Federal Accounting Standards Advisory Board

June 10, 2020

MEMBER ACTIONS REQUESTED:

- Respond to staff questions (p.10) by **June 18th**

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**[1]

OBJECTIVES

The objective of this session is to review an updated draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313* and staff's analysis of a proposal presented by Treasury and OMB.

PHASE

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

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 (MARKED VERSION)*

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

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Attachment 3- Staff Draft Interpretation of Federal Financial Accounting Standards, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313 (CLEAN VERSION)*

Attachment 4- Treasury and OMB Proposed Revisions to Draft Interpretation

Attachment 5- Negative Surplus Warrant – Explanation and Application (Additional Information Prepared by staff of Treasury, Bureau of Fiscal Service)

Attachment 6- Staff Update on Debt Cancellation- Provided to Board on April 28, 2020

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.

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, one Board member expressed concern that all debt cancellation would be classified as an "other financing source." After discussion, 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 issues.

In April 2020, staff provided the Board with a memo conveying an update regarding the debt cancellation issue. The memo was a means to provide the results of the research performed by Treasury and OMB as well as the outreach performed by FASAB staff. FASAB staff also wanted to confirm the Board's support to continue work on the draft interpretation given the Board had decided to delay work pending the research.

NEXT STEPS

The next steps will depend on discussions and determinations at the June 2020 Board meeting. As the staff analysis provides, member feedback from the April 2020 update indicated that there were differing views by Board members on certain areas that will require deliberation. However, a majority of members agreed the project should move forward.

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.

Attachment 1- Staff Analysis

As the background in the memo explained, the Board agreed paragraph 313 regarding debt cancelation needed clarification and should be resolved with the lowest level of GAAP guidance necessary. 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 agreed to delay further consideration pending 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.

<u>April 2020 - Staff Update on Debt Cancellation Project</u>

In April 2020, staff provided the Board with a memo (See **Attachment 6**- Staff Update on Debt Cancellation- Provided to Board on April 28, 2020) providing the results of the research performed by Treasury and OMB as well as the outreach performed by staff.

As you may recall, the audit firm believed the draft interpretation was consistent with current GAAP and did not have any unintended consequences.

Department of Treasury, DCFO did not provide any comments to staff on the draft interpretation. However, after staff's April 2020 update, staff received a comment from the Treasury Board representative stating "while Treasury DCFO may have had no comment, Treasury – Fiscal Service has and continues to comment from the governmentwide reporting perspective and pursuant to Fiscal's role in the DHS/FEMA issue – i.e., as preparers of the posting logic." It should be noted that although FASAB staff did not receive comments through our inquiries with the Treasury staff, the distribution included all representatives (3 bureau fiscal service representatives and other Treasury DCFO staff) that we met with during the initial meetings that pertained to the issue. FASAB staff explained this to the Treasury Board member. It should also be noted that a Fiscal Service representative explained in a follow-up email that they did not provide feedback because it was their assumption their feedback would come through the Treasury Board member and his assigned staff at Board meetings. Therefore, FASAB staff believes all Treasury concerns have now been relayed to staff.

Certain members questioned if the DHS response supported the staff draft interpretation. As staff explained in the April update memo, DHS points out in their response: "As it's unlikely Treasury will revise/correct the current posting logic, the Interpretation should serve to fully support and validate the propriety of the TFM, so that there won't be any audit issues for agencies that are fully complying with it."

Staff notes that DHS's concern continues to be whether the interpretation guidance and the TFM will align.

Staff followed-up with DHS and explained, the purpose of the interpretation is to clear ambiguities that exist in GAAP—specifically par. 313 in this instance. Once the interpretation is issued, FASAB would expect that the TFM and related posting logic would be revised to align with GAAP guidance.

The April update memo also provided the results of Treasury and OMB's research into prior debt cancellations. Treasury and OMB acknowledged cancellations happen infrequently and provided one additional example.

Staff believes the feedback obtained from the reporting entities affected by the recent debt cancellation nor the additional research regarding previous debt cancellations should impede or prevent the Board from moving forward on the project.

Feedback from Members:

Although there were some divergent comments and views expressed by members to the questions included in the April 2020 staff update, the majority of members agreed that the project should continue. However, there were important points and differing views by members that may need Board discussion:

1. Treasury and OMB representatives believe the interpretation scope should be broadened and revised to be consistent with their proposal. This is addressed further in the section Treasury and OMB proposal.

2. One member does not believe there is a need for FASAB action. The member believes FASAB guidance is clear.

3. One member believes the circumstances are rare and the Board cannot eliminate the previous audit exception. Therefore, it may be prudent for the Board to delay action at this time and potentially fold it into a much broader document that would cover other issues that may arise once the Board can assess the COVID-19 issues.

4. The majority of members agreed that the current environment merits discussion by the Board. However, the majority of members believe the forgiveness of debt to non-federal entities would be outside of the scope of the interpretation or if any unusual circumstances do arise, SFFAS 7 should still be applicable.

As noted above, the majority of the Board believed the project should continue but staff believed it important to convey the views above. Staff realizes that some items will generally be discussed as the agenda item is discussed. Staff wanted to offer an opportunity at the beginning of the meeting if any member had specific views or concerns they wished to discuss.

Staff notes that Item #1 (Treasury and OMB proposal) will be addressed below. However, the Board may also wish to discuss matters #2- #4 or other matters from the April 2020 update.

QUESTION FOR THE BOARD:

1. Are there specific topics related to the feedback summarized above or anything from the April 2020 update that members would like to discuss at the June 2020 meeting?

Treasury and OMB proposal- (See **Attachment 4**- Treasury and OMB Proposed Revisions to Draft Interpretation)

As noted above, Treasury and OMB provided staff proposed revisions to the staff draft interpretation in April. It was provided as a “consensus Treasury and OMB edits largely to add clarity to a number of key points.”

