United States Government Notes to the Financial Statements for the Fiscal Years Ended September 30, 2021, and 2020

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 or disclosure entities. The determination as to whether an organization is a consolidation entity or disclosure entity is 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.

Consolidation entities are organizations that are consolidated in the financial statements. 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.

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 28—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—Investments in Special Purpose Vehicles for additional information on SPVs and Note 28—Disclosure Entities and Related Parties 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 are prepared in accordance with the standards established by FASAB. As permitted by FASAB standards, certain components of the federal government prepare their financial statements following the standards established by FASB. Information from those components is included within the government's consolidated financial statements without conversion to FASAB standards. Intra-governmental transactions are eliminated in consolidation, except as described in the Other Information–Unmatched Transactions and Balances. See Note 1.U—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 and Note 30—COVID-19 Activity in the notes to the financial statements.

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

In FY 2016, the government began implementing the requirements of new standards related to the reporting for inventory and related property, net and general PP&E. These standards are available to each reporting entity once per line item addressed in the standard. 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. 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, 2020 and 2021. 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, 2020 and 2021. DOD has not declared full implementation yet; therefore, this standard continues to be partially implemented each year.

New Standards Issued and Not Yet Implemented

As of September 2021, FASAB has issued the following new standards that are applicable to the *Financial Report*, but are not yet implemented at the government-wide level for FY 2021:

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 No. 54, Leases*, issued in June 2020, defers the effective date of SFFAS No. 54 to FY 2024 and early implementation is not permitted.

In July 2021, FASAB issued SFFAS No. 59, *Accounting and Reporting Government Land*. Per SFFAS No. 59, starting in FY 2026, land and permanent land rights will no longer be capitalized, and the previously capitalized amounts will be removed from the Balance Sheet. Also, starting in FY 2026, SFFAS No. 59 requires certain disclosures in the notes to the financial statements, including estimated acreage of land and permanent land rights and its predominant use. For FY 2022 through FY 2025, such disclosures are required to be presented as RSI. These include:

- Estimated acres of general PP&E land and stewardship land using three predominant use sub-categories:
  - Conservation and preservation land;
  - Operational land; and
  - Commercial use land.
- Estimated acres of land held for disposal or exchange.

C. Accounts Receivable, Net

Accounts receivable 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.

Other 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. See Note 3—Accounts Receivable, Net for additional information.

D. Loans Receivable, Net

Direct loans committed after FY 1991 are recognized as assets at the PV of their estimated net cash inflows. 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.

For direct loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the PV of estimated cash outflows over the life of the loans minus the PV of estimated cash inflows. For the fiscal year during which new direct loans are disbursed, the components of the subsidy expense of those new direct loans 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 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 before FY 1992 are valued under two different methodologies within the government: the allowance-for-loss method and the PV method. Under the allowance-for-loss method, the outstanding principal of direct loans is reduced by an allowance for uncollectible amounts. Under the PV 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. See Note 4—Loans Receivable, Net and Loan Guarantee Liabilities for additional information.

E. Loan Guarantee Liabilities

Loan guarantees committed after FY 1991 are recognized as liabilities at the PV of their estimated net cash outflows. Disclosure is made of the face value of guaranteed loans outstanding, and the amount guaranteed.

For guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the PV of estimated cash outflows over the life of the loans minus the PV of estimated cash inflows. The subsidy cost is reestimated each year 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).

Loan guarantees committed before FY 1992 are valued under two different methodologies within the government: the allowance-for-loss method and the PV method. Under the allowance-for-loss method 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 PV method, the liability for loan guarantees is the PV of expected net cash outflows due to the loan guarantees. See Note 4—Loans Receivable, Net and Loan Guarantee Liabilities for additional information.

F. 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 are valued using either historical cost or a method that reasonably approximates historical cost. Historical cost methods include first-in-first-out, weighted average, and MAC. Historical cost includes all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, are charged to operations of the period. Donated inventory and operating materials and supplies are valued at their FV at the time of donation. Inventory as well as operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) are valued at the FV of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the FV of the asset received is recognized as a gain or a loss.

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, 2021. 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. See Note 5—Inventory and Related Property, Net, for additional information.

G. General Property, Plant, and Equipment, Net

General PP&E consists of tangible assets (e.g., buildings and structures, furniture and fixtures, equipment, and land) 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. General PP&E also includes software, land rights, and assets acquired through capital leases.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment* requires that general PP&E is recorded at cost. Cost includes 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. DOD has partially implemented SFFAS No. 50 by electing to exclude certain land and land rights. For certain DOD components that have implemented SFFAS No. 50, with respect to land and land rights, acreage information is disclosed, and such land and land rights are not included on the Balance Sheet.

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 are capitalized and depreciated or amortized. Depreciation and amortization expense is 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 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 27—Stewardship Property, Plant, and Equipment.

H. Investments

Most 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, *Reporting Entity*. These investments are reported at FV. FV is the estimate of the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions. Market or observable inputs are used as the preferred source of values, followed by assumptions based on hypothetical transactions in absence of market inputs. Certain investments are measured at FV using NAV per share. NAV is the amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. See Note 7—Investments for additional information.

I. 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 FV. 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 the CARES Act, coupled with the CAA and ARP enacted in FY 2021. 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 FV.

The valuation to estimate the investment's FV 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.

J. 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 FV. 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 liquidation preference of investment in the GSEs' senior preferred stock, with a corresponding decrease to cash held by Treasury for government-wide operations. In addition, the liquidation preference of 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 FV 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.

K. Federal Debt and Interest Payable

Federal debt is primarily comprised of Treasury securities, which are debt instruments issued to the public 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 nonmarketable 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 13—Federal Debt and Interest Payable for additional information.

L. 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.

In accordance with 38 CFR § 17.36(c), the VA makes an annual enrollment decision that identifies which veterans, by priority, will be treated for that fiscal year based on funds appropriated, estimated collections, usage, the severity index of enrolled veterans, and changes in cost. While VA expects to continue to provide medical care to veterans in future years, an estimate of this amount cannot be reasonably made. These medical care expenses are recognized in the period the medical care services are provided.

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 14—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 14—Federal Employee and Veteran Benefits Payable for additional information.

M. 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 15—Environmental and Disposal Liabilities for additional information.

N. Benefits Due and Payable

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. See Note 16—Benefits Due and Payable for additional information.

O. 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 trusteed, terminated and probable plan terminations. The liability is 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 multiemployer 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 22—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 14—Federal Employee and Veteran Benefits Payable. See Note 17—Insurance and Guarantee Program Liabilities for additional information.

P. 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.

Q. Commitments

Commitments reflect binding agreements that may result in the future expenditure of financial resources that are not recognized or not fully recognized on the Balance Sheet and should be disclosed. Commitments may include, for example, certain long-term leases, undelivered orders, P3s, international or other agreements in support of international economic development, or agreements in support of financial market stability. See Note 21—Commitments for additional information.

R. 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 is 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 22—Contingencies for additional information.

S. 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.

Funds from dedicated collections on the Statement of Operations and Changes in Net Position are presented on the consolidated basis. The consolidated dedicated collections presentation eliminates balances and transactions between funds from dedicated collections held by the entity. For additional information on funds from dedicated collections, see Note 23—Funds from Dedicated Collections.

T. 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 25—Social Insurance and 26—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.

SOSI and SCSIA are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions and expectations of future conditions. Actual results could differ materially from the estimated amounts. Each statement includes information to assist in understanding the effect of changes in assumptions to the related information.

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 statements. 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.

U. 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 includes unmatched intra-governmental balances on the Balance Sheet and includes 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. Unresolved intra-governmental differences (i.e., unmatched transactions and balances) result in errors in the consolidated financial statements. The ultimate effect on the accrual-based financial statements of resolving and correcting these differences has not been fully determined and could be material.

The unmatched transactions and balances are needed to balance the accrual-based financial statements. The Statement of Operations and Changes in Net Position and the Balance Sheet include specific lines for the unmatched transactions and balances, while the unmatched transactions and balances are recorded in existing lines in the Statement of Net Cost. 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.

---

[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.

V. 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 2021 for changes in accounting principle was $0.7 billion, mostly due to DOD's continued 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*.

Also, in FY 2021 CAA required VA to record obligations for hospital care or medical services furnished at non-VA facilities at the time of approval. VA accounted for this new authority as a retrospective change that is analogous to a change in accounting principle by adjusting FY 2020 amounts on the Balance Sheet and other financial statements. These restatements impacted the liabilities, costs, and net position of the government and are reflected on the following statements: 1) on the Balance Sheet, accounts payable, federal employee and veteran benefits payable, and net position for funds other than those from dedicated collections; 2) on the Statement of Net Cost, gross cost; 3) on the Statement of Operations and Changes in Net Position, funds other than those from dedicated collections and the total columns, net cost, and net position end of period; and 4) on the Reconciliation of Net Operating Cost and Budget Deficit, net operating cost, federal employee and veteran benefits payable, and accounts payable. In total, the government's reported FY 2020 net cost increased by $0.2 billion and FY 2020 net position decreased by $0.1 billion as a result of VA's retrospective changes. Refer also to the Note 12—Accounts Payable and Note 14—Federal Employee and Veteran Benefits Payable.

