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# Interpretation of Federal Financial Accounting Standards 11, Debt Cancellation: An Interpretation of SFFAS 7, Paragraph 313

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## Status

Issued	November 29, 2021
Effective Date	Effective upon issuance.
Affects	SFFAS 7, par. 313.
Affected by	None.
Related Guidance	

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## Summary

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 Statement of Federal Financial Accounting Standards (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.

Statement of Federal Financial Accounting Concepts (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 Interpretation clarifies that the standards provide that debt cancellation is a nonexchange activity that should be reported on the SCNP. This Interpretation also clarifies that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item<sup>1</sup> "gain" or "loss" be displayed on the SCNP.

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<sup>1</sup>While in certain standards the Board has determined that requiring a specific line item for display is appropriate, in most standards it is not appropriate because items may need to be displayed separately or be included with other items based on materiality.

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In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered. 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 enacted legislation canceling the debt. This Interpretation does not provide guidance on budgetary accounting.

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## Materiality

The provisions of this Interpretation need not be applied to information if the effect of applying the provision(s) is immaterial.<sup>2</sup> A misstatement, including omission of information, is material if, in light of surrounding facts and circumstances, it could reasonably be expected that the judgment of a reasonable user relying on the information would change or be influenced by the correction or inclusion of the information. Materiality should be evaluated in the context of the specific reporting entity. Determining materiality requires appropriate and reasonable judgment in considering the specific facts, circumstances, size, and nature of the misstatement. Consequently, after quantitative and qualitative factors are considered, materiality may vary by financial statement, line item, or group of line items within an entity.

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<sup>2</sup>Refer to Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, chapter 7, titled *Materiality*, for a detailed discussion of the materiality concepts.

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## Interpretation

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### 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*.

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### 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.

3. 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 states, "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:

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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. SFFAS 7, Appendix B includes cancellation of debt under Intragovernmental Transactions: Nonexchange transactions-intragovernmental: gains and losses.
6. Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*, paragraph 100 provides that nonexchange activity is reported on the statement of changes in net position (SCNP).
7. When considering SFFAS 7, paragraph 313 and SFFAC 2 together, this Interpretation clarifies that the standards provide that debt cancellation is a nonexchange activity that should be reported on the 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 Interpretation clarifies that paragraph 313 of SFFAS 7 should not be interpreted to require that a particular line item<sup>3</sup> "gain" or "loss" be displayed on the SCNP. Rather, this Interpretation requires that debt cancellation activity be included on the SCNP and reporting be consistent with guidance in SFFAS 7, Appendix B. Reporting entity management is responsible for determining the most appropriate line item presentation and display<sup>4</sup> and related disclosures, such as contextual information about the debt cancellation (for example, the statutory authority cancelling the debt or the reason for the debt), if appropriate.
9. In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered by reporting entities. 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 enacted legislation canceling the debt. For example, Congress may provide an appropriation to the agency for the purposes of cancelling the

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<sup>3</sup>While in certain standards the Board has determined that requiring a specific line item for display is appropriate, in most standards it is not appropriate because items may need to be displayed separately or be included with other items based on materiality.

<sup>4</sup>OMB prescribes form and content in OMB Circular A-136, *Financial Reporting Requirements*, based on the requirements and guidance contained in FASAB standards but also may provide more specific detailed instructions. See the Basis for Conclusions paragraphs A21-A22 for additional discussion.

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debt or it may cancel the debt without providing an appropriation. This Interpretation does not provide guidance on budgetary accounting.

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## Effective Date

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

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

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### Background

A1. The Federal Accounting Standards Advisory Board (FASAB or "the Board") was asked to review paragraph 313 of SFFAS 7, which pertains to debt cancellation, to determine if it needs to be revised. Specifically, issues were raised during audits related to the proper 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. The Office of Management and Budget (OMB) and Treasury determined the posting logic for the debt cancellation scenario described in this Interpretation. Treasury and OMB concurred that a negative surplus

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warrant should be used. Per the Fiscal Service guidance, which Treasury and OMB agreed upon, the agency was required to show an increase to Fund Balance with Treasury (FBWT) and a subsequent decrease to FBWT representing debt repayment to implement the cancellation. The posting logic resulted in the agency reporting what appeared like an appropriation provided by the legislation by recording the debt cancellation as a budgetary financing source on its SCNPs.

- A5. However, the reporting entities disagreed on 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 SCNPs but recognized as nonexchange gain in accordance with SFFAS 7 because the legislation did not provide for an appropriation. The auditors did not agree with Fiscal Service's prescribed posting logic and identified this treatment as a material weakness. To avoid losing its unmodified opinions on its agency financial report and closing package audits, the agency made the correcting entry required by the auditors to reverse the posting logic and recognize a nonexchange gain on the SCNPs.

## **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 the 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."



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Understanding that debt cancellation is nonexchange activity is very important because it specifies reporting as provided in SFFAC 2.

- 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 and why it 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.

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A11. SFFAC 2, paragraph 100 provides that nonexchange activity is reported on the SCNP. Therefore, previous Boards were clear that debt cancellation activity is nonexchange and should be reported on the SCNP.

A12. It should also be noted that paragraph 133 of SFFAS 7 states:

Gains and losses are recognized rather than revenues and expenses in order to differentiate unusual or nonrecurring transactions for evaluating an entity's performance or setting its prices. Material gains and losses are expected to be infrequent. They would normally be of a type that management would want to be considered in appraisals of its operations.