Staff reviewed the proposal and identified many helpful edits and suggestions. Certain changes that improved the clarity have been incorporated into the updated Staff Draft Interpretation of Federal Financial Accounting Standards, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*. However, due substantial edits and other revisions, some edits were no longer appropriate.

There is one very important key difference in the Treasury/OMB proposal—debt cancellation would be reported as a “budgetary financing source” or an “other financing source” on the Statement of Changes in Net Position (SCNP) whereas the staff proposal provides that debt cancellation would be classified as an “other financing source” on the SCNP.

Staff does not believe the draft interpretation should allow the flexibility to recognize debt cancellation as either a “budgetary financing source” or an “other financing source” on the SCNP based on the language in the SFFAS 7 basis for conclusions. While staff recognizes the language in the basis is not authoritative, it does provide reasoning and factors considered in forming the conclusions within the standards.

Specifically, SFFAS 7, Basis for Conclusions paragraphs 209-212 provides discussion about the budgetary process and its linkage to accounting. 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. Debt cancellations should be classified as an “other financing source” on the SCNP, whether an appropriation was received or not.
Staff notes that certain members have recognized that where debt cancellation activity should be reported on the SCNP (as an “other financing source” or “budgetary financing source”) was the main issue during the FY 2018 DHS audit.

As noted above, FASAB staff held discussions with the auditors and the auditors conveyed that they believed the staff draft interpretation was consistent with current GAAP and did not have any unintended consequences. Therefore, staff believes the staff draft would be an appropriate path forward to resolving the noted issues and clarifying GAAP.

Furthermore, in previous meetings, the Board determined that SFFAS 7, paragraph 313 was still accurate. The Board determined that the SFFAS 7 guidance does not lead to changes to fund balance because there is no new form of budget authority provided, meaning, fund balance did not change as a result of the relief and liability reduction. Accordingly, the debt cancellation as non-exchange activity should be reported as an “other financing source” on the SCNP. In the example considered, there was no appropriation. SFFAS 7 basis for conclusions provides the literature of how to account for debt cancellation with an appropriation. Therefore, staff is unclear where there is a need for flexibility in this situation.

Further, the draft interpretation does suggest reporting entity management is responsible for the most appropriate line item presentation and display and related disclosures, such as information about the debt cancelation. Therefore, the reminder will encourage the reporting of additional information regarding the debt cancellation that will be more useful to readers. There is an also expansion of this in the basis for conclusions.

In summary, staff believes the suggested flexibility in the Treasury/OMB proposal would not resolve the question driving the Interpretation and is not supported by language that is currently in the basis for conclusions.

Absent further definite criteria, it is difficult to view the flexibility as a preferable option. Further, staff believes the Board may wish to consider if this alternative should be considered in a broader scope project—such as an amendment or complete review of SFFAS 7 and not a an interpretation due to the inconsistency with the basis for conclusions.

In summary, staff believes whether flexibility is offered is an important point the Board should consider and may be a decision point on whether to move forward with an interpretation.

QUESTIONS FOR THE BOARD:

2. Do members have any specific questions they would like to ask Treasury and OMB regarding their proposal. If so, staff will forward these to Treasury and OMB representatives before the meeting.

3. Do members agree with staff’s analysis above? Alternatively, do you believe the Board should not issue any guidance?

Negative Surplus Warrant – Explanation and Application

In addition to providing proposed revisions to the staff draft interpretation, Treasury also provided a short write-up entitled, "Negative Surplus Warrant – Explanation and Application and asked that we share with the Board. It was prepared by the staff of Treasury, Bureau of Fiscal Service as additional background information. (See **Attachment 5**- Negative Surplus Warrant – Explanation and Application -Additional Information Prepared by staff of Treasury, Bureau of Fiscal Service)

At the beginning of the project, staff met with representatives from OMB and Treasury, Bureau of Fiscal Service to obtain an understanding of the debt cancellation issue and negative surplus warrants. Staff has included an excerpt from the October 2019 binder materials specific to the discussions with the representatives from OMB and Treasury, Bureau of Fiscal Service.

While overall the information appears generally consistent with the Negative Surplus Warrant –Explanation and Application (see Attachment 5); there was one fact that was conveyed during the informational sessions that seems worth noting. Representatives previously conveyed that there was a shift a shift away from using negative surplus warrants. Please see the excerpt from the October 2019 Board briefing materials:

> "Counsel determined that the language did not support an appropriation. Because there was no authority for an appropriation or a warrant, OMB and Treasury budget and accounting staff determined a negative surplus warrant should be used to provide the budgetary financing resource. In effect, it was a non-appropriation providing budget authority via the funding mechanism created through a negative surplus warrant.
>
> Typically, an appropriation or warrant increases budget authority. A surplus warrant decreases budget authority. A negative surplus warrant is used to increase budget authority. FASAB staff asked for examples of when a negative surplus warrant would be used. Though it is not used routinely, a negative surplus warrant can be used if an agency erroneously returns money to Treasury. Treasury would issue a negative surplus warrant to provide the authority and fund balance to the agency. In the past there have also been negative surplus warrants completed for single annual year HHS TAS for the purposes of "upward adjustments for returned Indefinite authority related to prior year unpaid obligations" and these are now and moving forward being processed as new Indefinite warrants to the expired period of availability TAS.
>
> Treasury representatives confirmed that the negative surplus warrant for the $16 B for FEMA legislative debt forgiveness was a unique and extraordinary occasion that Treasury and OMB Chief Counsels opined did not meet the legal requirements for an appropriation. The negative surplus warrant was the only accounting and budget mechanism to record FBWT and authority with the General Fund for FEMA's use.

