if appropriate, to provide context for the cancellation.
9. As noted in paragraph 313 of SFFAS 7, the cancellation of debt requires an Act of Congress. Each debt cancellation is governed by the particular language used in the legislation canceling the debt. For example, Congress may provide an appropriation to the agency when debt is canceled or it may cancel the debt without providing an appropriation.
10. The Board provides further rationale and explanation of SFFAS 7 requirements in the basis for conclusions. As described in paragraphs 209-212 of SFFAS 7, appropriations are the most widely used form of budget authority that makes funds available to incur new obligations. SFFAS 7, footnote 43 provides: “Amounts appropriated to...repay debt are not available to incur new obligations and hence are not considered budget authority.” Likewise, debt cancellation activity would not be considered new budget authority.
11. As such, all debt cancellation should be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.

## EFFECTIVE DATE

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

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

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<sup>3</sup> While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately due to materiality or be included with other items for presentation.

## APPENDIX A: BASIS FOR CONCLUSIONS

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

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

### BACKGROUND

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- A1. The Federal Accounting Standards Advisory Board (FASAB) was asked to review paragraph 313 of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* that pertains to debt cancellation to determine if it needs to be revised. Specifically, issues were raised during audits related to the accounting treatment of a cancellation of debt that affected several reporting entities.

#### **Debt Cancellation Example**

- A2. The request for guidance was based on an issue where an agency borrowed from the Department of the Treasury (Treasury) resulting in a payable/receivable relationship. Congress canceled debt through legislation and relieved the agency of liability.
- A3. Each debt cancellation is governed by the particular language used in the enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency for the purposes of cancelling the debt or it may simply cancel the debt without providing an appropriation. In this particular example, the debt was canceled without providing an appropriation.
- A4. Treasury's, Bureau of the Fiscal Service (Fiscal Service) is responsible for prescribing the accounting posting logic for the agencies through the Treasury Financial Manual. Fiscal Service is also responsible for ensuring proper application of intragovernmental eliminations at the government-wide financial reporting level. OMB and Treasury determined the posting logic for the debt cancellation scenario described in this draft interpretation. Treasury and OMB concurred that a negative surplus warrant should be used. Per the Fiscal Service (Treasury and OMB agreed upon) guidance, the agency was required to show an increase to Fund Balance with Treasury (FBWT) to implement the cancellation. The posting logic resulted in the agency recording the debt cancellation as a budgetary financing source on their Statement of Changes of Net Position (SCNP). The posting logic resulted in the agency reporting an appropriation provided by the legislation

as a “budgetary financing source” and its use to effect the debt cancellation on the SCNP and to show it as this financing source as having been used.

- A5. However, there was disagreement between the reporting entities regarding the proper entries. Specifically, the auditors of the agency that was relieved of the liability believed the cancellation of debt should be reported on the SCNP, but recognized as non-exchange gain in accordance with SFFAS 7 because the legislation did not provide for an appropriation. The auditors did not agree with the Fiscal Service prescribed posting logic and identified this treatment as a material weakness. To avoid losing their unmodified opinions on their AFR and closing package audits, the agency made the correcting entry required by the auditors to reverse the posting logic and recognize a non-exchange gain as an “other financing source” on the SCNP.

### **GAAP Guidance**

- A6. SFFAS 7 paragraph 313 provides:

“Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity’s operations and is not directly related to the entity’s costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.”

- A7. Paragraph 313 is part of Appendix B, Guidance for the Classification of Transactions in SFFAS 7. Appendix B provides authoritative guidance on classifying transactions. Specifically, the appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and “other financing sources,” and the reasoning behind these standards as explained in the Introduction and the Basis for Conclusions. Cancellation of debt is included under Intragovernmental Transactions: Nonexchange transactions—intragovernmental: gains and losses.
- A8. Not only is the transaction labeled a Nonexchange transaction per Appendix B Table of Transactions in SFFAS 7, but paragraph 313 of SFFAS 7 clearly provides that debt cancellation is nonexchange activity by stating “As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.” Understanding that debt cancellation is nonexchange activity is very important because it specifies reporting as prescribed in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.
- A9. The Introduction of SFFAS 7, paragraphs 16.-17 provides the following explanation regarding the difference between nonexchange and exchange revenue:

16. The essential differences among exchange revenues, nonexchange revenues, and other financing sources affect the way they are recognized and measured under the accrual method of accounting. Properly classifying these inflows according to their nature, therefore, provides the basis for applying

different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting objectives as they have been described in Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

17. To help meet those objectives, classifications were developed to determine what specific kinds of revenue should be deducted from the cost of providing goods and services by the reporting entities. Only revenue classified as exchange revenue should be matched with costs. Nonexchange revenue and other financing sources are not matched with costs because they are not earned in the operations process. Because they are inflows that finance operations, nonexchange revenues and other financing sources should be classified in accordance with other rules and should be recognized only in determining the overall financial results of operations for the period. This differs from the focus used in the private sector, where the focus is on net income for business organizations, and on changes in net assets for not-for-profit organizations. It is also a different focus from that used previously in reporting on U.S. Government operations. Under the old federal accounting standards, the focus was on matching all of an entity's financing with incurred expenses to report "net results of operations" which generally was not useful in evaluating performance. The new focus is on costs—both gross and net—which are useful in evaluating performance on many levels.

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

"Nonexchange revenue transactions do not require a Government entity to give value directly in exchange for the inflow of resources. The Government does not "earn" the nonexchange revenue. The cost that nonexchange revenue finances falls on those who pay the taxes and make the other nonexchange payments to the Government. The different character of nonexchange revenues requires that they be distinguished from exchange revenues. They should, therefore, be shown in a way that does not obscure the entity's net cost of operations."

- A11. SFFAC 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position. Therefore, previous Boards were clear that debt cancellation activity is nonexchange and should be reported on the Statement of Changes in Net Position.

- A12. SFFAS 7, Introduction paragraphs 23-26 provides discussion about the budgetary perspective as follows:

23. The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's

operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.

24. Budgetary resources have a different character than both exchange revenue and nonexchange revenue. Budgetary inflows should be shown in a way that reflects two different perspectives: the proprietary effect and the budgetary effect. Proprietary accounting treats these resources much as capital and lines of credit are treated in private sector accounting, and provides information about their availability in the Balance Sheet or in notes. Appropriations are recognized as capital when enacted into law, while borrowing authority is disclosed in notes. Because Government entities are expected to expend capital from appropriations rather than maintain it, the accounting for the use of appropriations differs in this respect from the private sector's accounting for capital. The accounting for "appropriations used" has been simplified and parallels their budgetary effect.

25. The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.

26. Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations. U.S. Government financial statements have not been used for planning and control as well as they might have been. In part, this is because accounting standards have not been fully attuned to the Government's needs and circumstances. Another important reason is the continuing primacy of the budget as a financial planning and control tool. General purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

A13. SFFAS 7, Basis for Conclusions paragraphs 209-212 provides discussion about the budgetary process and its linkage to accounting. Certain paragraphs provide detail about budget authority, as included below:

209. The budgetary process provides a component entity with budgetary resources through appropriations acts. Budget authority may be provided in the form of appropriations, borrowing authority, contract authority, or spending authority from offsetting collections. An appropriation may make funds available from the General Fund, special funds, or trust funds—including amounts received from earmarked taxes—or may authorize the spending of offsetting collections credited to expenditure accounts. Budgetary resources also include unobligated balances remaining from prior reporting periods and a number of adjustments (e.g., recoveries of prior year obligations).

Execution of the budget includes the obligation of budgetary resources and the outlays to liquidate the obligations.

210. Borrowing authority is sometimes used instead of appropriations to incur obligations and make payments to liquidate them out of borrowed money. However, borrowing money under this authority does not change the net position of the entity. The liability created by the borrowing is recorded along with the related asset (the cash borrowed). Repayment of the liability later will normally require the use of an offsetting collection or an appropriation. Assets acquired as a result of borrowing may be later amortized or written off and become part of an entity's costs. When this occurs, or in the unusual event that the borrowing finances expenses rather than assets, the entity's net position will be reduced.

