

Statements of Federal Financial Accounting Standards (SFFAS)



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D.C. 20503

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Interpretation Numbers 1 and 2 related to
Statement of Federal Financial Accounting Standards
Numbers 4, 5, and 7

AGENCY: Office of Management and Budget.

ACTION: Notice of Interpretations.

SUMMARY: This Notice includes two interpretations of Statements of Federal Financial Accounting Standards (SFFAS), adopted by the Office of Management and Budget (OMB). These interpretations were recommended by the Federal Accounting Standards Advisory Board (FASAB) and adopted in their entirety by OMB.

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SUPPLEMENTARY INFORMATION: This Notice includes two interpretations of Statements of Federal Financial Accounting Standards (SFFAS), adopted by the Office of Management and Budget (OMB). These interpretations were recommended by the Federal Accounting Standards Advisory Board (FASAB) and adopted in their entirety by OMB.

Under a Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and OMB on Federal Government Accounting Standards, the Comptroller General, the Secretary of the Treasury, and the Director of OMB (the Principals) decide upon standards and concepts after considering the recommendations of FASAB. After agreement to specific standards and concepts, they are published in the *Federal Register* and distributed throughout the Federal Government.

An Interpretation is a document, originally developed by FASAB, of narrow scope which provides clarification of the meaning of a standard, concept or other related guidance. Once approved by the designated representatives of the Principals, they are published in the *Federal Register*.

This Notice, including the first two interpretations of SFFAS, is available on the OMB home page on the internet which is currently located at /OMB/, under the caption "*Federal Register* Submissions."

G. Edward DeSeve

Controller

INTERPRETATION NUMBER 1 OF
STATEMENT OF FEDERAL FINANCIAL
ACCOUNTING STANDARDS NUMBER 7

Reporting on Indian Trust Funds in General Purpose Financial Reports of the Department of the Interior (DOI) and in the Consolidated Financial Statements of the United States Government: An Interpretation of SFFAS No. 7

INTRODUCTION

1. The DOI requested guidance about how to report information on Indian trust funds in the general purpose financial report of the Department. The Indian trust funds are managed by DOI's Office of Special Trustee, Office of the Secretary. (Prior to FY 1996, the trust funds were managed by the Bureau of Indian Affairs.) Some of the funds belong to individual Indians, others belong to tribes. The funds are managed by the Federal Government in a trust arrangement. While the government's responsibility for all of these funds is of a fiduciary nature, some portion of the annual flows for some of the funds have been included in the *Budget of the United States Government*. (Further discussion regarding types of funds involved is provided in paragraphs 7 and 8.)

2. According to Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, "Entity and Display," inclusion of a program in the section of the Federal Budget, currently entitled "Federal Programs by Agency and Account," is conclusive evidence that the program should be part of the reporting entity. The question thus arises whether the assets and activities of the Indian trust funds should be reported in DOI's general purpose financial statements. Also, Statement of Federal Financial

Accounting Standards (SFFAS) No. 7, "Accounting for Revenue and Other Financing Sources," requires certain disclosures regarding "dedicated collections," including fiduciary funds. During discussion of this issue at the Federal Accounting Standards Advisory Board (FASAB), questions arose about what type of disclosures should be provided regarding the Indian trust funds.

INTERPRETATION

3. The assets, liabilities and operating transactions of the Indian trust funds are not part of DOI and should not be included in the balance sheet, statement of net cost, and statement of changes in financial position of the Department or of the United States Government. However, the Department does have a fiduciary responsibility for these funds and is required to report on them in footnotes to the financial statements by SFFAS No. 7, paragraphs 83-87.

SCOPE OF INTERPRETATION

4. This Interpretation deals with what information about Indian trust funds should be included in the general purpose financial report of DOI and the consolidated financial statements of the United States Government. It does not address issues regarding: (1) reporting formats for the footnote disclosure required by SFFAS No. 7, (2) inclusion or exclusion of other fiduciary funds as components of the Federal reporting entity, (3) inclusion or exclusion of any funds or entities in the *Budget of the United States Government*, or (4) reporting on other funds labeled "trust funds" in the Federal Budget, reporting for trust funds, or reporting on deposit funds generally.¹

EFFECTIVE DATE

5. The interpretation is effective upon implementation of SFFAS No. 7, which is effective for reporting periods that begin after September 30, 1997. Earlier application of SFFAS No. 7 is encouraged.

APPENDIX: BASIS FOR CONCLUSIONS

ENTITY CRITERIA

6. In its discussion of the budgetary perspective, SFFAC No. 2 notes:

- 18. Care must be taken in determining the nature of all trust funds and their relationship to the entity responsible for them. A few trust funds are truly fiduciary in nature. Most trust funds included in the Federal Budget are not of a fiduciary nature and are used in Federal financing in a way that differs from the common understanding of trust funds outside the Federal Government. In many ways, these trust funds can be similar to revolving or special funds in that their spending is financed by earmarked collections.

19. In customary usage, the term "trust fund" refers to money belonging to one party and held "in trust" by another party operating as a fiduciary. The money in a trust must be used in accordance with the trust's terms, which the trustee cannot unilaterally modify, and is maintained separately and not commingled with the trustee's own funds. This is not the case for most Federal funds that are included in the Federal Budget -- the fiduciary relationship usually does not exist. The beneficiaries do not own the funds and the terms in the law that created the trust fund can be unilaterally altered by Congress.

7. Indian trust funds are "true" trust funds in the customary sense, in which there is a legal fiduciary relationship between the Federal Government as trustee and the Indians as trustor. The Federal Government does not own the assets of the funds. In some cases, the Federal Government's trustee relationship is with individuals, in other cases with tribes. For many of the funds involved, a tribe or individual can use the funds or dissolve the trust at any time; however, there is a restriction on the use of funds that have been received through legal judgments. Those funds are generally not available until the beneficiaries agree how the funds are to be distributed among them.

8. The Federal Budget treats the two types of Indian trust funds differently. Tribal funds are included in the Federal Budget. Individuals' funds are not in the Federal Budget; they are treated as deposit funds. The Indian tribal trust funds appear to meet SFFAC No. 2's conclusive criterion because of their budgetary treatment. The question regarding these funds is whether this implies that these funds should be reported on the face of DOI's financial statements, with the assets, liabilities, revenues and expenses of the Department.

9. Another question arises regarding the Indian trust funds that do not appear to meet the conclusive criterion: would they meet the indicative criteria? DOI interprets the indicative criteria in paragraph 44 of SFFAC No. 2 to mean that the Indian trust funds do not possess any of these characteristics.

10. Some people believe that the sixth indicative criterion does, in fact, apply: "... a fiduciary relationship with a reporting entity ..." However, they believe that meeting any single indicative criterion is not necessarily sufficient to define the Indian trust funds as part of a reporting entity. SFFAC No. 2 cautioned expressly that "no single indicative criterion is a conclusive criterion."

11. Other people do not believe that even this indicative criterion applies. They believe that, notwithstanding the use of this terminology, the relationship discussed in the sixth indicative criterion concerns factors relating to committing the component entity financially, controlling the collection and disbursement of funds, or having financial interdependence. They believe that this type of financial control and interdependence does not exist between the Indian trust funds and the Federal Government.

12. While the Indian tribal funds might appear to meet the criteria for inclusion as a component of the Federal reporting entity (by virtue of the budgetary criterion, if no other), the sovereignty of the Indian tribes as entities outside the Federal Government, and the fiduciary relationship between the Federal Government and the Indians, indicate that the criteria stated in SFFAC No. 2 should not be interpreted to suggest that the assets, liabilities, revenues and expenses of these fiduciary funds should be reported on the face of DOI's financial statements.

13. SFFAC No. 2's discussion of the budget perspective cautions that, when defining a reporting entity, care must be taken in determining the nature of all trust funds and their relationship to the entity responsible for them (SFFAC No. 2, paragraph 18). This provides some common sense advice relevant to the Indian trust funds.

DISCLOSURES FOR DEDICATED COLLECTIONS

14. As noted, the disclosure requirements for dedicated collections in SFFAS No. 7, paragraphs 83-87, are applicable to the Indian trust funds. DOI should include this information in footnotes to its basic financial statements. In addressing the comments received on the exposure draft leading to SFFAS No. 7, the Board specifically noted that:

- 226.1 The proposed standard did not cover funds administered by a Federal entity in a fiduciary relationship with beneficiaries that were not included in the entity's financial statement. In addition, it did not cover other funds which are of the same nature as many trust funds. The standard now requires disclosures for these funds also.

1 This restriction on the scope of this interpretation does not imply that this treatment would be inappropriate for the other fiduciary funds. Other funds were not included in the research supporting this Interpretation and are, therefore, excluded.

INTERPRETATION NUMBER 2 OF
STATEMENT OF FEDERAL FINANCIAL
ACCOUNTING STANDARDS NUMBERS 4 AND 5

Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS No. 4 and SFFAS No. 5

INTRODUCTION

1. The Federal Accounting Standards Advisory Board (FASAB) was asked to clarify Federal accounting standards as they relate to the Treasury Judgment Fund. The Treasury Judgment Fund was established by Congress in the 1950's to pay in whole or in part the court judgments and settlement agreements negotiated by the Department of Justice (DOJ) on behalf of agencies, as well as certain types of administrative awards. The Congress established the Judgment Fund as a permanent, indefinite appropriation.

2. The clarification addresses (1) how Federal entities should report the costs and liabilities arising from claims to be paid by the Treasury Judgment Fund and (2) how the Judgment Fund should account for the amounts that it is required to pay on behalf of Federal entities. This interpretation has been prepared on the basis of the following three accounting Standards:

-- Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government"

-- SFFAS No. 5, "Accounting for Liabilities of the Federal Government"

-- SFFAS No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting."

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

INTERPRETATION

Accounting by the Federal Entity

3. SFFAS No. 5 states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. The Federal entity's management, as advised by DOJ, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss.¹ The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

4. Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source"² amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity.

Accounting by the Treasury Judgment Fund

5. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss. According to SFFAS No. 4, the imputed financing source amount recognized by the Federal entity and the expense recognized by the Judgment Fund would be eliminated at the Federal consolidated financial report level.

EFFECTIVE DATE

6. This interpretation is effective upon implementation of SFFAS No. 4 and SFFAS No. 5, which become effective for fiscal periods beginning after September 30, 1996.

APPENDIX A: BASIS FOR CONCLUSIONS

7. This interpretation is primarily based on the principles of SFFAS No. 5 and SFFAS No. 4. The following brief discussion explains the basis for the interpretation in terms of those standards which are the foundation for the interpretation.

8. In accordance with the general principles of the liability standard (SFFAS No. 5), once a legal claim is filed against a Federal entity, the entity's management should determine the likelihood that the Federal entity will incur a loss related to the claim,³ regardless of the fact that the payment may be paid in full or in part by the Judgment Fund. The contingencies⁴ section of SFFAS No. 5 states that, if the likelihood of the contingent loss is remote, no reporting is necessary; if the likelihood of the loss is reasonably possible and the amount is measurable, the estimated loss should be disclosed; and, if the likelihood of loss is probable (more likely than not which is a greater than 50 percent chance of occurrence) and estimable, the estimated loss must be recognized as a liability. If the probability of the loss is changed at any time prior to payment of the claim, the proper adjustments should be recognized (e.g., from disclosure (reasonably possible) to recognition (probable)). If at any time the estimated loss amount changes, the liability and expense should be adjusted to reflect the change.⁵

9. In accordance with the principles of SFFAS No. 4,⁶ a Federal entity incurring a loss or expense must recognize the full cost of the loss (claim), regardless of who is actually paying the (settlement or judgment) amount. The standard requires the Federal entity incurring a loss or expense to use an estimate of the cost if the actual cost information is not provided. The estimate must be reasonable and should be aimed at determining realistic losses expected.

APPENDIX B: ILLUSTRATIVE JOURNAL ENTRIES

Based on the above noted accounting standards and the generalized events described below, the conceptual journal entries⁷ should be as follows:

Federal entity entries:

The Federal entity's management, through the advisement of DOJ, has determined that the probability of the legal claim ending in a loss against the Federal entity is probable and the loss is estimable. The entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted as necessary based on any changes in the estimated loss.

Entry #1:

Debit Expense
Credit Liability -- Legal claims

Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for payment of the claim, the liability should be removed and an other financing source recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would only reflect that amount paid by the Judgment Fund on behalf of the Federal entity.

Entry #2:

Debit Liability -- Legal claims

Credit Imputed Financing Source -- Expenses Paid by Other Entities⁸

1 See paragraph 39 in SFFAS No. 5 for the complete discussion on "Estimating Contingent Liabilities."

2 See paragraph 73 in SFFAS No. 7 for the complete discussion on "Financing Imputed for Cost Subsidies."

3 In most cases this determination involves DOJ.

4 A contingency is an existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain or loss.

5 See paragraphs 35 - 42 in SFFAS No. 5 for the complete discussion on "Contingencies."

6 See paragraphs 89 - 104 and 105 - 115 in SFFAS No. 4 for the complete discussion on "Full Cost" and "Inter-entity Costs," respectively.

7 Actual journal entries are under the authority of the Standard General Ledger.

8 According to SFFAS No. 4, the imputed financing source and expenses paid **for** other entities amounts would be eliminated at the consolidation level.