



Federal Accounting Standards Advisory Board

August 15, 2018

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne
Through: Wendy M. Payne, Executive Director

Subj: **Draft Interpretation- Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5 - Tab A¹**

MEMBER ACTIONS REQUESTED:

- Respond to staff question (p.3) by August 24th
- Prepare to approve staff recommendation or provide alternatives

MEETING OBJECTIVES

The objective of this session is to consider the updated draft Interpretation, *Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*.

BRIEFING MATERIAL

The staff analysis is attached along with a question for the Board on page 3. You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>.

Attachment A- Staff Analysis

Attachment B- Draft Interpretation- Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5- MARKED VERSION

Attachment C- Draft Interpretation- Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5- CLEAN

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

At the June 2018 Board meeting, members agreed with staff's recommendation to prepare an Interpretation to provide clarification and guidance regarding contingent liabilities and cleanup costs when multiple component reporting entities are involved. Staff provided a first draft of an Interpretation on July 27, 2018 for member comments. Member comments were incorporated into this version for the August Board meeting.

NEXT STEPS

The next steps will depend on the comments received on the updated draft interpretation. Although we do not anticipate a ballot at the August meeting, a pre-ballot draft would follow the August meeting and a ballot would be expected at the October meeting.

MEMBER FEEDBACK

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at batchelorm@fasab.gov with a cc to paynew@fasab.gov.

Attachment A- Staff Analysis

As noted, at the June 2018 Board meeting, members agreed with staff's recommendation to prepare an Interpretation to provide clarification and guidance regarding contingent liabilities and cleanup costs when multiple component reporting entities are involved.

Staff provided a first draft of an Interpretation on July 27, 2018 for member comments. Staff received comments from 5 members. Members were in agreement with the overall interpretation but offered areas for improvement, clarification and streamlining. Member comments were incorporated in the version provided for the August Board meeting.

Because there weren't major technical issues identified, staff believes the document will be ready to move to pre-ballot after the August meeting. Further, it should be ready to ballot at the October meeting. While it may be possible to ballot sooner, the Board should remain cognizant of the timing and the audit timeframes in the federal financial management community for participation in due process.

STAFF RECOMMENDATION & QUESTIONS FOR THE BOARD:

Staff recommends moving to a pre-ballot draft after the August meeting. Therefore, members should ensure all technical matters have been brought up for discussion by the close of the August meeting. Staff also requests that editorial comments and suggestions be forwarded so they may be included in the pre-ballot.

Does the Board agree with the staff recommendation to move to a pre-ballot draft after the August meeting and ballot draft for the October meeting?

Alternatively, if members disagree, what alternatives do you prefer?



Federal Accounting Standards Advisory Board

[Attachment A- Marked Version](#)

GUIDANCE ON IDENTIFIED
LIABILITIES INVOLVING MULTIPLE
COMPONENT REPORTING ENTITIES:
AN INTERPRETATION OF SFFAS 5

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Interpretation of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by [date 90 days after issuance]

October XX, 2018

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- [Memorandum of Understanding](#) among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- [Mission statement](#)
- [Documents for comment](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

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Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) requests your comments on the exposure draft of a proposed Interpretation, entitled *Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*. Specific questions for your consideration appear on page 6, but you are welcome to comment on any aspect of this proposal. If you do not agree with specific matters or proposals, your responses will be most helpful to the Board if you explain the reasons for your positions and any alternatives you propose. Responses are requested by **DUE DATE**.

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All comments received by FASAB are considered public information. Those comments may be posted to [FASAB's website](#) and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Please provide your comments by email to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax comments to 202-512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at 202-512-7350 to determine if your comments were received.

FASAB's rules of procedure provide that the Board may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. FASAB will publish notice of the date and location of any public hearing on this document in the Federal Register and in its newsletter.

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Sincerely,

D. Scott Showalter
Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

With the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 47, Reporting Entity, SFFAS 55, Amending Inter-entity Cost Provisions, and Technical Bulletin 2017-2, Assigning Assets to Component Reporting Entities, there is a need for additional guidance to assist in the application of identified general liability standards and principles at the component reporting entity level.

This Interpretation is intended to provide clarification and guidance regarding contingent liabilities and cleanup costs when multiple component reporting entities are involved. Specifically, this Interpretation would provide guidance regarding cleanup cost liabilities where the component reporting entity responsible for reporting the asset is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that asset. This Interpretation would also provide clarification for contingent liabilities where a single component reporting entity within a department is designated to manage litigation and settle any resulting liabilities on behalf of all departmental components.