211. Contract authority is not a reportable financing source because it only allows agencies to incur obligations in advance of receiving funds to pay for any resulting liabilities. The funds to liquidate any resulting liabilities will come from an appropriation or offsetting collections. For financial statement purposes, a financing source is recognized in accordance with the appropriate accounting standards for the type of financing received to liquidate the liability. Under past practice the financing was recognized at the time liabilities were incurred, but under the new standard the financing will not be recognized until liquidating appropriations are made available, which may be in the same reporting period as the liability is incurred or a later period.

212. Appropriations, including permanent indefinite appropriations, are the most widely used form of budget authority. When obligated by orders for, or receipt or provision of, goods, services, or benefits, they are reflected as obligations incurred.<sup>FN 43</sup> When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.

<sup>FN43</sup> Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered budget authority.

### **Nonexchange Activity Reported on Statement of Changes in Net Position**

- A14. When considering SFFAS 7 and SFFAC 2 together, GAAP clearly provides that debt cancellation is nonexchange activity that should be reported on the Statement of Changes in Net Position. It is important to note that paragraph 313 of SFFAS 7 provides "As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender."
- A15. However, the Board recognizes that there could be uncertainty conceptually with respect to applying "gain" and "loss" to intragovernmental transactions. The Board believes the previous Board was clear in their intent by classifying debt cancellation as nonexchange. However, valid concerns were raised regarding the potential ambiguity of the terms "gain" and "loss" in the context of intragovernmental transactions, and therefore, the Board believed it important to clarify that ambiguity through this proposed interpretation.
- A16. This interpretation clarifies that paragraph 313 of SFFAS 7 should not be interpreted to require that a line item "gain" or "loss" be displayed on the SCNP, only that debt cancellation activity be included on the SCNP.

- A17. While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately due to materiality or may need to be included with other items for presentation. Instead, most standards allow reporting entities flexibility in determining the best presentation. The Board did not prescribe specific line items for display in paragraph 313 of SFFAS 7. Reporting entity management is responsible for determining the most appropriate presentation and display. Much judgment and consideration of materiality is required and it would be specific to each reporting entity.
- A18. The Office of Management and Budget (OMB) specifies the form and content of agency financial statements, pursuant to its authority under the Chief Financial Officers Act of 1990, as amended (31 U.S.C. § 3515(d)) through issuance of Bulletins and Circulars. OMB prescribes form and content based on the guidance contained in FASAB standards but also may provide more specific detailed instructions on the format of line items in an authoritative Bulletin on Form and Content.
- A19. Although the Board does not prescribe line items, paragraphs 209-212 of SFFAS 7 provides discussion about budgetary accounting and its linkage to accounting that is relevant to this topic that may assist users in making classification and display decisions. Footnote 43 to paragraph 212 provides: “Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered new budget authority.” Likewise, debt cancellation activity would not be considered new budget authority. Therefore, debt cancellations would be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.
- A20. For example, in the debt cancellation example discussed in the draft interpretation, there was no change to the fund balance for the reporting entity that received the relief (the balance was the same before and after the liability was reduced), because there was no new form of budget authority provided for new obligations. Therefore, it was a non-exchange “other financing source” on the SCNP.

## Disclosures

- A21. The Board considered whether this proposed Interpretation should clarify disclosures. The Board believed it important to remind users that management is responsible for reporting, presentation, and display. Therefore, this would include consideration of additional disclosures. Meaning, the reporting entity may believe it relevant to provide readers information about debt cancellation and the impact<sup>4</sup> of the debt cancellation.

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<sup>4</sup> For example, if a cancellation of debt is for a business-type activity, and it prevents the reporting entity from having to increase future charges for goods or services the reporting entity should disclose this. In addition, a summary of the impact of the cancellation on the reporting entity, the lender, and current and future users of the goods or services could be provided.



## APPENDIX B: ABBREVIATIONS

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FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFRR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards

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