United States Government Notes to the Financial Statements for the Fiscal Years Ended September 30, 2020, and 2019

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* provides criteria for identifying organizations that are included in the *Financial Report* as consolidation entities, disclosure entities, and related parties. Consolidation entities are organizations that should be consolidated in the financial statements based on the assessment of the following characteristics as a whole, the organization: a) is financed through taxes and other non-exchange revenues; b) is governed by the Congress or the President; c) imposes or may impose risks and rewards to the government; and d) provides goods and services on a non-market basis.

For disclosure entities, data is not consolidated in the financial statements, instead 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.

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.

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 (see Note 26—Disclosure Entities and Related Parties for additional information on these disclosure entities).

Also, under GAAP criteria, the FR System and SPVs are not consolidated into the government's consolidated financial statements (see Note 8 for additional information on SPVs and Note 26 for additional information concerning the FR System).

For additional 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 FASAB's SFFASs. Intra-governmental transactions are eliminated in consolidation, except as described in the Other Information–Unmatched Transactions and Balances. See Note 1.S—Unmatched Transactions and Balances for additional 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 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 PV 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 SOSI and the SCSIA, 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 23—Social Insurance and 24—Long-Term Fiscal Projections. 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, General Fund transfers to Medicare Parts B and D reported in the SOSI are eliminated when preparing the government-wide consolidated financial statement. The SOSI shows the projected General Fund transfer(s) as eliminations 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 SOSI. 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

For FY 2020, consistent with SFFAS No. 57, *Omnibus Amendments 2019*, which rescinded SFFAS No. 8, *Supplementary Stewardship Reporting*, the Required Supplementary Stewardship Information section of the consolidated financial statements was eliminated. As a result, the information on stewardship investments in: 1) non-federal property; 2) human capital; and 3) R&D are no longer presented in the *Financial Report*.

SFFAS No. 58, *Deferral of the Effective Date of SFFAS 54*, *Leases* defers the effective date for SFFAS No. 54, *Leases* for three years and is effective upon issuance.

In FY 2016, the government began implementing the requirements of new standards related to the reporting for Inventory and Related Property and PP&E. These standards are available to each reporting entity once per line item addressed in the standard. The standards being implemented are:

[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.

- 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. SFFAS No. 48 was effective beginning in FY 2017. Early implementation was permitted. DOD did partially implement in 2016 and select component entities have continued to implement in 2017, 2018, 2019 and 2020. DOD has not declared full implementation yet; therefore, this standard continues to be partially implemented each year.
- 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. SFFAS No. 50 was effective beginning in FY 2017. Early implementation was permitted. DOD did partially implement in 2016 and select component entities have continued to implement in 2017, 2018, 2019 and 2020. DOD has not declared full implementation yet; therefore, this standard continues to be partially implemented each year.

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 government-wide level for FY 2020:

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 financial statements and includes appropriate disclosures. This Statement requires that federal lessees (for other than intra-governmental leases) recognize a lease liability and a right-to-use lease 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 intra-governmental leases. A federal lessor would recognize a lease receivable and deferred revenue, unless it meets any of the scope exclusions or the definition/criteria of short-term leases, contracts or agreements that transfer ownership, or intra-governmental leases. SFFAS No. 58, *Deferral of the Effective Date of SFFAS 54, Leases*, issued in June 2020, defers the effective date of SFFAS No. 54 to FY 2024 and early implementation is not permitted.

C. Accounts Receivable, Net

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 may include statistical sampling of receivables, specific identification and intensive analysis of each case, aging methodologies, and percentage of total receivables based on historical collection.

Accounts receivable also includes the amount of taxes receivable that 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 allowance for uncollectible amounts represents the difference between gross taxes receivable and the amounts estimated to be collectible. See Note 3—Accounts Receivable, Net for additional information.

D. Direct Loans and Loan Guarantees Receivable, Net and Loan Guarantees Liability

Direct loans obligated and loan guarantees committed after FY 1991 are reported based on the PV 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

PV of their net cash inflows is recognized as a subsidy cost allowance. The PV 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 PV 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 FY 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 PV of the expected net cash flows. The liability for loan guarantees is the PV of expected net cash outflows due to the loan guarantees. See Note 4—Direct Loans and Loan Guarantees Receivable, Net and Loan Guarantees Liability for additional information.

E. Inventory and Related Property, Net

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. OM&S is tangible personal property to be consumed in normal operations and stockpile materials are strategic and critical materials being held due to statutory requirements for use in national defense, conservation, or national emergencies.

SFFAS No. 3, *Accounting for Inventory and Related Property*, requires that inventories, OM&S, and stockpile materials to be valued using either historical cost or a method that reasonably approximates historical cost. Historical cost methods may include first-in-first-out, weighted average, and MAC. 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, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, 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 inventory and related property, net; DOD values substantially all of its inventory available and purchased for resale using the MAC method as of September 30, 2020. OM&S are valued using various methods including MAC, 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 MAC method. DOD continues to implement SFFAS No. 48, permitting alternative methods in establishing opening balances. See Note 5—Inventory and Related Property, Net, for additional information.

F. General Property, Plant, and Equipment, Net

General 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 general PP&E to a form and location suitable for its intended use. General 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 one of three alternative methods for establishing an opening balance for general PP&E. The alternative methods include: using deemed cost to establish opening balances of general PP&E, selecting between deemed cost and prospective capitalization of internal use software, and allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

By excluding land and land rights from the opening balance of general PP&E future land and land right acquisitions is to 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 usually records general PP&E at the estimated historical cost. However, when applicable DOD will continue to adopt SFFAS No. 50.

Costs to acquire general PP&E, extend the useful life of existing general PP&E, or enlarge or improve its capacity, that exceed federal entities' capitalization thresholds is to be capitalized and depreciated or amortized. Depreciation and amortization expense is to be recognized on all capitalized general PP&E, except land and land rights of unlimited duration. In the case of constructed general PP&E, this is to be recorded as construction work in process until it is placed in service, at which time the balance is transferred to general PP&E. See Note 6—General Property, Plant, and Equipment, Net, for additional information.

For financial reporting purposes, heritage assets (excluding multi-use heritage assets) and stewardship land are not recorded as part of general 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 general 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 additional information on stewardship assets, see Note 25—Stewardship Property, Plant, and Equipment.

G. Securities and Investments

Most securities and investments are held by component entities that apply FASB standards and are not converted to FASAB standards in consolidation as permitted by SFFAS No. 47. Securities and investments are classified as held-to-maturity, available-for-sale, and trading. Held-to-maturity securities are reported at cost, net of unamortized premiums and discounts. Available-for-sale securities are reported at fair value. Trading securities are reported at fair value. The investment categories are classified by security type; Non-U.S. government, mortgage/asset backed, commercial, corporate and other bonds, unit trust and common stocks. Securities and investments are also classified using fair value measurement hierarchy levels 1, 2, 3, and "other" category. See Note 7—Securities and Investments for additional information.

H. Investments in Special Purpose Vehicles

Treasury invested in common stock warrants and equity investments in SPVs for the purpose of enhancing the liquidity of the U.S. financial system. These equity investments are reported at fair value. In addition to SPV investments, warrants are held for the purchase of common stock received as compensation from recipients of financial assistance to support ongoing employment of aviation workers during the pandemic under Section 4117 of the CARES Act. The warrants are assets of the U.S. government and Treasury is precluded from using the cash proceeds realized from the financial instruments received. These investment holdings are also reported at fair value.

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 SPVs on the Balance Sheet. See Note 8—Investments in Special Purpose Vehicles for additional information.

I. 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. 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 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 for government-wide operations. In addition, the investments in the GSEs will increase, based on the quarterly earnings of the GSEs, up to the adjusted capital reserve amounts set for each GSE.

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 which are accrued when declared.

The potential liabilities to the GSEs, if any, are assessed annually and recorded at the gross estimated amount. For additional information on investments in GSEs, refer to Note 9—Investments in Government-Sponsored Enterprises.

J. Federal Debt and Interest Payable

Treasury securities are debt instruments issued to raise money needed to operate the federal government and pay off maturing obligations. Treasury issues these debt instruments to the public in the form of marketable bills, notes, bonds, TIPS and FRNs, and in the form of non-marketable securities including Government Account Series securities, U.S. Savings Securities, and State and Local Government Series securities. The amount of the debt, or principal, is also called the security's face value or par value. To accurately reflect the federal debt, Treasury records principal transactions with the public at par value at the time of the transaction. 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 (term greater than one year) and the straight-line method for short-term securities (term of one year or less). In addition, the principal for TIPS is adjusted daily based on the Consumer Price Index for all Urban Consumers. Certain Treasury securities also pay interest. For marketable securities, Treasury issues notes and bonds that pay semi-annual interest based on the security's stated interest rate, while FRNs, which have interest rates that are indexed to the highest accepted discount rate of the most recent Treasury 13-week bill auction, pay interest quarterly based on the interest rate at the time of payment. TIPS, on the other hand, pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal. However, for all security types accrued interest is recorded as an expense when incurred, instead of when paid. See Note 12—Federal Debt and Interest Payable for additional information.

K. 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, education and training benefits, post-retirement health benefits, and life insurance benefits, are recorded at estimated PV of future benefits, less any estimated PV of future normal cost contributions. Normal cost is the portion of the actuarial PV 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 pension program for veterans is not accounted for as a "federal employee pension plan" under SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, due to differences between its eligibility conditions and those of federal employee pensions. Therefore, a future liability for pension benefits is not recorded. These benefits are recognized as expenses when benefits are paid rather than when employee services are rendered.

The actuarial liability for FECA benefits is recorded at estimated PV 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, ORB, and 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 13—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 PV estimates of federal employee pension, ORB, and OPEB liabilities. See Note 13—Federal Employee and Veteran Benefits Payable for additional information.

L. 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. See Note 14—Environmental and Disposal Liabilities for additional information.

M. Insurance and Guarantee Program Liabilities

Insurance programs 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 adverse event. Certain consolidation entities with significant insurance and guarantee programs (i.e., PBGC, FDIC and FCSIC) apply FASB standards, and are not converted to FASAB standards in consolidation, as permitted by SFFAS No. 47.

PBGC recognizes a single-employer program liability for probable plan terminations, which represents PBGC's best estimate of the losses, net of plan assets, and the PV of expected recoveries (from sponsors and members of their controlled group) for plans that are likely to terminate in the future. PBGC recognizes a multi-employer program liability for future financial assistance to insolvent plans and to plans deemed probable to becoming insolvent.

FDIC records a liability for FDIC-insured institutions that are likely to fail when the liability is probable and reasonably estimable, absent some favorable event such as obtaining additional capital or merging. The FDIC liability is derived by applying expected failure rates and loss rates to the institutions based on supervisory ratings, balance sheet characteristics, and projected capital levels.

PBGC's exposure to losses from plan terminations and FDIC's exposure to losses from insured institutions that are classified as reasonably possible are disclosed in Note 20—Contingencies.

All other insurance and guarantee programs are accounted for in the consolidated financial statements in accordance with SFFAS No. 51, *Insurance Programs.*

Programs that administer direct loans and loan guarantees, qualify as social insurance, are authorized to engage in disaster relief activities, provide grants, provide benefits or assistance based on an individual's or a household income and/or assets, assume the risk of loss arising from federal government operations, pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal entity, indemnify contractors, agreement partners, and other third parties for loss or damage incurred while or caused by work performed for a federal entity, or are workers' or occupational illness compensation programs that compensate current or former employees (or survivors) and certain third parties for injuries and occupational diseases obtained while working for a federal entity are excluded from insurance programs.

There are three categories of insurance programs: 1) exchange transaction insurance programs other than life insurance; 2) non-exchange transaction insurance programs; and 3) life insurance programs.