A13. Further, the Board also discussed the relationship between revenues and gains in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, as follows:

55. Existing standards or established practice may indicate that certain increases and decreases in assets should be reported as gains and losses, rather than revenues and expenses. Use of the terms *gains and losses* generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature or their having resulted from peripheral or incidental activities of an entity.

56. The definitions of revenue and expense in this Statement include items that might be reported as gains and losses. Gains and losses are considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets. Whether certain kinds of revenues and expenses should be reported as gains and losses and, if so, under what circumstances, is beyond the scope of this Statement.

A14. SFFAS 7 also provides discussion of budgetary accounting as it pertains to meeting the objectives of federal financial reporting. For example, SFFAS 7, Introduction paragraphs 23-26 discuss the budgetary accounting perspective. SFFAS 7, paragraphs 77-82 discuss budgetary accounting and current disclosures. In addition, paragraphs 203-223 of the Basis for Conclusions provide further rationale and explanation of SFFAS 7 specific to budgetary principles, the budget process, and its link to proprietary accounting.

### **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 SCNP. 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."

- A16. 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 its 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 Interpretation.
- A17. 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.
- A18. While in certain standards the Board has determined that requiring a specific line item for display is appropriate, in most standards it is not appropriate because items may need to be displayed separately or be included with other items based on materiality or 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. Judgment, as well as consideration of materiality, is required and is specific to each reporting entity.
- A19. In addition to the proprietary accounting and reporting discussed above, budgetary accounting should be considered by reporting entities. 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 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.
- A20. As noted, this Interpretation does not provide guidance on budgetary accounting. OMB, in coordination with Treasury, provides guidance on budgetary accounting<sup>5</sup> for debt cancellation based upon language provided in the legislation canceling the debt and based upon budget concepts. OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, provides instructions on, among other things, budget execution, including guidance on the apportionment and reappportionment process, a report on budget execution and budgetary resources (SF 133), and a checklist for fund control regulations. In addition, the Treasury Financial Manual is Fiscal Service's official publication of policies, procedures, and instructions concerning financial management in the federal government.

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<sup>5</sup>See paragraphs 23-26 and paragraphs 77-82 of SFFAS 7 for discussion about budgetary information and the budgetary accounting perspective. In addition, paragraphs 203-223 of the Basis for Conclusions provides further rationale and explanation of SFFAS 7 specific to budgetary principles, the budget process and its link to proprietary accounting.

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## OMB A-136 Form and Content

- A21. 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 in OMB Circular A-136, *Financial Reporting Requirements*, based on the requirements and guidance contained in FASAB standards but also may provide more specific detailed instructions.
- A22. As part of the research on this project, FASAB coordinated with OMB and determined that certain changes to the form and content requirements provided for the SCNP in A-136 ensure clarity and consistency with GAAP. Specifically, eliminating the sub-categories "Budgetary Financing Sources" and "Other Financing Sources (Nonexchange)" presented under the Cumulative Results on the SCNP simplifies the presentation and thereby enhances the clarity.

## Disclosures

- A23. The Board considered whether this Interpretation should clarify disclosures. The Board believed it important to remind users that management is responsible for reporting, presentation, and display. Therefore, this includes consideration of additional disclosures. The reporting entity may believe it relevant to provide readers information about debt cancellation and the impact<sup>6</sup> of the debt cancellation.

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## Summary of Outreach Efforts and Responses

- A24. FASAB issued the exposure draft (ED), *Debt Cancellation: An Interpretation of SFFAS 7, Paragraph 313*, on May 25, 2021, with comments requested by July 23, 2021.
- A25. Upon release of the ED, FASAB notified constituents through the FASAB website and listserv, the Federal Register, and FASAB newsletter. FASAB also provided news releases to its press contacts, including various news organizations and committees of professional associations generally commenting on EDs in the past. Staff also provided copies of the ED directly to agencies that were directly impacted by the particular issue in prior years.

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<sup>6</sup>For example, if a cancellation of debt is for a business-type activity and it prevents the reporting entity from having to increase future charges for goods or services, the reporting entity should disclose this. In addition, a summary of the impact of the cancellation on the reporting entity, the lender, and current and future users of the goods or services could be provided.

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A26. To encourage responses, a reminder notice was provided to FASAB's listserv near the comment deadline.

A27. FASAB received 17 comment letters from preparers, auditors, professional associations, and users of federal financial information. The Board considered responses to the ED at its August 2021 meeting. The Board did not rely on the number in favor of or opposed to a given position. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A28. The majority of respondents generally agreed with the Interpretation. Specifically, respondents generally agreed the Interpretation clarified that the standards provide that debt cancellation is a nonexchange activity that should be reported on the SCNP. The Interpretation also clarifies 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.

A29. One respondent disagreed with certain aspects of the proposal and requested clarification on reporting the restructuring of debt and other aspects of paragraph 313 of SFFAS 7. The Board carefully considered the comments but deemed the referenced transactions outside of the scope of the Interpretation. Certain respondents provided minor editorial clarifications that were carefully considered and incorporated.

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## Board Approval

A30. This Interpretation was approved for issuance by all members of the Board.

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## 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
SCNP	Statement of Changes in Net Position
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards