Federal Accounting Standards Advisory Board

February 11, 2020

Memorandum

MEMBER ACTIONS REQUESTED:
• Respond to staff questions (p.3) by **February 18th**

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Through: Monica R. Valentine, Executive Director

Subj: **Technical Clarifications of Existing Standards** – Staff Draft Guidance— *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313* – **Tab G**[1]

MEETING OBJECTIVES

The objective of this session is to consider an initial staff draft, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*. As you may recall the Board first discussed this topic at the October 2019 Board meeting and agreed that an Interpretation would be used at the December 2019 meeting. The objective for this session will be to gather the Board's feedback on staff's initial draft.

PHASE

This project is in the development phase. Specifically, staff developed a first draft of an interpretation exposure draft.

BRIEFING MATERIAL

The briefing materials include this memorandum and the following attachement.

Attachment 1- Staff Draft Interpretation of Federal Financial Accounting Standards, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*

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

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

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* and asked whether the paragraph needed to be updated or guidance provided. 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. Although two members initially disagreed, after further discussion it was agreed that an interpretation should be used due to the narrow issue being addressed. The members requested that a question to respondents be added to ask if this proposal clarifies paragraph 313.

NEXT STEPS

The next steps will depend on the feedback received from the Board and how much additional work and related deliberation that remains on the staff draft interpretation. Staff is prepared to take member feedback and recommendations and move forward to a revised draft and then pre-ballot. If member feedback is minor, there is the option to move to a pre-ballot before the April 2020 meeting. Staff notes there is also the option to have an electronic version between meetings that would allow for moving the document along quicker if the Board agrees.

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 with a cc to valentinem@fasab.gov.

QUESTIONS FOR THE BOARD:

1. Does the Board agree with staff's recommendations for the proposed interpretation? If not, please explain or provide alternatives.

2. Does the Board agree with staff's proposed questions? Specifically, do members believe questions are sufficient to ensure the respondents will comment on whether the proposed interpretation clarifies paragraph 313 of SFFAS 7? If members disagree, please explain or provided alternatives.

3. Based on FASAB's MOU and Rules of Procedures, Interpretations do not require disclosures but may clarify them. Staff recalls during our Board deliberations, that there was discussion if additional disclosures would be appropriate. Staff has included paragraph 10 in the guidance "Reporting entities are encouraged to disclose additional information, if appropriate." In addition, a detailed paragraph is included in the basis for conclusions regarding disclosures. Does the Board agree? If members disagree, please explain or provided alternatives.

4. Does the Board have any other suggestions or comments on the interpretation?

Federal Accounting Standards Advisory Board

DEBT CANCELLATION:

AN INTERPRETATION OF SFFAS 7 PARAGRAPH 313

Interpretation of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by August XX, 2020

May XX, 2020

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

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

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

Copyright Information

Contact Us

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May 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, entitled *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*. Specific questions for your consideration appear on page 6, 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 August XX, 2020.

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

Mail delivery is delayed by screening procedures. Please provide your comments by email to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax comments to 202-512-7366. Alternatively, you may mail your comments to:

Monica R. Valentine, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

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.

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

WHAT IS THE BOARD PROPOSING?

Issues were raised during recent 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. When considering SFFAS 7 paragraph 313 and SFFAC 2 together, this proposed interpretation would clarify that the standards clearly provide that debt cancellation is a nonexchange activity that should be reported on the Statement of Changes in Net Position.

This proposed Interpretation would also clarify that paragraph 313 of SFFAS 7 does not specify that a particular line item "gain" or "loss" must be displayed on the Statement of Changes in Net Position, only that debt cancellation activity be included on the Statement of Changes in Net Position. The proposed Interpretation would also provide that debt cancellation would be classified as "an other financing source" on the Statement of Changes in Net Position, whether an appropriation was received or not.

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

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

The provisions of this Interpretation need not be applied to immaterial items. 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. {UPDATE WHEN SFFAC ISSUED}

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QUESTIONS FOR RESPONDENTS

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

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

The questions in this section are available in a Microsoft Word file for your use at http://www.fasab.gov/documents-for-comment/. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366. Alternatively, you may mail your responses to:

Monica R. Valentine, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

All responses are requested by August 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.

This proposed interpretation would clarify that the standards provide that debt cancellation is a nonexchange activity and should be reported on the Statement of Changes in Net Position. 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."

This proposed interpretation would clarify that paragraph 313 of SFFAS 7 does not specify that a particular line item[1] "gain" or "loss" must be displayed on the Statement of Changes in Net Position, only that debt cancellation activity be included on the Statement of Changes in Net Position. Reporting entity management is responsible for determining the most appropriate presentation and display. Refer to paragraphs XX

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

Q3. SFFAS 7 basis for conclusions paragraphs 209-212 discusses the proprietary accounting linkage to budgetary accounting. The proposed interpretation would clarify that debt cancellation activity be classified as an "other financing source" on the Statement of Changes in Net Position, whether an appropriation was received or not. Refer to paragraphs XX

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

Q4. **Do you believe that the proposed interpretation clarifies ambiguity regarding debt cancellation and would resolve issues that exist? 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.**

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

PROPOSED INTERPRETATION

SCOPE

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

INTERPRETATION

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

   > "Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity's operations and is not directly related to the entity's costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender. 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. Paragraph 313 is part of Appendix B, "Guidance for the Classification of Transactions,"of SFFAS 7. Appendix B provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or other financing sources. 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.

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

5. 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.

6. 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 does not specify that a particular

line item[2] "gain" or "loss" must be displayed on the Statement of Changes in Net Position, only that debt cancellation activity be included on the Statement of Changes in Net Position. Reporting entity management is responsible for determining the most appropriate presentation and display.

7. 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 cancelled or it may simply cancel the debt without providing an appropriation.

8. The Board provides much reasoning and further explanation behind SFFAS 7 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. 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.

9. As such, all debt cancellation would be classified as an "other financing source" on the Statement of Changes in Net Position, whether an appropriation was received or not.

10. Reporting entities are encouraged to disclose additional information, if appropriate.

EFFECTIVE DATE

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

The provisions of this Interpretation need not be applied to immaterial items.

[2] 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

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

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

BACKGROUND

A1. The Federal Accounting Standards Advisory Board (FASAB) 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 2018 audits related to the accounting treatment of a $16 billion cancellation of debt that impacted several reporting entities and resulted in a material weakness being reported at one agency.

Debt Cancellation Example

A2. The request for guidance was based on an issue raised during the FY2018 audit cycle. Previously, Federal Emergency Management Agency (FEMA, an agency of the Department of Homeland Security) borrowed from Treasury and the agencies were showing a payable/receivable relationship. In the Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017 (Public Law 115-72), Congress cancelled $16 billion of the FEMA's debt to the Department of the Treasury for the National Flood Insurance Program. Specifically, section 308 of this law cancelled this amount and relieved FEMA and the National Flood Insurance Fund of this liability.

A3. 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 cancelled or it may simply cancel the debt without providing an appropriation. In this particular example, section 308 of Public Law 115-72 provided that, of FEMA's indebtedness under any notes or other obligations issued pursuant to specified provisions of law, "an amount of $16,000,000,000 is hereby cancelled. To the extent of the amount cancelled, the Administrator and the National Flood Insurance Fund are relieved of all liability to the Secretary of the Treasury under any such notes or other obligations, including for any interest due under such notes and any other fees and charges payable in connection with such notes, and the total amount of notes and obligations issued by the Administrator pursuant to such sections shall be considered to be reduced by such amount…".

A4. Treasury, Bureau of the Fiscal Service is responsible for determining or prescribing the accounting posting logic for the agencies through the Treasury Financial Manual and to ensure that eliminations are proper at the government-wide level. The posting logic that was developed for the debt cancellation in this particular scenario was based on determinations made by OMB and Treasury. Treasury and OMB concurred and determined that a negative surplus warrant should be used. Per the Treasury guidance, DHS/FEMA was required to record the debt cancellation as a budgetary financing source on their Statement of Changes of Net Position (SCNP) and to show this financing source as having been used. Therefore, the Treasury guidance required an increase to DHS's Fund Balance with Treasury (FBWT) to implement the cancellation.

A5. During the 2018 audits, there was disagreement among the reporting entities regarding the proper entries. Specifically, DHS/FEMA believed the cancellation of debt should be recognized as non-exchange gain in accordance with SFFAS 7. Despite concerns, DHS/FEMA prepared September 30, 2018 financial statements in accordance with the Treasury prescribed posting logic. During the FY 2018 audit of DHS, the auditors identified this reporting treatment as a material weakness. In order not to lose the unmodified opinions on their AFR and closing package audits, DHS made the correcting entry required by the auditors to undo the posting logic, and recognize a non-exchange gain for $16 billion which was reflected in both DHS's AFR and the closing package financial statements.