For exchange transaction insurance programs other than life insurance, revenues are recognized when earned over the insurance arrangement period and liabilities are recognized for unearned premiums, unpaid insurance claims, and for losses on remaining coverage. Losses on remaining coverage represent estimated amounts to be paid to settle claims for the period after year-end through the end of insurance coverage in excess of the summation of unearned premiums and premiums due after the end of the reporting period.

For non-exchange transaction insurance programs, revenue is recognized the same as other non-exchange transaction revenue, no unearned premium liability is recorded and a liability is only recognized for unpaid insurance claims.

For life insurance programs, revenue is recognized when due and liabilities are recognized for unpaid insurance claims and future policy benefits. The liability for future policy benefits represents the expected PV of future claims to be paid to, or on behalf of, existing policyholders, less the expected PV of future net premiums to be collected from those policyholders. Life insurance programs are disclosed in Note 13—Federal Employee and Veteran Benefits Payable. See Note 16—Insurance and Guarantee Program Liabilities for additional information.

N. Deferred Maintenance and Repairs

DM&R 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. DM&R are not expensed in the Statements of Net Cost or accrued as liabilities on the Balance Sheet. However, DM&R 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.

O. Commitments

In the normal course of business, the government has several 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. See Note 19—Commitments, for additional information.

P. 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.

A contingent liability should be disclosed if any of the conditions for liability recognition do not meet the above criteria and there is at least a reasonable possibility that a loss may be incurred. See Note 20—Contingencies for additional information.

Q. 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, see Note 15—Benefits Due and Payable. No liability is recognized for future benefit payments not yet due. For additional information, see Note 23—Social Insurance and the unaudited RSI—Social Insurance section.

R. 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 additional information on funds from dedicated collections, see Note 21—Funds from Dedicated Collections.

S. 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. In FY 2020, a change has been made to the Unmatched Transactions and Balances to include unmatched intra-governmental balances on the Balance Sheet and only include unmatched intra-governmental current year transactions on the Statement of Operations and Changes in Net Position to reconcile the change in net position to ensure beginning and ending 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 net position on the Balance Sheet and Statement of Operations and Changes in Net Position into balance. The primary factors affecting this out of balance situation are:

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

As intra-governmental 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 additional information.

T. Changes in Accounting Principle

A change in accounting principle results from either adopting a new accounting pronouncement or an entity adopting an allowable alternative accounting principle on the basis that is preferable. Generally, as applicable, changes in accounting principle are shown as an adjustment to beginning net position in the Statement of Operations and Changes in Net Position of the period in which the change is implemented.

Adjustments to beginning net position in FY 2020 for changes in accounting principle was $12.5 billion between the Funds from Dedicated Collections and Funds other than those from Dedicated Collections due to Note 21—Funds from Dedicated Collections applying SFFAS No. 43, *Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Earmarked Funds.* SFFAS No. 43 is not a new standard but does allow a reporting methodology change between combined (excluding eliminations between Funds from Dedicated Collections) and consolidated (including eliminations between Funds from Dedicated Collections) when deemed necessary. The reporting methodology was changed from combined in FY 2019 to consolidated in FY 2020. See Note 21—Funds from Dedicated Collections for additional information.

U. Correction of Errors

Correction of errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time financial statements were prepared. When preparing comparative financial statements, if the material error occurred in the prior period presented and the effect is known, then the affected line items of the prior period are restated.

In FY 2019, DOD followed SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principle* and corrected an error that increased its assets and net position by $7.3 billion. For FY 2019, restatements were made that decreased the correction of errors line on the Statement of Operations and Changes in Net Position by $13.5 billion to ($6.2) billion. The unmatched transactions and balances line on the Statement of Operations and Changes in Net Position was adjusted by $1.2 billion to $0.4 billion to remove unmatched amounts reported on the Balance Sheet. On the Balance Sheet a line was added called unmatched transactions and balances in the amount of $14.7 billion.

The following lines were impacted by the restatement: 1) on the Balance Sheet, net position for Funds other than those from Dedicated Collections; total net position; and total liabilities and net position; 2) on the Statement of Operations and Changes in Net Position Funds other than those from Dedicated Collections and Total columns, unmatched transactions and balances, net operating cost, and net position, end of period; 3) on the Reconciliation of Net Operating Cost and Budget Deficit, net operating cost, adjustments to beginning net position, and unmatched transactions and balances; and 4) the Unmatched Transactions and Balances table in Other Information (unaudited).

V. Changes in Presentation

Changes in presentation are done to improve clarity of the presentation of the *Financial Report* and include changes since the prior year that are not the result of correction of errors or changes in accounting principles. The adjustments to beginning net position on the FY 2019 Statement of Operation and Changes in Net Position was broken out between changes in accounting principle and correction of errors to conform to the FY 2020 presentation. Unfunded leave was previously reported in Note 17—Other Liabilities. In FY 2020 unfunded leave is reported in Note 13—Federal Employee and Veteran Benefits Payable. A change in presentation was identified in Note 3—Accounts Receivable, Net to conform to the FY 2020 presentation. Refer to the individual notes for additional information.

W. 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 22—Fiduciary Activities, for additional information.

X. 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 direct loans and loan guarantees receivables, federal employee and veteran benefits payable, securities and investments, investments in SPVs, investments in GSEs, tax receivables, loan guarantees liability, depreciation, 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* loan receivables and loan guarantees are disclosed in Note 4—Direct Loans and Loan Guarantees Receivable, Net and Loan Guarantees Liability.

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.

Estimates are also used to determine the fair value of investments in SPVs and GSEs. The fair value of the SPV preferred equity investments are estimated based on a discounted cash flow valuation methodology, whereby the primary input is the PV of the projected annual cash flows associated with these investments. The value of the GSEs 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 PV of the projected quarterly cash flows to equity holders. 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. For additional information on investments in SPVs and GSEs see Note 8—Investments in Special Purpose Vehicles and Note 9—Investments in Government-Sponsored Enterprises.

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,* and to the government's funding commitment to the GSEs under the SPSPAs. Treasury estimates and records the NPV of this potential liability, if any, based on the probable future occurrence of excess cash flows received above the full recovery of the costs associated with these programs. For additional information on investments in GSEs and the amended SPSPAs, see Note 9—Investments in Government-Sponsored Enterprises.

Y. 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 that engage in financial transactions with foreign countries.

The government also takes on credit risk related to committed, but undisbursed direct loans, CARES Section 4003 COVID-19 credit program receivables, funding commitments to GSEs, CARES Section 4003 Section 13(3) funding provided to CCF, MSF, MLF, TALF, and other activities. Many of these programs were developed or provided credit support to the pandemic emergency relief programs of the Federal Reserve Board, to provide credit where borrowers are not able to get access to credit with reasonable terms and conditions. These programs 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.

Z. Treaties and Other International Agreements

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

- No present or contingent obligation to provide goods, services, or financial support,
- Present obligation to provide goods, services, or financial support, or
- Contingent obligation to provide goods, services, or financial support.

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 create no present or contingent obligations to engage in them. 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, and involve a present obligation, and therefore result in liability recognition. Such present obligation may relate to the U.S. government providing financial and in-kind support, including assessed contributions, voluntary contributions, grants, and other assistance to international organizations in which it participates as a member. 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 additional 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 which result in contingencies that may require recognition or disclosure in the financial statements. Such contingencies may stem from commitments in a treaty or other international agreement to provide goods, services, or financial support when a future event occurs, or from litigation, claims, or assessments forged by other parties to the agreement. For additional information related to treaties and other international agreements that fall under the last category, refer to Note 20—Contingencies.

AA. Public-Private Partnerships

Federal P3s are risk-sharing arrangements or transactions with expected lives greater than five years between public and private sector entities. Such arrangements or transactions provide a service or an asset for government and/or general public use where in addition to the sharing of resources, each party shares in the risks and rewards of said arrangements or transactions. The P3s that are deemed material to the consolidated financial statements and have met the criteria of SFFAS No. 49, *Public-Private Partnerships*, are disclosed. See Note 27—Public-Private Partnerships for additional information.