> Given the uniqueness of the negative surplus warrants and that they are rare; Treasury representatives stated there has been a shift away from this type of transaction for several reasons, including discussions with OMB on proper posting and reporting changes."

QUESTION FOR THE BOARD:

4. Do members have any specific questions they would like to ask Treasury, Bureau Fiscal Service regarding the negative surplus warrant explanation. If so, staff will forward these to the appropriate representatives before the meeting.

Updated Staff Draft Interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*

Staff has included a Marked and Clean copy of an updated staff draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313* for members' consideration and review.

In summary, most changes relate to items agreed to at the February 2020 Board meeting. This included removing the detail and specifics regarding DHS, FEMA and Treasury. Instead, staff provided a more general description of a debt cancellation scenario.

In addition, the Board agreed to remove the paragraph about encouraging disclosures. Instead, the Board agreed it would be preferable to combine the discussion regarding disclosures with the discussion about line item presentation and display in paragraph 8.

Staff also incorporated other comments and suggestions received from members from the February 2020 meeting. As noted above, staff also incorporated several suggestions from the Treasury and OMB proposal.

Staff made other streamlining edits as necessary. Staff notes that this document has **not** been reviewed by FASAB's communication specialist for grammar and consistency. This would be done as we move closer to a pre-ballot.

QUESTIONS FOR THE BOARD:

5. Does the Board agree with the updated staff draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313*? If not, please explain or suggest an alternative.

6. Do members have any suggested edits or changes to the draft interpretation?

QUESTIONS FOR THE BOARD

1. **Are there specific topics related to the feedback summarized above or anything from the April 2020 update that members would like to discuss at the June 2020 meeting?**

2. **Do members have any specific questions they would like to ask Treasury and OMB regarding their proposal? If so, staff will forward these to Treasury and OMB representatives before the meeting.**

3. **Do members agree with staff's analysis above? Alternatively, do you believe the draft interpretation should provide flexibility? Alternatively, do you believe the Board should not issue any guidance?**

4. **Do members have any specific questions they would like to ask Treasury, Bureau Fiscal Service regarding the negative surplus warrant explanation? If so, staff will forward these to the appropriate representatives before the meeting.**

5. **Does the Board agree with the updated staff draft interpretation, Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313? If not, please explain or suggest an alternative.**

6. **Do members have any suggested edits or changes to the draft interpretation?**

Attachment 2-

Draft Interpretation
Debt Cancellation:
An Interpretation of SFFAS 7 paragraph 313 (MARKED VERSION)

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~~TBD XX, 2020

~~May~~TBD 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

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Federal Accounting Standards Advisory Board

~~May~~ TBDXX, 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~~TBD, 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~~ TBD 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 (SCNP). When considering paragraph 313 of 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~~SCNP.

This proposed Interpretation would also clarify that paragraph 313 of SFFAS 7 should not be interpreted to require ~~does not specify~~ that a particular line item "gain" or "loss" ~~must~~ be displayed on the SCNP. ~~Statement of Changes in Net Position,~~ Rather, this proposed interpretation would clarify ~~only~~ that debt cancellation activity should ~~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 SCNP~~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. 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.

~~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~~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~~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." 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 ~~does not specify~~ that a particular line item[1] "gain" or "loss" ~~must~~ be displayed on the SCNP~~Statement of Changes in Net Position~~. Rather, the proposed interpretation provides ~~only~~ that debt cancellation activity be classified as an "other financing source" on the SCNP, whether an appropriation was received or not. In addition, ~~included on the Statement of Changes in Net Position. R~~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. 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.~~ Q3. **Do you believe that the proposed interpretation clarifies ambiguity regarding debt cancellation and would resolve any existing or anticipated 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~~ due to materiality.

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. 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~~,~~."~~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.~~ As noted, ~~Specifically,~~ the appendix provides authoritative guidance for the classification of ~~specific~~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." ~~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.~~

~~3.~~5. Cancellation of debt is included under Intragovernmental Transactions: Nonexchange transactions—intragovernmental: gains and losses.

~~4.~~6. SFFAC 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the Statement of Changes in Net Position.

~~5.~~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).

~~6.~~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~~does not specify~~ that a particular line item[2] "gain" or "loss"~~ must~~ be displayed on the (SCNP). ~~Statement of Changes in Net Position, only that~~Rather, the proposed interpretation requires that debt cancellation activity be included on the (SCNP)~~Statement of Changes in Net Position~~. 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 (e.g., the statutory authority cancelling the debt, the reason for the debt), if appropriate, to provide context for the cancellation.

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

~~8.~~10. The Board provides further rationale and explanation of ~~much reasoning and further explanation behind~~ 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, f~~F~~ootnote 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.~~11. As such, all debt cancellation ~~w~~should be classified as an "other financing source" on the SCNP~~Statement of Changes in Net Position~~, whether an appropriation was received or not.

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

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[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.

EFFECTIVE DATE

~~11.~~12. The requirements of this Interpretation are effective upon issuance.

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

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~~affected 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 where ~~raised during the FY2018 audit cycle. Previously, Federal Emergency Management Agency (FEMA,~~ an agency~~ of the Department of Homeland Security)~~ borrowed from the Department of the Treasury (Treasury) ~~and the agencies were showing~~resulting in a payable/receivable relationship. ~~In the Additional Supplemental Appropriations for Disaster Relief Requirements Act, 2017 (Public Law 115-72),~~ Congress ~~cancelled~~ canceled~~$16 billion of the FEMA's~~ debt through legislation and relieved the agency of ~~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 enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency ~~when~~ for the purposes of cancelling the debt ~~is cancelled~~ or it may simply cancel the debt without providing an appropriation. In this particular example, the debt was canceled without providing an appropriation. ~~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's, Bureau of the Fiscal Service (Fiscal Service) is responsible for ~~determining or~~ prescribing the accounting posting logic for the agencies through the Treasury Financial Manual. ~~-~~Fiscal Service is also responsible for ensuring proper application of intragovernmental ~~and to ensure that~~ eliminations ~~are proper~~ at the government-wide financial reporting level. OMB and Treasury determined ~~T~~the posting logic ~~that was developed~~ for the debt cancellation scenario described in this draft interpretation. ~~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~~Fiscal Service (Treasury and OMB agreed upon) guidance, ~~DHS/FEMA~~ 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). ~~and to show this financing source as having been used.~~ 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. ~~Therefore, the Treasury guidance required an increase to DHS's Fund Balance with Treasury (FBWT) to implement the cancellation.~~