A6. Because of the differences in posting logics at the reporting entities, meaning some followed the Treasury issued guidance and other trading partners did not--this caused $64 billion in intragovernmental elimination differences at the government wide level.

GAAP Guidance

A7. 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."

A8. Paragraph 313 is part of Appendix B, Guidance for the Classification of Transactions in SFFAS 7. Appendix B provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or other financing sources. 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.

A9. Not only is the transaction labeled a Nonexchange transaction per Appendix B Table of Transactions in SFFAS 7, but par. 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 prescribes reporting as prescribed in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

A10. The Introduction of SFFAS 7, par. 16.-17 provides the following explanation regarding the difference between nonexhange and exchange revenue:

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

A11. Par. 21 of SFFAS 7 provides further explanation regarding nonexchange revenue 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."

A12. SFFAC 2, *Entity and Display*, par. 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position. Therefore, previous Boards were clear that debt cancellation activity that is nonexchange and should be reported on the Statement of Changes in Net Position.

A13. 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.
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> 24. Budgetary resources have a different character than both exchange revenue and nonexchange revenue. Budgetary inflows should be shown in a way that reflects two different perspectives: the proprietary effect and the budgetary effect. Proprietary accounting treats these resources much as capital and lines of credit are treated in private sector accounting, and provides information about their availability in the Balance Sheet or in notes. Appropriations are recognized as capital when enacted into law, while borrowing authority is disclosed in notes. Because Government entities are expected to expend capital from appropriations rather than maintain it, the accounting for the use of appropriations differs in this respect from the private sector's accounting for capital. The accounting for "appropriations used" has been simplified and parallels their budgetary effect.
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> 25. The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.
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> 26. Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations. U.S. Government financial statements have not been used for planning and control as well as they might have been. In part, this is because accounting standards have not been fully attuned to the Government's needs and circumstances. Another important reason is the continuing primacy of the budget as a financial planning and control tool. General purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

A14. 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. [FN 43] When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.
>
> [FN43] 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

A15. 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 par. 313 of SFFAS 7 provides "As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender."

A16. However, the Board recognizes that some users have difficulty conceptually applying terms "gain" and "loss" to intragovernmental transactions. Others believe that confusion may exist because some users relate these terms to the Statement of Net Cost. Although the Board believes the previous Board was clear in their intent by classifying debt cancellation as nonexchange; valid concerns were raised regarding the potential ambiguity of the terms "gain" and "loss" when considered in relation to intragovernmental transactions.

A17. This interpretation clarifies that paragraph 313 of SFFAS 7 does not specify that a line item "gain" or "loss" be displayed on the Statement of Changes in Net Position, only that debt cancellation activity be included on the Statement of Changes in Net Position.

A18. While in certain standards, the Board may have determined that requiring a specific line item for display was appropriate, most standards do not prescribe a specific reference or line item display because items may need to be displayed separately due to materiality or 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.

A19. The Office of Management and Budget 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.

A20. Although the Board does not prescribe line items, par. 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 Statement of Changes in Net Position, whether an appropriation was received or not.

A21. For example, in the DHS/FEMA debt cancellation example, there was no net change to the fund balance for the reporting entity (the balance was the same before and after the liability was reduced), because there was no new form of budget authority provided. Therefore, it was a non-exchange "other financing source" on the Statement of Changes in Net Position.

Disclosures

A22. The Board considered whether this proposed Interpretation should clarify disclosures. Considering there were differing views on the debt cancellation by some, the Board believed it important to encourage additional disclosures if appropriate. Meaning, the reporting entity may believe it relevant to provide readers information regarding the impact[3] of the debt cancellation. The Board notes there is an existing project to review all note disclosures and Statement of Federal Financial Accounting Concepts 3, *Management's Discussion and Analysis*, and SFFAS 15, *Management's Discussions and Analysis*, also provides guidance on information to include in the management's discussion and analysis if deemed appropriate.

A23.

[3] For example, when such cancellation of debt is for a business-type activity, it may prevent the reporting entity from having to increase future charges for goods or services. The reporting entity should disclose this and a summary of the impact of the cancellation on the reporting entity, the lender, and current and future users of the goods or services provided.

APPENDIX B: ABBREVIATIONS

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

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