United States Government Notes to the Financial Statements for the Fiscal Years Ended September 30, 2018, and 2017

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The government includes the executive branch, the legislative branch, and the judicial branch. This *Financial Report* includes the financial status and activities related to the operations of the government. SFFAS No. 47, *Reporting Entity*, effective for fiscal year 2018, provides criteria for identifying organizations that are included in the *Financial Report* as “consolidation entities” and “disclosure entities.” Consolidation entities are consolidated into the government’s financial statements. For disclosure entities, information is disclosed in the notes to the financial statements concerning (a) the nature of the federal government’s relationship with the disclosure entities, (b) the nature and magnitude of relevant activity with the disclosure entities during the period and balances at the end of the period, and (c) a description of financial and non-financial risks, potential benefits and, if possible, the amount of the federal government’s exposure to gains and losses from the past or future operations of the disclosure entity or entities.

Disclosure entities have a greater degree of autonomy than consolidation entities. Disclosure entities may maintain a separate legal identity, have a governance structure that vests most decision-making authorities in a governing body to insulate the organization from political influence, and/or have relative financial independence. These entities may include, but are not limited to, quasi-governmental and/or financially independent entities and organizations owned and/or controlled by the federal government as a result of (a) regulatory actions (such as organizations in receivership or conservatorship) or (b) other federal government intervention actions if the relationship with such entities is not expected to be permanent.

SFFAS No. 47 also provides guidance for identifying related parties and in determining what information to provide about related party relationships of such significance that it would be misleading to exclude such information. (See Appendix A—Reporting Entity, for a more detailed discussion.)

Based on the criteria in GAAP for federal entities, the assets, liabilities, and results of operations of Fannie Mae and Freddie Mac are not consolidated into the government's consolidated financial statements. However, the values of the investments in such entities, changes in value, and related activity with these entities are included in the government's consolidated financial statements. Although federal investments in Fannie Mae and Freddie Mac are significant, these entities do not meet the GAAP criteria for consolidation entities.

For fiscal year 2018, under SFFAS No. 47 criteria, Fannie Mae and Freddie Mac were owned or controlled by the federal government as a result of (a) regulatory actions (such as organizations in receivership or conservatorship) or (b) other federal government intervention actions. Under the regulatory or other intervention actions, the relationship with the federal government is not expected to be permanent. These entities are classified as disclosure entities based on their characteristics as a whole. For fiscal year 2017, these entities met the criteria of paragraph 50 of Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display* and do not appear in the federal budget section “Federal Programs by Agency and Account." SFFAS No. 47 replaced reporting entity criteria in SFFAC No. 2 (see Note 25—Disclosure Entities and Related Parties for additional information on these disclosure entities).

Also, under GAAP criteria, the FR System is not consolidated into the government's consolidated financial statements (see Note 25—Disclosure Entities and Related Parties for further information concerning the Federal Reserve System).

Implementation of SFFAS No. 47, as of October 1, 2017, did not have a significant impact on the composition of the entities consolidated in the *Financial Report* as compared to entities consolidated under SFFAC No. 2, for fiscal year 2017 (see Note 1.S—Adjustments to Beginning Net Position for information on the changes in accounting principles). For further information regarding Reporting Entity, see Appendix A—Reporting Entity.

B. Basis of Accounting and Revenue Recognition

Consolidated Financial Statements

The consolidated financial statements of the government were prepared using GAAP, primarily based on Federal Accounting Standards Advisory Board's (FASAB's) SFFAS. Intragovernmental transactions are eliminated in consolidation, except as described in the Other Information– Unmatched Transactions and Balances. See Note 1.R—Unmatched Transactions and Balances for detailed information. The consolidated financial statements include accrual-based financial statements and sustainability financial statements, which are discussed in more detail below, and the related notes to the consolidated financial statements. Collectively, the accrual-based financial statements, the sustainability financial statements, and the notes represent basic information that is deemed essential for the financial statements and notes to be presented in conformity with GAAP.

Accounting standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information. Accordingly, modifications may have been made to certain presentations and disclosures.

Accrual-Based Financial Statements

The accrual-based financial statements were prepared under the following principles:

- Expenses are generally recognized when incurred.
- Non-exchange revenue, including taxes, duties, fines, and penalties, are recognized when collected and adjusted for the change in net measurable and legally collectible amounts receivable (modified cash basis). Related refunds and other offsets, including those that are measurable and legally payable, are netted against non-exchange revenue.
- Exchange (earned) revenue is recognized when the government provides goods and services to the public for a price. Exchange revenue includes user charges such as admission to federal parks and premiums for certain federal insurance.

The basis of accounting used for budgetary purposes, which is primarily on a cash basis (budget deficit) and follows budgetary concepts and policies, differs from the basis of accounting used for the financial statements which follow GAAP. See the Reconciliations of Net Operating Cost and Budget Deficit in the Financial Statements section.

Sustainability Financial Statements

The sustainability financial statements were prepared based on the projected present value of the estimated future revenue and estimated future expenditures, primarily on a cash basis, for a 75 year period.[1] They include the SLTFP, covering all federal government programs, and the Statements of Social Insurance and the Statements of Changes in Social Insurance Amounts, covering social insurance programs (Social Security, Medicare, Railroad Retirement, and Black Lung programs). These estimates are based on economic as well as demographic assumptions presented in Notes 22 and 23. The sustainability financial statements are not forecasts or predictions. The sustainability financial statements are designed to illustrate the relationship between receipts and expenditures, if current policy is continued. For this purpose, the projections assume, among other things, that scheduled social insurance benefit payments would continue after related trust funds are projected to be depleted, contrary to current law, and that debt could continue to rise indefinitely without severe economic consequences.

By accounting convention, the Statements of Social Insurance do not include projected general revenues that, under current law, would be used to finance the remainder of the expenditures in excess of revenues for Medicare Parts B and D that is reported in the Statements of Social Insurance. The SLTFP include all revenues (including general revenues) of the federal government.

New Standards Issued in Prior and Current Years and Implemented in Current Year

Beginning in fiscal year 2018, the government implemented, or began to implement, the requirements of new standards for: Reporting Entity, Tax Expenditures, Budget and Accrual Reconciliation, Assigning Assets to Component Reporting Entities, Amending Inter-Entity Cost Provisions, and Classified Activities. The new standards implemented are:

- SFFAS No. 47, *Reporting Entity*. SFFAS No. 47 established principles to identify organizations for which elected officials are accountable. The standard also guides preparers of general purpose federal financial reports (GPFFRs) in determining what organizations to report upon, whether such organizations are considered "consolidation entities" or "disclosure entities," and what information should be presented about those organizations. The standard also requires information to be provided about related party relationships of such significance that it would be misleading

[1] With the exception of the Black Lung program, which has a rolling 25-year projection period that begins on the September 30 valuation date each year.

to exclude information. Note 25— Disclosure Entities and Related Parties has been added to the *Financial Report* to capture additional information required under SFFAS No. 47. Refer to Note 25—Disclosure Entities and Related Parties and Appendix A for detailed information. SFFAS No. 47 became effective in fiscal year 2018.

- SFFAS No. 52, *Tax Expenditures*. SFFAS No. 52 requires certain information on tax expenditures to be included in the *Financial Report* to assist users in understanding the existence, purpose, and impact of tax expenditures. Disclosures within the notes to the financial statements should include a "plain language" definition, examples of types, and a description of how tax expenditures affect non-exchange revenue, tax collections and refunds, as well as whether tax expenditure amounts are presented in the basic financial statements. The MD&A should include a "plain language" definition, the general purpose, and examples of types of tax expenditures. The MD&A should also include information about other factors that may affect tax collections in order to place tax expenditure information in an appropriate context, a description of how tax expenditures are treated for budgetary and financial reporting purposes, and a statement regarding the availability of published information on tax expenditures, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained. SFFAS No. 52 also encourages presentation of tax expenditures as unaudited other information (OI) in the *Financial Report*. SFFAS No. 52 became effective in fiscal year 2018.
- In October 2017, FASAB issued SFFAS No. 53, *Budget and Accrual Reconciliation; Amending SFFAS No. 7, and 24 and Rescinding SFFAS No. 22*. SFFAS No. 53 amends component entity requirements for a reconciliation between budgetary and financial accounting information established by SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. To increase informational value and usefulness, and to support the governmentwide financial statement reconciling net operating cost to the budget deficit, this Statement provides for the budget and accrual reconciliation (BAR) to replace the statement of financing. The BAR explains the relationship between the entity's net outlays on a budgetary basis and the net cost of operations during the reporting period. The BAR starts with net cost of operations and is adjusted by components of net cost that are not part of net outlays, components of net outlays that are not part of net cost, and other temporary timing differences, which reflect some special adjustments. SFFAS No. 53 is effective in 2019 and early implementation is permitted. During fiscal year 2018, USDA, VA, HHS, HUD, and Millennium Challenge Corporation (MCC) adopted this standard.
- Technical Bulletin (TB) 2017-2, *Assigning Assets to Component Reporting Entities*. TB 2017-2 provides guidance to address areas not directly covered in existing Statements and clarifies existing standards. The TB provides that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. The TB provides that assets may only be assigned by a component reporting entity to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department). This TB facilitates reporting for large and complex organizations so that reporting is better aligned with their operations and results in less costly financial reporting by permitting the reporting entity to align reporting with established funding and governance structures. Component reporting entities should describe the policies used to assign significant assets. This TB also reduces barriers to and cost of adopting GAAP. TB 2017-2 became effective in fiscal year 2018.
- In May 2018, FASAB issued SFFAS No. 55, *Amending Inter-Entity Cost Provisions*. SFFAS No. 55 revises SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts* (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*). SFFAS No. 4 required component reporting entities to recognize the full costs of services received from other federal reporting entities even if there was no requirement to reimburse the providing entity for the full cost of such services. This Statement revises SFFAS No. 4 to provide for the continued recognition of significant inter-entity costs by business-type activities and rescinds the following: a) SFFAS No. 30, *Inter-Entity Cost Implementation: Amending SFFAS No. 4, Managerial Cost Accounting Standards and Concepts* and b) Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the OMB. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs. Component reporting entities should disclose that only certain inter-entity costs are recognized for goods and services that are received from other federal entities at no cost or at a cost less than the full costs. SFFAS No. 55 is effective in 2019 and early implementation is permitted. During fiscal year 2018, DOD adopted this standard.
- SFFAS No. 56, *Classified Activities*. SFFAS No. 56 permits financial statement modifications that do not affect net results of operations or net position to prevent the disclosure of classified national security information or activities. In addition, this Statement allows a component reporting entity to be excluded from one reporting entity and consolidated into another reporting entity, and the effect of the modification may change the net results of operations

and/or net position. Further, interpretations of this Statement, which may themselves contain classified information, will address the requirements of this and other standards and permit other modifications when needed to prevent the disclosure of classified information. Modifications permitted by this Statement and future interpretations may affect the net results of operations and/or net position of those entities applying the interpretations. This standard may be implemented for fiscal year 2018.

In fiscal year 2016, the government began implementing the requirements of new standards related to the reporting for: Inventories and Related Property and Property, Plant, and Equipment. The standards being implemented are:

- FASAB issued SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.* SFFAS No. 48 permits a reporting entity to apply an alternative valuation method in establishing opening balances and applies when a reporting entity is presenting financial statements or one or more line items addressed by this statement. This standard can be applied for the first time or after a period during which existing systems could not provide the information necessary for producing GAAP-based financial statements without use of the alternative valuation methods. This is intended to provide an alternative method to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS No. 3, *Accounting for Inventory and Related Property.* This application is available to each reporting entity only once per line item addressed in this statement. Reporting entities that meet either condition and elect to apply this statement should follow the guidance in SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles.* SFFAS No. 48 was effective beginning in fiscal year 2017. Early implementation was permitted. DOD did partially implement in 2016 and select component entities have continued to implement in 2017 and 2018. DOD has not declared full implementation yet.
- FASAB issued SFFAS No. 50, *Establishing Opening Balances for General Property, Plant and Equipment.* SFFAS No. 50 permits a reporting entity to apply an alternative valuation method in establishing opening balances and applies when a reporting entity is presenting financial statements or one or more line items addressed by this statement. This standard can be applied for the first time or after a period during which existing systems could not provide the information necessary for producing GAAP-based financial statements without use of the alternative valuation methods. This is intended to provide an alternative method to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balance in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. This application is available to each reporting entity only once per line item addressed in this statement. Reporting entities meeting the conditions and electing to apply this statement should follow the guidance in SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles.* SFFAS No. 50 was effective beginning in fiscal year 2017. Early implementation was permitted. DOD did partially implement in 2016 and select component entities have continued to implement in 2017 and 2018. DOD has not declared full implementation yet.

New Standards Issued and Not Yet Implemented

FASAB issued the following new standards that are applicable to the *Financial Report*, but are not yet implemented at the governmentwide level for fiscal year 2018:

- In April 2016, FASAB issued SFFAS No. 49, *Public-Private Partnerships Disclosure Requirements.* SFFAS No. 49 establishes principles to ensure disclosure about Public-Private Partnerships (P3s) are presented in the reporting entity's GPFFRs. P3s are defined as "risk sharing" arrangements or transactions lasting more than five years between public and private sector entities. Disclosure requirements comprise quantitative and qualitative information to assist users in understanding the nature of P3s. P3 disclosures help achieve the operating performance and budgetary integrity objectives outlined in SFFAC No. 1. P3s are a form of investments. They should be adequately disclosed in order to assist report users in determining: (a) the important assets of the U.S. government and how effectively they are being managed and (b) the identification of risks. SFFAS No. 49 is effective for periods beginning after September 30, 2018 and early implementation is permitted; however, it is not being early implemented in fiscal year 2018.
- In January 2017, FASAB issued SFFAS No. 51, *Insurance Programs*. SFFAS No. 51 establishes accounting and financial reporting standards to ensure that insurance programs are adequately defined and report consistent information about the liabilities for losses incurred and claimed as well as expected losses during remaining coverage. These will replace the insurance guarantee program standards provided in paragraphs 97-121 of SFFAS No. 5, *Accounting for Liabilities of the Federal Government.* To support consistency, it identifies three categories: 1) exchange transaction insurance programs other than life insurance, 2) non-exchange transaction insurance programs and 3) life insurance programs. Insurance programs are categorized based upon the type of revenue received as defined by SFFAS No. 7, *Accounting for Revenue and Other Financing and Concepts for Reconciling Budgetary and Financial Accounting,* as amended. SFFAS No. 51 provides guidance as to how and when insurance

programs should recognize revenue, expenses and liabilities according to the aforementioned categories. The recognition measurement, and disclosure guidance provides for concise, meaningful and transparent information regarding the operating performance of insurance programs. SFFAS No. 51 is effective for periods beginning after September 30, 2018 and early implementation is not permitted.

- In April 2018, FASAB issued SFFAS No. 54, *Leases: An Amendment of SFFAS No. 5, Accounting for Liabilities of the Federal Government, and SFFAS No. 6, Accounting for Property, Plant, and Equipment*. SFFAS No. 54 revises the financial reporting standards for federal lease accounting. It provides a comprehensive set of lease accounting standards to recognize federal lease activities in the reporting entity's GPFFRs and includes appropriate disclosures. This Statement requires that federal lessees recognize a lease liability and a leased asset at the commencement of the lease term, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, or contracts or agreements that transfer ownership, or intragovernmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria or short-term leases, contracts or agreements that transfer ownership, or intragovernmental leases. SFFAS No. 54 is effective in 2021 and early adoption is not permitted.

C. Accounts and Taxes Receivable

Accounts receivable represent claims to cash or other assets from entities outside the government that arise from the sale of goods or services, duties, fines, certain license fees, recoveries, or other provisions of the law. Accounts receivable are reported net of an allowance for uncollectible amounts. An allowance is established when it is more likely than not the receivables will not be totally collected. The allowance method varies among the entities in the government and is usually based on past collection experience and is reestimated periodically as needed. Methods include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection.

Taxes receivable consist primarily of uncollected tax assessments, penalties, and interest when taxpayers have agreed or a court has determined the assessments are owed. Taxes receivable do not include unpaid assessments when taxpayers or a court have not agreed that the amounts are owed (compliance assessments) or the government does not expect further collections due to factors such as the taxpayer's death, bankruptcy, or insolvency (write-offs). Taxes receivable are reported net of an allowance for the estimated portion deemed to be uncollectible. The majority of the allowance for uncollectible amounts is based on projections of collectible amounts from a statistical sample of unpaid assessments.

D. Loans Receivable and Loan Guarantee Liabilities

Direct loans obligated and loan guarantees committed after fiscal year 1991 are reported based on the present value of the net cash flows estimated over the life of the loan or guarantee. The difference between the outstanding principal of the direct loans and the present value of their net cash inflows is recognized as a subsidy cost allowance. The present value of estimated net cash flows of the loan guarantees is recognized as a liability for loan guarantees.

The subsidy expense for direct or guaranteed loans disbursed during a fiscal year is the present value of estimated net cash flows for those loans or guarantees. For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs. Credit programs reestimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees, by taking into account all factors that may have affected the estimated cash flows. Any adjustment resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense).

Direct loans obligated and loan guarantees committed before fiscal year 1992 are valued under two different methodologies within the government: the allowance-for-loss method and the present-value method. Under the allowance-for-loss method, the outstanding principal of direct loans is reduced by an allowance for uncollectible amounts; the liability for loan guarantees is the amount the entity estimates would more likely than not require future cash outflow to pay default claims. Under the present-value method, the outstanding principal of direct loans is reduced by an allowance equal to the difference between the outstanding principal and the present value of the expected net cash flows. The liability for loan guarantees is the present value of expected net cash outflows due to the loan guarantees.

E. Inventories and Related Property

Inventory is tangible personal property that is (1) held for sale, principally to federal entities, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. SFFAS No. 3, *Accounting for Inventory and Related Property*, requires inventories held for sale and held in reserve for future sale within the government to be valued using either historical cost or a method that reasonably approximates historical cost. Historical cost methods include first-in-first-out, weighted average, and moving average. Any other valuation method may be used if the results reasonably approximate one of the historical cost methods. FASAB issued additional guidance SFFAS No. 48, which permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, OM&S, and stockpile materials and is intended to provide an alternative valuation method when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS No. 3.

As the largest contributor of inventories and related property, DOD values approximately 99 percent of its resale inventory using the moving average cost method as of September 30, 2018. DOD reports the remaining 1 percent of resale inventories at an approximation of historical cost using latest acquisition cost adjusted for holding gains and losses. OM&S are valued using various methods including moving average cost, standard price, historical cost, replacement price, and direct method. DOD uses both the consumption method (expensed when issued to an end user for consumption in normal operations) and the purchase method (expensed when purchased) of accounting for OM&S. Stockpile Materials are accounted for using actual cost or the lower of cost or market method. DOD continues to implement SFFAS No. 48, permitting alternative methods in establishing opening balances.

F. Property, Plant, and Equipment

Property, Plant, and Equipment (PP&E) consists of tangible assets that have an estimated useful life of two or more years, are not intended for sale in the ordinary course of business, and are intended to be used or available for use by the entity. These tangible assets may include land, land rights, assets acquired through capital leases, buildings and structures, furniture and fixtures, equipment, and vehicles.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment* requires general PP&E to be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. PP&E used in government operations are carried at acquisition cost, with the exception of some DOD equipment. FASAB issued additional guidance, SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment* which states that a reporting entity may choose alternative methods for establishing an opening balance for land and land rights. The entity may exclude land and land rights from the opening balance of general PP&E. In so doing, future land and land right acquisitions should be expensed. An entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. DOD generally records PP&E at the estimated historical cost. However, when applicable DOD will continue to adopt SFFAS No. 50.

Costs to acquire PP&E, extend the useful life of existing PP&E, or enlarge or improve its capacity, that exceed federal entities' capitalization thresholds should be capitalized and depreciated or amortized. Depreciation and amortization expense should be recognized on all capitalized PP&E, except land and land rights of unlimited duration. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance is transferred to PP&E.

For financial reporting purposes, heritage assets (excluding multi-use heritage assets) and stewardship land are not recorded as part of PP&E. Since heritage assets are intended to be preserved as national treasures, it is anticipated that they will be maintained in reasonable repair and that there will be no diminution in their usefulness over time. Many assets are clearly heritage assets. For example, the National Park Service manages the Washington Monument, the Lincoln Memorial and the Mall. Heritage assets that are predominantly used in general government operations are considered multi-use heritage assets and are included in PP&E. Stewardship land is also consistent with the treatment of heritage assets in that much of the government's land is held for the general welfare of the nation and is intended to be preserved and protected. Stewardship land is land owned by the government but not acquired for or in connection with general PP&E. Because most federal land is not directly related to general PP&E, it is deemed to be stewardship land and accordingly, it is not reported on the Balance Sheet. Examples of stewardship land include national parks and forests. For more details on stewardship assets, see Note 24—Stewardship Land and Heritage Assets.

G. Debt and Equity Securities

Debt and equity securities are classified as held-to-maturity, available-for-sale, and trading. Held-to-maturity debt and equity securities are reported at cost, net of unamortized premiums and discounts. Available-for-sale debt and equity securities are reported at fair value. Trading debt and equity securities are reported at fair value.

H. Investments in Government-Sponsored Enterprises

The senior preferred stock and associated warrants for the purchase of common stock in the GSEs (Fannie Mae and Freddie Mac) are presented at their fair value. Senior Preferred Stock Purchase Agreements (SPSPAs), which Treasury entered into with each GSE when they were placed under conservatorship, can result in payments to the GSEs when, at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE exceed its respective assets. Such payments result in an increase to the investment in the GSEs' senior preferred stock, with a corresponding decrease to cash held by Treasury.

The valuation to estimate the investment's fair value incorporates forecasts, projections, and cash flow analyses. Changes in valuation, including impairments, are deemed usual and recurring and thus are recorded as exchange transactions on the Statement of Net Cost and investments in GSEs on the Balance Sheet. The government also records dividends related to these investments as exchange transactions and accrues when declared.

The potential liabilities to the GSEs, if any, are assessed annually and recorded at the gross estimated amount. For more detailed information on investments in GSEs, refer to Note 8—Investments in Government-Sponsored Enterprises.

I. Federal Debt

Accrued interest on Treasury securities held by the public is recorded as an expense when incurred, instead of when paid. Certain Treasury securities are issued at a discount or premium. These discounts and premiums are amortized over the term of the security using an interest method for all long-term securities and the straight line method for short-term securities. Treasury also issues Treasury Inflation-Protected Securities (TIPS). The principal for TIPS is adjusted daily over the life of the security based on the Consumer Price Index for all Urban Consumers (CPI-U).

J. Federal Employee and Veteran Benefits Payable

Generally, federal employee and veteran benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans, veterans' compensation, burial and education benefits, post-retirement health benefits, and post-retirement life insurance benefits, are recorded at estimated present value of future benefits, less any estimated present value of future normal cost contributions. Normal cost is the portion of the actuarial present value of projected benefits allocated as an expense for employee services rendered in the current year. Actuarial gains and losses (as well as prior service cost, if any) are recognized immediately in the year they occur without amortization.

VA also provides certain veterans and/or their dependents with pension benefits, based on annual eligibility reviews, if the veteran died or was disabled for nonservice-related causes. The actuarial present value of the future liability for these VA pension benefits is a non-exchange transaction and is not required to be recorded on the Balance Sheet. These benefits are recognized as expenses when benefits are paid rather than when employee services are rendered.

The liabilities for *Federal Employees' Compensation Act* (FECA) benefits are recorded at estimated present value of future benefits for injuries and deaths that have already been incurred.

Gains and losses from changes in long-term assumptions used to estimate federal employee pensions, Other Retirement Benefits (ORB), and Other Postemployment Benefits (OPEB) liabilities are reflected separately on the Statement of Net Cost and the components of the expense related to federal employee pension, ORB, and OPEB liabilities are disclosed in Note 12—Federal Employee and Veteran Benefits Payable as prescribed by SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*. In addition, SFFAS No. 33 also provides a standard for selecting the discount rate assumption for present value estimates of federal employee pension, ORB, and OPEB liabilities.

K. Environmental and Disposal Liabilities

Environmental and disposal liabilities are recorded at the estimated current cost of the cleanup plan, including the level of restoration to be performed, the current legal or regulatory requirements, and the current technology. Cleanup costs are the costs of removing, containing or disposing of hazardous waste. Hazardous waste is a solid, liquid, or gaseous waste that, because of its quantity or concentration, presents a potential hazard to human health or the environment. Cleanup costs include, but are not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and post-closure costs. Where technology does not exist to clean up radioactive or hazardous waste, only the estimable portion of the liability (typically monitoring and safe containment) is recorded.

L. Insurance and Guarantee Program Liabilities

Insurance and guarantee programs (such as Federal Crop Insurance Program and Benefit Pension Plans Program) are authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an insured event. Programs excluded from this category include social insurance, loan guarantee, and federal employee and veteran benefit programs. Insurance and guarantee program funds are commonly held in revolving funds in the government and losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims or have authority to borrow from the Treasury. The values of insurance and guarantee program liabilities are particularly sensitive to changes in underlying estimates and assumptions. Insurance and guarantee programs with recognized liabilities in future periods (i.e., liabilities that extend beyond one year) are reported at their net present value.

M. Deferred Maintenance and Repairs

Deferred maintenance and repairs are maintenance and repairs that were not performed when they should have been or scheduled maintenance and repairs that were delayed or postponed. Maintenance is the act of keeping fixed assets in acceptable condition, including preventative maintenance, normal repairs, and other activities needed to preserve the assets, so they continue to provide acceptable service and achieve their expected life. Maintenance and repairs exclude activities aimed at expanding the capacity of assets or otherwise upgrading them to serve needs different from those originally intended. Deferred maintenance and repairs are not expensed in the Statements of Net Cost or accrued as liabilities on the Balance Sheet. However, deferred maintenance and repairs information is disclosed in the unaudited RSI section of this report. Please see unaudited RSI, Deferred Maintenance and Repairs for additional information including measurement methods.

N. Contingencies

Liabilities for contingencies are recognized on the Balance Sheet when both:

- A past transaction or event has occurred, and
- A future outflow or other sacrifice of resources is probable and measurable.

The estimated contingent liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, then that amount is recognized. If no amount within the range is a better estimate than any other amount, then the minimum amount in the range is recognized and the range and a description of the nature of the contingency is disclosed.

Contingent liabilities that do not meet the above criteria for recognition, but for which there is at least a reasonable possibility that a loss may be incurred, are disclosed in Note 18—Contingencies.

O. Commitments

In the normal course of business, the government has a number of unfulfilled commitments that may require the use of its financial resources. Note 19—Commitments describes the components of the government's actual commitments that are disclosed due to their nature and/or their amount. They include long-term leases, undelivered orders, and other commitments.

P. Social Insurance

A liability for social insurance programs (Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment) is recognized for any unpaid amounts currently due and payable to beneficiaries or service providers as of the reporting date. No liability is recognized for future benefit payments not yet due. For further information, see Note 22—Social Insurance and the unaudited RSI—Social Insurance section.

Q. Funds from Dedicated Collections

Generally, funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources that remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the government's general revenues. The three required criteria for a fund from dedicated collections are:

- A statute committing the government to use specifically identified revenues and/or other financing sources that are originally provided to the government by a non-federal source only for designated activities, benefits, or purposes;
- Explicit authority for the fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
- A requirement to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the government's general revenues.

For more details on funds from dedicated collections, see Note 20—Funds from Dedicated Collections.

R. Unmatched Transactions and Balances

The reconciliation of the change in net position requires that the difference between ending and beginning net position equals the difference between revenue and cost, plus or minus prior-period adjustments.

The unmatched transactions and balances are needed to bring the change in net position into balance. The primary factors affecting this out of balance situation are:

- Unmatched intragovernmental transactions and balances between federal entities; and
- Errors and restatements in federal entities reporting.

As intragovernmental transactions and balances reduce to immaterial amounts, the corresponding individual lines in the Unmatched Transactions and Balances table are adjusted to remove the differences for the fiscal year. Please refer to the table of Unmatched Transactions and Balances in Other Information (Unaudited) for examples of the individual lines. Materiality for these adjustments is considered in the absolute value, when at or below $0.1 billion.

Refer to the Other Information (unaudited)—Unmatched Transactions and Balances for detailed information.

S. Adjustments to Beginning Net Position

During fiscal years 2017 and 2018, DOD reported adjustments to beginning net position impacting the financial statements. DOD reported a decrease of $2.5 billion and an increase of over $37 billion in fiscal years 2018 and 2017, respectively, to beginning net position due to continuing implementation of SFFAS No. 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials* and SFFAS No. 50, *Establishing Opening Balances for General Property, Plant, and Equipment.*

SFFAS No. 47, *Reporting Entity,* was implemented in fiscal year 2018. The standard requires that consolidation entities be consolidated in their entirety. Prior to fiscal year 2018, only the federal portion of Smithsonian Institution was consolidated. For fiscal year 2018, all activities (federal and non-federal portions) of Smithsonian Institution were consolidated, resulting in a $2.6 billion adjustment to the fiscal year 2018 beginning net position.

In fiscal year 2017, Note 20—Funds from Dedicated Collections included $0.2 billion in adjustments to beginning net position for Gulf Coast Ecosystem Restoration Council and HUD. In fiscal year 2018, the adjustments to beginning net position for Smithsonian Institution of $2.6 billion related to dedicated collection funds.

T. Reclassifications

Certain fiscal year 2017 amounts were reclassified to conform to the fiscal year 2018 presentation. For example, reclassifications were made to certain line items presented on the Reconciliation of Net Operating Cost and Budget Deficit and the Statement of Changes in Cash Balance from Budget and Other Activities to provide a further breakdown of certain categories of transactions. Also, a review was done to enhance the format and readability of the *Financial Report* leading to consolidation of immaterial lines within tables, removal of information not required by FASAB, and be more in line with entity reporting requirements. In fiscal year 2018, the presentation of Note 4—Loans Receivable and Loan Guarantee Liabilities, Net for fiscal year 2017 was reclassified to mirror entity financial reporting reducing the need for manual calculations. The presentations of Note 5—Inventories and Related Property, Net, Note 6—Property, Plant, and Equipment, Net, and Note 13—Environmental and Disposal Liabilities removed the breakout of DoD for fiscal years 2017 and 2018.

U. Restatements

In fiscal year 2018, HUD recognized material misstatements that were due to (1) a discounting error in the Federal Housing Administration (FHA) cash flow model used to calculate the recovery rate applied to the annual financial statement re-estimate and (2) FHA not accounting for a contingency paid by the Treasury Judgment Fund. The corrections resulted in the restatement of certain prior year amounts reported on the Balance Sheet, Statement of Net Cost, Statement of Operations and Changes in Net Position, Reconciliations of Net Operating Cost and Budget Deficit, Note 4—Loans Receivable and Loans Guarantee Liabilities, Net (understated by $1.7 billion), and Note 16—Other Liabilities (overstated by $0.1 billion).

In fiscal year 2018, HUD made re-estimate presentation changes to subsidy expense (income) ($3.5 billion decrease), principal amount of loans under guarantee ($3.2 billion increase), and principal amount guaranteed by the United States ($2.6 billion increase) presented in Note 4—Loans Receivable and Loans Guarantee Liabilities fiscal year 2017 tables. HUD also changed the presentation of Note 20—Funds from Dedicated Collections from consolidation (includes eliminations) to combined (excludes eliminations) adjusting the ending net position by $0.1 billion in fiscal year 2017.

Also, in fiscal year 2018 errors were noted in the presentation of Note 19—Commitments for undelivered orders and other commitments that required correction of balances reported in fiscal year 2017. The corrections resulted in the restatement of prior year amounts for DOJ's undelivered orders ($13.9 billion increase) and Treasury's all other commitments ($10.8 billion increase).

Fiscal year 2017 beginning net position was restated by $51.2 billion due to compilation errors in the presentation of the Balance Sheet and Note 6—Property, Plant, and Equipment, Net. In addition, the related activity caused a restatement on the Statement of Net Cost in the amount of $1.3 billion.

V. Fiduciary Activities

Fiduciary activities are the collection or receipt, as well as the management, protection, accounting, investment and disposition by the government of cash or other assets in which non-federal individuals or entities have an ownership interest that the government must uphold. Fiduciary cash and other fiduciary assets are not assets of the government and are not recognized on the Balance Sheet. See Note 21—Fiduciary Activities, for further information.

W. Use of Estimates

The government has made certain estimates and assumptions relating to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities to prepare these financial statements. There are a large number of factors that affect these assumptions and estimates, which are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. As such, actual results will differ from these estimates and such differences may be material.

Significant transactions subject to estimates are included in the balance of loans and credit program receivables, federal employee and veteran benefits payable, credit reform subsidy costs, investments in GSEs, and other non-federal securities and related impairment, tax receivables, loan guarantees, depreciation, imputed costs, other actuarial liabilities, cost and earned revenue allocations, as well as contingencies and any related recognized liabilities.

The government recognizes the sensitivity of credit reform modeling to slight changes in some model assumptions and uses regular review of model factors, statistical modeling, and annual reestimates to reflect the most accurate cost of the credit programs to the U.S. government. *Federal Credit Reform Act of 1990* (FCRA) loan receivables and loan guarantees are disclosed in Note 4—Loans Receivable and Loan Guarantee Liabilities, Net.

The forecasted future cash flows used to determine credit reform amounts are sensitive to slight changes in model assumptions, such as general economic conditions, specific stock price volatility of the entities in which the government has an equity interest, estimates of expected default, and prepayment rates. Therefore, forecasts of future financial results have inherent uncertainty.

The annual valuation performed as of September 30 on the senior preferred stock and warrants comprising the Investments in GSEs line item on the Balance Sheets incorporates various forecasts, projections, and cash flow analyses to develop an estimate of the asset's fair value. The value of the senior preferred stock is estimated by first estimating the fair value of the total equity of each GSE (which, in addition to the senior preferred stock, is comprised of other equity instruments including common stock, common stock warrants, and junior preferred stock). The fair value of the total equity is based on a discounted cash flow valuation methodology, whereby the primary input is the present value of the projected quarterly dividend payments. The fair value of the GSEs' other equity instruments are then deducted from its total equity, with the remainder representing the fair value of the senior preferred stock. The primary input into the warrants valuation is the market value of the shares of common stock of the GSEs which, along with the junior preferred stock, are traded on the over-the-counter (OTC) Bulletin Board. Treasury evaluates the need for adjusting the OTC market-based valuation of the warrants for the effects, if any, of significant events occurring after the close of the market but before the end of the measurement date. Treasury records any changes in valuation, including impairment, on the Statement of Net Cost and the Balance Sheet. Since the valuation is an annual process, Treasury deems changes in valuation of the senior preferred stock and warrants as usual and recurring.

Treasury performs annual calculations, as of September 30, to assess the need for recording an estimated liability in accordance with SFFAS No. 5, *Accounting for Liabilities of The Federal Government,* related to the government's funding commitment to the GSEs under the SPSPAs. Liability recognition is predicated on the probable future occurrence of an excess of liabilities and minimum capital reserve amounts, as defined, over the assets of either GSE at the end of any reporting quarter. The occurrence of future GSE deficits, which ultimately determines the liability to the GSEs, is most sensitive to future changes in the housing price index and, to a lesser extent, future changes in guarantee fees received by the GSEs on single family mortgages and interest rates. For more detailed information on investments in GSEs and the amended SPSPAs, see Note 8—Investments in Government-Sponsored Enterprises.

The government offers its employees' pension and other post-employment retirement benefits, as well as life and health insurance. OPM administers the largest civilian plan and DOD and VA administer the military plans. Generally the benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans, veterans' compensation and burial benefits, post-retirement health benefits, life insurance benefits, education benefits, and *FECA* benefits are recorded at estimated present value of future benefits, less any estimated present value of future normal cost contributions. See Note 12—Federal Employee and Veteran Benefits Payable for additional information.

X. Credit Risk

Credit risk is the potential, no matter how remote, for financial loss from a failure of a borrower or counterparty to perform in accordance with underlying contractual obligations. The government takes on credit risk when it makes direct loans or guarantees to non-federal entities, provides credits to foreign entities, or becomes exposed to institutions which engage in financial transactions with foreign countries.

The government also takes on credit risk related to committed, but undisbursed direct loans, funding commitments to GSEs, and other activities. These activities generally focus on the underlying problems in the credit markets. These programs were developed to provide credit where borrowers are not able to get access to credit with reasonable terms and conditions. Because these programs attempt to correct for a market imperfection, it can expose the government to potential costs and losses. The extent of the risk assumed is described in more detail in the notes to the financial statements, and where applicable, is factored into credit reform models and reflected in fair value measurements.

Y. Treaties and Other International Agreements

For accounting purposes, treaties and other international agreements may be understood as falling into three broad categories:

- No commitment to spend money,
- Commitment to spend money, or
- Potential obligation to spend money.

The proper financial reporting of treaties and other international agreements depends on the probable future outflow or other sacrifice of resources as a result of entering into the agreement.

In many cases, treaties and other international agreements establish frameworks that govern cooperative activities with other countries, but leave to the discretion of the parties whether to engage in any such activities. In other cases, the agreements may contemplate specific cooperative activities, but obligations to engage in them are made subject to the availability of funds. Cooperative activities relevant to these treaties and other international agreements fall under the first category, which does not result in the U.S. government incurring any financial liability. Since these treaties and other international agreements have no financial impact, they are not reported or disclosed in this *Financial Report*.

Some treaties and other international agreements fall under the second category, involving specific obligations by the U.S. government to pay money to other countries or international organizations. Examples of such agreements include those that establish international organizations under which the U.S. government undertakes obligations to pay assessed dues to the organization; grant agreements under which the U.S. government provides foreign assistance funds to other countries; and claims settlement agreements under which the U.S. government agrees to pay specific sums of money to settle claims. For further information related to treaties and other international agreements that fall under the second category, refer to Note 19—Commitments.

The last category encompasses those treaties or other international agreements that may result in contingent liabilities arising from litigation or claims. Information relevant to contingent liabilities stemming from the U.S. government's involvement in treaties or other international agreements is captured in the annual legal representation letter process, and, if applicable, reported on the Balance Sheet or disclosed in Note 18—Contingencies.