However, ~~During the 2018 audits,~~ there was disagreement between~~among~~ the reporting entities regarding the proper entries. Specifically, the auditors of the agency that was relieved of the liability ~~DHS/FEMA believed the~~ 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 ~~. Despite concerns, DHS/FEMA prepared September 30, 2018 financial statements in accordance with the Treasury~~Fiscal Service prescribed posting logic~~.~~ and ~~During the FY 2018 audit of DHS, the auditors~~ identified this ~~reporting~~ treatment as a material weakness. ~~In order not t~~To avoid losing~~lose~~ their unmodified opinions on their AFR and closing package audits, the agency ~~DHS~~ made the correcting entry required by the auditors to ~~undo~~reverse the posting logic~~,~~ and recognize a non-exchange gain as an "other financing source" on the SCNP ~~for $16 billion which was reflected in both DHS's AFR and the closing package financial statements.~~.

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A5. ~~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.~~

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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 ~~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.

A8. Not only is the transaction labeled a Nonexchange transaction per Appendix B Table of Transactions in SFFAS 7, but par~~.~~agraph 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~~specifies reporting as prescribed in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

A9. The Introduction of SFFAS 7, par~~.~~agraphs 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. Par~~.~~agraph 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*, par~~.~~agraph 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.

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. [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

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 par~~.~~agraph 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 ~~some users have difficulty~~ conceptually with respect to 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 t~~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 ~~when considered in relation to~~ 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 ~~does~~ not be interpreted to require ~~specify~~ that a line item "gain" or "loss" be displayed on the SCNP~~Statement of Changes in Net Position~~, only that debt cancellation activity be included on the SCNP~~Statement of Changes in Net Position~~.

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, par~~.~~agraphs 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~~Statement of Changes in Net Position~~, whether an appropriation was received or not.

A20. For example, in the ~~DHS/FEMA~~ debt cancellation example discussed in the draft interpretation, there was no ~~net~~ 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~~Statement of Changes in Net Position~~.

Disclosures

A21. The Board considered whether this proposed Interpretation should clarify disclosures. T~~Considering there were differing views on the debt cancellation by some, t~~he Board believed it important to ~~encourage~~remind users that management is responsible for reporting, presentation, and display. Therefore, this would include consideration of additional disclosures ~~if appropriate~~. Meaning, the reporting entity may believe it relevant to provide readers information about debt cancellation and ~~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.~~

A22.

[3] For example, if a ~~when such~~ cancellation of debt is for a business-type activity, and it ~~may~~ prevents the reporting entity from having to increase future charges for goods or services~~. T~~the reporting entity should disclose this~~. and~~ 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

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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Attachment 3-

Draft Interpretation
Debt Cancellation:
An Interpretation of SFFAS 7 paragraph 313 (CLEAN VERSION)

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 TBD XX, 2020

TBD 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

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Federal Accounting Standards Advisory Board

TBDXX, 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 TBD, 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, 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 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?

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. 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.

TABLE OF CONTENTS

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 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[1] “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.**

[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 due to materiality.

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. 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[2] "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 cancelation (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 or a budgetary financing source.

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

12. 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 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. [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

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 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.

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[3] of the debt cancellation.

[3] 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

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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Attachment 4-

Treasury and OMB Proposed Revisions to Draft 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

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Federal Accounting Standards Advisory Board

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~~ should not be interpreted to require that a particular line item "gain" or "loss" ~~must~~ be ~~displayed~~ reported on the Statement of Net Cost or the Statement of Changes in Net Position. Rather, ~~only~~ this interpretation would clarify that debt cancellation activity should only be ~~included~~ reported on the Statement of Changes in Net Position. The proposed Interpretation would also provide that debt cancellation ~~w~~could be classified as "an other financing source" or a "budgetary financing source" on the Statement of Changes in Net Position, depending on the text of the debt cancellation legislation ~~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}

TABLE OF CONTENTS

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~~ should not be interpreted to require ~~specify~~ that a particular line item[1] "gain" or "loss" ~~should~~ be reported on the Statement of Net Cost ~~or must be displayed on the Statement of Changes in Net Position~~in the event of a debt cancellation.~~,~~ Rather, this interpretation would clarify ~~only~~ that debt cancellation activity should only be ~~included~~ reported 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 could be classified as a "budgetary financing source" or an "other financing source" ~~or a "budgetary financing source"~~ on the Statement of Changes in Net Position, depending on the ~~language within the respective Congressional~~ terms of the enacted legislation providing for the cancellation~~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 any existing or anticipated 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.

Q5. **Do you believe that the proposed interpretation could potentially create ambiguity ~~regarding~~with respect to existing FASAB guidance concerning debt cancellation, appropriations, or ~~any existing FASAB guidance~~other federal accounting issues? If so, please provide detail about specific issues or FASAB guidance that should be considered by the Board in connection with this Interpretation.**

[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 due to materiality~~for presentation~~.

Commented [BDC1]: Staff acknowledged in Par. A16 that there could be confusion if lay users relate gain/loss to the SNC. We should clarify here that there is no impact to the SNC.

Commented [BRS2]: OMB and Treasury believe that, regardless of rarity, scenarios could give rise to either budgetary or other financing sources. Suggest putting both (at a minimum "other financing resources" in quotes throughout document.

Commented [BRS3]: Not entirely appropriate to refer to appropriations language authorizing an action. These two concepts are typically separate and distinct.

Commented [JCSE4]: SFFAS 43 Appendix C shows appropriations as a budgetary financing source in contrast to SFFAS 7, which shows appropriations as an "other financing source".

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 SFFAS 7, Appendix B, "Guidance for the Classification of Transactions,"~~of within SFFAS 7.~~ Appendix B provides authoritative guidance ~~on which whether~~for the classification of specific transactions based on the standards for accounting for revenue and other financing sources. The type of transaction may be an ~~should be classified as~~ exchange transaction~~s, , and which should be classified as,~~a nonexchange transaction~~s~~, or an "other financing source"~~s~~, ~~or~~ which are ~~amounts~~transactions not classified ~~in~~ as exchange or non-exchange~~other categories~~. ~~Specifically, the appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources, and~~Appendix B of SFFAS 7 also includes 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~~.~~, ~~along with~~including appropriations used, 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.

Commented [BRS5]: From SFFAS 7, par 239.

Commented [BDC6]: It is important to distinguish transaction types in order to show that Appendix B includes more transaction descriptions than just Other Financing Sources. Borrowed text from Appendix B.

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 should ~~does~~ not be interpreted ~~specify~~to require that a particular line item[2] “gain” or “loss” ~~should~~ be reported on the Statement of Net Cost ~~or~~ ~~must be displayed on the Statement of Changes in Net Position,~~. Rather, ~~only~~this interpretation would clarify that debt cancellation activity should only be ~~included~~ reported on the Statement of Changes in Net Position. Reporting entity management is responsible for determining the most appropriate presentation and display.

Commented [BDC7]: Staff acknowledged in Par. A16 that there could be confusion if lay users relate gain/loss to the SNC. We should clarify here that there is no impact to the SNC.

Commented [BRS8R7]: This paragraph revised and conforming changes made to Q2 and A17.

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~~ 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, ~~F~~footnote 43 provides: “Amounts appropriated to…repay debt are not available to incur new obligations and hence are not considered budget authority.” ~~Likewise, d~~Debt cancellation activity, which may require the use of new budget authority to effect the cancellation transaction, would not be considered new budget authority for the purposes of incurring new obligations ~~or a budgetary financing source~~. ~~[*Alternate* to last sentence: Likewise, Dthenew , but]~~. A determination as to the existence and purpose of new budget authority would be made pursuant to the terms of the enacted legislation.

Commented [BRS9]: Proposed revisions to par 8 creates a transition to/sets up Par 9.

9. As such, ~~all~~ debt cancellation would be ~~classified~~ reported as either a “budgetary financing source” or an “other financing source” ~~or “budgetary financing source”~~ on the Statement of Changes in Net Position, depending on the terms of the enacted legislation providing for the cancellation~~whether an appropriation was received or not~~.

10. Reporting entities are encouraged to disclose additional information (e.g., the statutory authority cancelling the debt, the reason for the debt), if appropriate, to provide context for the cancellation.

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 due to materiality.

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~~ resulting in the agencies ~~were showing~~reporting 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 enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency ~~when~~ for the purposes of cancelling the debt, ~~is cancelled~~ or it may simply cancel the debt without providing an appropriation. In the ~~this~~ case of DHS/FEMA~~particular example~~, section 308 of Public Law 115-72 provided that notwithstanding "… any borrowing agreement entered into between the Department of the Treasury and the Federal Emergency Management Agency, of the indebtedness of the Administrator under any notes or other obligations issued … ~~, 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’s~~,~~ Bureau of the Fiscal Service is responsible for determining and~~or~~ prescribing the accounting posting logic for the agencies through the Treasury Financial Manual and ~~to~~ for ensur~~e~~ing ~~that~~ proper application of intragovernmental eliminations ~~are proper~~ at the government-wide financial reporting level. OMB and Treasury determined ~~T~~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 and OMB guidance, DHS/FEMA ~~was required to show~~reflected an increase ~~to~~in DHS’s Fund Balance with Treasury (FBWT) to implement the cancellation. The posting logic resulted in DHS ~~having to record~~ reporting the appropriation provided by the legislation ~~debt cancellation~~ as a “budgetary financing source” and its use to effect the debt cancellation on their Statement of Changes of Net Position (SCNP) ~~and to show it as 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 FY 2018 audits, ~~there was disagreement between~~~~among the reporting entities regarding the proper entries~~the lender (Treasury) and the borrower (DHS/FEMA) reported the debt cancellation transaction differently~~.~~. Specifically, DHS/FEMA initially believed the cancellation of debt should be recognized as a non-exchange gain on the Statement of Changes in Net Position in accordance with SFFAS 7. ~~Despite concerns,~~ However, per consultation with OMB and Treasury, pursuant to Treasury posting logic guidance, DHS/FEMA ~~prepared September 30, 2018 financial statements in accordance with the Treasury and OMB prescribed posting logic~~reported the cancellation as an appropriation adjustment (i.e., budgetary financing source) on the Statement of Changes in Net Position. During the FY 2018 DHS audit ~~of DHS~~, ~~the~~ DHS auditors identified this reporting treatment as ~~a~~ among the deficiencies contributing to a material weakness. ~~To avoid~~ ~~In order not to losinge~~ In response to auditor concerns ~~their unmodified opinions on their AFR and closing package audits~~, DHS made ~~the~~ correcting entr~~y~~ies ~~required by the auditors~~ to reverse~~undo~~ the transaction posted pursuant to the posting logic~~,~~ and ~~to~~ instead revert to its initial accounting treatment, and recognized a $16 billion non-exchange gain on the Statement of Changes in Net Position ~~for $16 billion, which was reflected~~ in both DHS’s AFR and the closing package financial statements. By comparison, the Treasury Department ~~’s Office of Chief Financial Officer followed~~ reported the debt cancellation pursuant to the prescribed posting logic, which resulted in some audit concern (same auditor as DHS/FEMA), but which was determined to be immaterial ~~when preparing its own statements for the Department and its auditor did not object~~.

A6. ~~Because of the differences~~Inconsistent application of their~~in~~ posting logic~~s~~ ~~used~~ by~~at~~ the two reporting entities, with ~~meaning some~~ Treasury following~~ed~~ the Treasury issued guidance and DHS not following the guidance per auditor request, ~~other trading partners did not this caused~~resulted in ~~a $64 billion in~~ intragovernmental elimination differences~~s~~ ~~arose~~ at the government-wide level, which Treasury’s Fiscal Service eliminated via journal voucher.~~.~~

GAAP Guidance

Commented [BRS10]: Trying to succinctly explain the process from start to finish and reinforce the case that budget authority could potentially be used.

Commented [BDC11]: More accurate to say “contributed to a financial reporting material weakness” or “contributed to deficiencies leading to a material weakness.” The DHS unresolved material weakness had originated in 2003 and comprised several agencies, not just FEMA.
COMMENT REVISED,

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 SFFAS 7, Appendix B, “Guidance for the Classification of Transactions”~~ in SFFAS 7~~. Appendix B provides authoritative guidance ~~on which~~for the classification of specific transactions based on the standards for accounting for revenue and “other financing sources”. The type of transaction may be an ~~should be classified as~~ exchange transaction~~s~~, ~~and which should be classified as~~a nonexchange transaction~~s~~, or an “other financing source”~~s~~. ~~Specifically, the appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources, and~~Appendix B of SFFAS 7 also includes 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.

Commented [BRS12]: Conform to Par 3 edits. Intent was to align more closely with SFFAS 7, Appx B text.

A9. Not only is the transaction labeled a Nonexchange transaction per SFFAS 7, 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.
>
> 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

Commented [BRS13]: Since this is actually a line item title, suggest all references be shown in quotes to avoid confusion.

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 considered 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.
>
> 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.

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, t~~The Board recognizes that there could be uncertainty with respect to applying ~~some users have difficulty conceptually applying~~ the concepts of ~~terms~~ "gain" and "loss" to intragovernmental transactions, including whether such transactions would affect the ~~were the primary reason that DHS declined to follow the prescribed posting logicto intragovernmental transactions. Others believeThe Board also believes that confusion those terms may causeexist because some users to 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 a nonexchange transaction and hence not applicable to the Statement of Net Cost,~~;~~ valid concerns were raised regarding the potential ambiguity of the terms "gain" and "loss" in the context of ~~when considered in relation to~~ intragovernmental transactions.

Commented [BRS14]: Subjective, Can't speak to the primary reason beyond responding to auditor concerns.

A17. This interpretation clarifies that paragraph 313 of SFFAS 7 ~~does~~ should not ~~specify~~be interpreted to require that a line item "gain" or "loss" be ~~displayed~~ reported on the Statement of Net Cost ~~Statement of Changes in Net Position~~in the event of a debt cancellation. Rather, this interpretation~~, only~~ would clarify that debt cancellation activity should only be reported as an "other financing source" or a "budgetary financing source" ~~included~~ on the Statement of Changes in Net Position, depending on the enacted legislation providing for the cancellation.

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

Commented [BRS15]: We refer to OMB both with this long title and the acronym. Presumably we should be consistent.

A20. Although the Board does not prescribe line items, par. 209-212 of SFFAS 7 provide~~s~~ 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, d~~Debt cancellation activity, which may require the use of new budget authority to effect the cancellation transaction, would not be considered new budget authority for the purposes of incurring new obligations~~or a budgetary financing source~~. A determination as to the existence and purpose of new budget authority would be made pursuant to the terms of enacted legislation. ~~Therefore~~As such, debt cancellations c~~w~~ould be ~~classified~~ reported as either~~as~~ a "budgetary financing source" or an~~n~~ "other financing source" on the Statement of Changes in Net Position ~~or as a "budgetary financing source"~~ if~~, whether an appropriation was received~~depending on the terms of the enacted legislation ~~or not~~.

Commented [BRS16]: Revisions to A20 intended to align with/conform to Par 8 and 9

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 for new obligations. Therefore, DHS/FEMA reported the cancelled amount as ~~it was~~ a non-exchange gain in the "other financing source~~"~~ section of~~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~~For example, 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

[3] For example, if a~~when such~~ cancellation of debt is for a business-type activity and ~~,~~ it ~~may~~ prevents the reporting entity from having to increase future charges for goods or services, ~~. T~~the reporting entity should disclose this. In addition, ~~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 could be provided.

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.

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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Attachment 5-

Negative Surplus Warrant – Explanation and Application (Additional Information Prepared by staff of Treasury, Bureau of Fiscal Service)

<u>Negative Surplus Warrant – Explanation and Application</u>

<u>Appropriation/Warrant Background</u>

- Each year, Congress passes annual and supplemental appropriation bills to fund the federal government. These appropriation acts provide budget authority to federal agencies to incur obligations and expend funds from the General Fund of the U.S. Government for specific purposes.
- The Department of the Treasury (Treasury) issues **Appropriation Warrants** as evidence of Congressional action to fund programs. These warrants serve to establish the amount and period of availability of monies the agency is authorized to withdraw from the General Fund of the U.S. Government (General Fund).
- When an agency does not spend its available money and sends the funds back to the General Fund of the U.S. Government, Treasury issues a **Surplus Warrant** to withdraw or cancel unobligated balances of appropriations. The evidence of a Treasury action that withdraws or cancels unobligated balances of appropriations is defined as a surplus warrant.
- In general, Treasury employs **negative surplus warrants** to correct or fix an accounting error. The **negative surplus warrant** reverses a surplus warrant. It is an accounting mechanism used to pull funds from the General Fund, subject to legislative authority and citation. The most common uses of the **negative surplus warrant** include:
    - Restore funds or balances that had been previously cancelled or returned to the General Fund.
    - Reverse a cancellation of funds performed incorrectly by agency.
- Corrections and adjustments to pull funds from the General Fund are subject to OMB Budget review and concurrence.

Application to Intragovernmental Debt Cancelation

- On occasion, Congress enacts into law an **appropriation** for the forgiveness of debt. When that occurs, Treasury processes a Treasury **warrant**, and subsequently, the receiving entity must repay the debt back to the Bureau of the Fiscal Service.
- There can be instances in which a law is enacted for the forgiveness of debt **<u>without</u>** the provision of an appropriation. When cancellation of debt is enacted without an appropriation, Treasury processes a **negative surplus warrant** into a specific agency general fund expenditure account, and then subsequently transfers those amounts to the applicable special or non-revolving trust fund expenditure account.
- To date, use of a negative surplus warrant to effect a debt cancellation has been extremely rare.

<u>Application to DHS Debt Cancellation</u>

- Section 308 of the *2017 Additional Supplemental Appropriations for Disaster Relief Requirements Act (Public Law 115-72)* specifies an amount of debt that is cancelled, but, unlike the appropriations provisions in the Act, does **<u>not</u>** specify an amount appropriated. Cancellation of intragovernmental debt does **<u>not</u>** require that funds be made available to repay it.

- It is significant to note that this legislation **DID NOT** (expressly or implicitly) require that funds be withdrawn from the Treasury to pay off the FEMA debt. *Public Law 115-72* contained "general provisions" that impose various requirements (as is typical of other appropriations acts) but did not appropriate amounts from the General Fund of the U.S. Government. Thus, Treasury and OMB OCC's both concluded that this cancellation did not constitute an appropriation.
- Where enacted legislation does **not** provide an appropriation to repay debt, Treasury **cannot** warrant (via an appropriation warrant) additional funds to the account to execute the repayment/cancelation. Consequently, both Treasury and OMB's Offices of Counsel determined a **negative surplus warrant** was most appropriate.

Attachment 6-

Staff Update on Debt Cancellation- Provided to Board on April 28, 2020

Federal Accounting Standards Advisory Board

April 28, 2020

Memorandum

MEMBER ACTIONS REQUESTED:
• Respond to staff questions (p.6) by May 7th

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Through: Monica R. Valentine, Executive Director

Subj: **Technical Clarifications of Existing Standards –Staff Update on Debt Cancellation**[1]

OBJECTIVES

The purpose of this paper is to provide the Board with a brief update regarding the debt cancellation issue the Board had been considering under the Technical Clarifications of Existing Standards project. As you may recall the Board considered an initial draft interpretation, *Debt Cancellation: An Interpretation of SFFAS 7 paragraph 313,* at the February 2020 meeting.

PHASE

This project is in the development phase. Specifically, staff provided the Board with a first draft of an interpretation exposure draft at the February 2020 Board meeting.

MATERIAL

The **Staff Update on Debt Cancellation** is attached along with questions for the Board on page 6.

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

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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.

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, one Board member expressed concern that all debt cancellation would be classified as an other financing source. After discussion, 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 issues.

NEXT STEPS

The next steps will depend on determinations made by the Board. Staff anticipates the Board will move forward with the 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 with a cc to valentinem@fasab.gov.

Attachment A- Staff Update on Debt Cancellation

Outreach to Reporting Entities

Although staff had provided the reporting entities that were impacted by the recent debt cancellation a copy of the draft interpretation for comment, we had not received comments. Therefore, staff followed up with the parties after the February board meeting. Staff asked for feedback and if the draft guidance would have resolved the issues.

Based on *discussions*[2] with the audit firm, they conveyed three main points:

1. The draft interpretation and guidance is consistent with current GAAP.
2. The draft interpretation and guidance does not have any unintended consequences.
3. The firm was a bit concerned with the amount of detail included regarding DHS, FEMA, and Treasury. [FASAB staff explained that the Board agreed that the detail regarding the audit and related history should be removed.]

Department of Treasury, DCFO did not have any comments on the draft interpretation.

FASAB staff received the following response from Department of Homeland Security.

> Hi Melissa,
>
> Here's our comments on the draft Interpretation of SFFAS 7 paragraph 313:
>
> While DHS understands that the draft Interpretation is intended to clarify SFFAS 7 paragraph 313 (debt cancellation guidelines) for general application by all agencies, our comments will focus on DHS's specific audit issue identified during the FY 2018 financial statements audit. For DHS, the key question is whether the draft Interpretation sufficiently validates and supports Treasury's debt forgiveness posting logic, and we are concerned our auditors will not see it as such.
>
> To recap, the audit issue was caused by DHS fully complying with Treasury's then newly published posting logic #411601 (which Treasury developed in collaboration with OMB's Budget Review team, and which involved TCs A200, A142, B120, and B134). However, our auditors (KPMG) determined this reporting treatment to be non-GAAP (i.e., not compliant with SFFAS 7 paragraph 313). KPMG and Treasury discussed the issue at the time, but in the end agreed to disagree on their interpretation/application of the standard, which left DHS in a difficult position of not being able to satisfy our external auditors while having to comply with Treasury guidance…
>
> From DHS's perspective, for this Interpretation to be useful in resolving the audit issue it should ultimately result in either 1) KPMG agreeing with Treasury's posting logic (e.g., if the Interpretation provides for certain exceptions to the rule such as the use of "negative surplus warrant"), or 2) Treasury agreeing to correct/revise their posting logic. Based on our review, the draft Interpretation appears to support KPMG's position of presenting the gain from debt

[2] The audit firm preferred to discuss the topic in a conference call. However, FASAB staff summarized the three points at the end of the conference call.

cancellation as nonexchange gain – Other Financing Sources on SCNP. However, Treasury has maintained strongly that the negative surplus warrant is a valid mechanism and that the current posting logic is not inconsistent with SFFAS 7 paragraph 313.

We recognize that it would be more relevant for Treasury and KPMG to review the draft Interpretation and weigh in, but in our opinion the primary objective of issuing this Interpretation should be to clarify further and prevent any inconsistent interpretation of SFFAS 7 paragraph 313 by different users (e.g., Treasury vs. the audit community). To achieve this goal, the Interpretation should provide sufficient detail and specific guidelines, including any exceptions to the general rule, such as discussing and explaining why using the negative surplus warrant is acceptable and even necessary in certain, unusual situations (e.g., due to legal considerations, etc.), and why presenting the negative surplus warrant on SCNP as Other Budgetary Financing sources and Appropriation Used is acceptable (as per the TFM). As it's unlikely Treasury will revise/correct the current posting logic, the Interpretation should serve to fully support and validate the propriety of the TFM, so that there won't be any audit issues for agencies that are fully complying with it. However, the current draft Interpretation seems to fall short of meeting this goal…

Please let us know if you have any questions. Thanks. /James

While FASAB staff understands DHS perspective to avoid future audit issues, it is also important to note that they stated, "it's unlikely Treasury will revise/correct the current posting logic." Therefore, their perspective was "the Interpretation should serve to fully support and validate the propriety of the TFM, so that there won't be any audit issues for agencies that are fully complying with it."

Treasury and other agency guidance should be consistent with GAAP. Therefore, FASAB staff believed it important to convey this to DHS. We have had additional follow-up with DHS to discuss this matter further and to ensure the purpose of a FASAB interpretation was fully understood. In addition, it should be clear that Treasury guidance and other agency guidance issued should be consistent and not conflict with GAAP.

As it stands, FASAB is not aware of situations or examples of debt cancellations examples when a negative surplus warrant should be used as a vehicle that would make budgetary financing sources appropriate. Treasury and OMB are researching prior debt cancellation examples and other information to support this. This information was conveyed to DHS.

FASAB staff does not believe that the feedback obtained from the reporting entities affected by the recent debt cancellation should impede or prevent the Board from moving forward on the project.

OMB and Treasury- Research Provided regarding Debt Cancellation

FASAB staff received an email from Treasury and OMB that provided the following one additional example:

Cancellation Event – 1984: Loans to the Smithsonian Institution, re: John F. Kennedy Parking Facilities account (033X0301)
Effective as of October 12, 1984, the obligations of the Board incurred under subsection (a) of this section shall bear no interest, and the requirement of the Board to pay the unpaid interest which has accrued on such obligations is terminated.

In conveying the example, Treasury and OMB acknowledged cancellations happen infrequently (since it was the only example they were able to identify through their research), and that Congress can use different approaches. In the new example provided, Congress canceled only the interest but also provided that no interest would be charged moving forward.

Treasury and OMB also provided suggested edits to the revised language to the draft interpretation. Staff explained that at the February 2020 Board meeting, the Board agreed to delay further consideration of the debt cancellation Exposure Draft pending additional research. Given the Board direction provided to staff, we are not including those suggested edits at this time.

Instead, staff requested that the Treasury and OMB representatives provide the results of the research and supporting information regarding issues areas that were discussed at the February board meeting. For example, areas in SFFAS 7 (footnote 43) and most importantly when a negative surplus warrant should be used as a vehicle that would make budgetary financing sources appropriate.

To date, staff has not received any additional information. If the information is received, staff will forward this to Board members.

FASAB staff does not believe that the 1984 example provided should impede or prevent the Board from moving forward on the project. (To date, no additional information or research has been provided.)

Other-Current Environment

As previously noted, we have only been provided two debt cancellation examples that span over the past 20 years. Therefore, most will agree that debt cancellations have been rare. Nonetheless, given the current environment with COVID-19 and the various relief programs—the potential for such occurrences may now exist. Further, given the significant role that debt forgiveness plays in the CARES Act, it would be reasonable to consider that we might also see a similar intra-governmental effect.

Despite the infrequency of past debt cancellations in past, staff recommends the Board carefully consider this issue as we move forward.

Although debt cancellations have been rare in the past, FASAB staff believes the current environment and various relief programs would highlight the need for clarity in this area.

QUESTIONS FOR THE BOARD:

1. **Staff does not believe the feedback from the reporting entities affected by the recent debt cancellation should impede or prevent the Board from moving forward on the project. Does the Board agree? If not, please explain or provide alternatives.**

2. **Staff does not believe the 1984 example provided should impede or prevent the Board from moving forward on the project. Does the Board agree? If not, please explain or provide alternatives.**

3. **Staff notes that the Board agreed to delay further consideration of the draft exposure draft pending the research by Treasury and OMB. Does the Board wish to continue work on the Interpretation?**

4. **If members agree to move forward with the project,**

    - **Do members have other comments for staff regarding this project? For example, do members envision any major changes in scope or other changes, beyond what was discussed at the February 2020 meeting? For example, do you envision the current environment as a reason to broaden the scope?**

    - **Staff notes that there are open items to deliberate, such as those that were brought up by Treasury at the February meeting. While the new example and research does not change the analysis thus far, Treasury has proposed revised language. Staff would provide an analysis of Treasury and OMB's suggested revisions at the June 2020 Board meeting.**