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 23—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 23—Funds from Dedicated Collections for additional information.

W. 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.

DOD followed SFFAS No. 21, *Reporting Corrections of Errors and Changes in Accounting Principle* and corrected FY 2020 errors identified as part of a department-wide effort to improve financial reporting. These corrections resulted in restatements of amounts in the consolidated financial statements, including a correction of error of $6.0 billion on the FY 2020 Statement of Operations and Changes in Net Position. These restatements are reflected on the following statements: 1) on the Balance Sheet; 2) on the Statement of Net Cost, gross cost; 3) on the Statement of Operations and Changes in Net Position, funds other than those from dedicated collections and the total columns, net cost, unmatched transactions and balances, correction of errors, and net position end of period; and 4) on the Reconciliation of Net Operating Cost and Budget Deficit, net operating cost acquisition of capital assets, investments, inventory and related property, net, adjustment to beginning net position, and all other reconciling items. In total, the government's reported FY 2020 net cost increased by $0.8 billion and FY 2020 net position increased by $4.9 billion. Refer also to Note 5—Inventory and Related Property, Net, Note 6—General Property, Plant, and Equipment, Net, Note 7—Investments, and Unmatched Transactions and Balances in Other Information (unaudited).

For FY 2020, a restatement was made that decreased the other commitments for U.S. participation in the IMF reported in Note 21—Commitments. Refer to the individual note for additional information.

X. 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. In FY 2021, the Statement of Operations and Changes in Net Position broke out the Unmatched transactions and balances from Net operating (cost)/revenue line and is presented as a standalone line in the net position section. Also, in FY 2021 the Balance Sheet was modified to present additional items separately including advances and prepayments, other deferred revenue, and liability for advances and prepayments, which were previously reported in Note 11—Other Assets and Note 19—Other Liabilities. Advances and prepayments is now reported in Note 10—Advances and Prepayments, other deferred revenue and liability for advances and prepayments are reported in Note 18—Advances from Others and Deferred Revenue, and the corresponding changes to Reconciliation of Net Operating Cost and Budget Deficit Statement. Further breakout of the all other reconciling items for allocations of special drawing rights was included in the Reconciliation of Net Operating Cost and Budget Deficit Statement. Statements of Changes in Cash Balance and Budget and Other Activities enhanced the presentation by breaking out special purpose vehicle disbursements, repayments of special purpose vehicle investments, and allocations of special drawing rights. In addition, refer to the following individual notes and other information for separate changes in presentation; Note 5—Inventory and Related Property, Net, Note 7—Investments, Note 20—Collections and Refunds of Federal Revenue, and Unmatched Transactions and Balances in Other Information (unaudited). The FY 2020 presentation was modified to conform to the FY 2021 presentation. Refer to the individual notes and Other Information (unaudited) for additional information.

Y. 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 24—Fiduciary Activities, for additional information.

Z. 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 receivable, net, federal employee and veteran benefits payable, investments, investments in SPVs, investments in GSEs, tax receivables, loan guarantee liabilities, 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—Loans Receivable, Net and Loan Guarantee Liabilities.

Estimates are also used to determine the FV of investments in SPVs and GSEs. The FV of the SPV preferred equity investments is 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 FV 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 FV 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 FV of the GSEs' other equity instruments are then deducted from its total equity, with the remainder representing the FV of the senior preferred stock.

Factors impacting the FV of the GSE warrants include the nominal exercise price and the large number of potential exercise shares, the market trading of the common stock that underlies the warrants as of September 30, the principal market, and the market participants. Other factors impacting the FV include, the holding period risk related directly to the assumption of the amount of time that it will take to sell the exercised shares without depressing the market. 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. For additional information on investments in GSEs and the amended SPSPAs, see Note 9—Investments in Government-Sponsored Enterprises.

AA. 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 Act Section 4003 COVID-19 credit program receivables, funding commitments to GSEs, CARES Act 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 FV measurements.

AB. 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 21—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 22—Contingencies.

AC. 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 29—Public-Private Partnerships for additional information.