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HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This proposal would facilitate reporting by related component reporting entities so that reporting is better aligned with their operations. Given the complex responsibilities and relationships among the components of large departments, this proposal would result in less costly financial reporting by aligning reporting with established funding and governance structures. This proposal would also reduce the barriers to and cost of adopting generally accepted accounting principles.

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MATERIALITY

The provisions of this Interpretation need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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QUESTIONS FOR RESPONDENTS

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) encourages you to become familiar with all proposals in the Interpretation before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Interpretation. Because FASAB may modify the proposals before a final Interpretation is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have regarding implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at <http://www.fasab.gov/documents-for-comment/>. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

All responses are requested by **[insert date]**.

Q1. The proposed Interpretation provides additional guidance regarding contingent liabilities when multiple component reporting entities are involved. Specifically, component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all components within the department. The same or a different component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved sub-components would have the information needed to apply the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 5, Accounting for Liabilities of the Federal Government. Generally, the sub-component responsible for managing litigation would have the information needed to recognize contingent liabilities and should report information in accordance with SFFAS 5. Other involved sub-components would not have the information needed to recognize contingent liabilities and should not report information on contingent liabilities managed by another sub-component. The component reporting entity designated to manage litigation should report information on contingent liabilities consistent with SFFAS 5. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation.

a. Do you agree or disagree with the guidance? Please provide the rationale for your answer.

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b. Alternatively, do you believe the sub-component whose actions gave rise to the litigation also should be permitted to report the information in accordance with SFFAS 5 if it has the information needed to do so? Please provide the rationale for your answer.

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Q2. The proposed Interpretation provides additional guidance regarding cleanup costs when multiple component reporting entities are involved. Specifically, for purposes of meeting the SFFAS 5 liability recognition criteria that “a future outflow or other sacrifice of resources is probable,” the criteria should be considered met by the component reporting entity that recognizes the general property, plant, and equipment (PP&E) during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup.

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Do you agree or disagree with the guidance? Please provide the rationale for your answer.

Q3. **Do you have any other comments or suggestions on the Interpretation? Please include if you believe there are additional areas that should be addressed. Please provide the rationale for your answer.**

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INTRODUCTION¶

<object>BACKGROUND¶

<#>Federal component reporting entities requested clarification about the recognition and measurement standards related to contingent liabilities and cleanup costs when multiple component reporting entities are involved. The recognition and measurement standards are provided in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* and SFFAS 6, *Accounting for Property, Plant and Equipment*, as amended. ¶

<#>Entities requested guidance regarding clean-up cost liabilities where the component reporting entity responsible for reporting the asset is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that asset. Also, entities requested clarification for contingent liabilities where a single component reporting entity within a department is designated to manage litigation and settle any resulting liabilities on behalf of all departmental components. ¶

¶
<object>PURPOSE¶

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<#>The purpose of this Interpretation is to provide clarification and guidance regarding contingent liabilities and cleanup costs when multiple component reporting entities are involved.¶

<#>¶

<object>MATERIALITY ¶

<#>The provisions of this Interpretation need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.¶

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PROPOSED INTERPRETATION

SCOPE

1. This Interpretation applies when a component reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

INTERPRETATION

General Principles for Component Reporting Entities

2. SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 19 states “A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”

3. **Paragraphs 56-57 of SFFAS 47, *Reporting Entity***, provide that component reporting entities’ GPFFRs must include all consolidation and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities.

56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity^{25 [footnote omitted]} and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

57. A component reporting entity’s GPFFR should include all organizations that would allow the users to hold the component reporting entity’s management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities^{26 [footnote omitted]} and disclosure entities administratively assigned to it.

4. SFFAS 47, paragraph 10 defines component reporting entity as follows:

Component Reporting Entity—“Component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity.⁷ Examples of component reporting entities include organizations such as executive departments, independent agencies,

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government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

^{FN7} The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

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5. In light of SFFAS 5 and SFFAS 47, the following general principles apply for component reporting entities:

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- a. Liabilities generally should be reported by the component reporting entity having the probable future outflow.
- b. Liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

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Guidance on Contingent Liabilities

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6. SFFAS 5, paragraph 38 states that a contingent liability should be recognized when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable.

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7. As noted above, liabilities generally should be reported by the component reporting entity having the probable future outflow, and all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

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8. To recognize and disclose contingent liabilities in accordance with SFFAS 5, as amended, a component reporting entity must have information about ongoing litigation and be able to exercise judgment regarding the possible outcomes. Where a single component reporting entity is the defendant in a case, that entity should have the needed information even in the event any ultimate claim will be settled by the Treasury Judgment Fund. Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*, provides guidance regarding recognition in such cases.

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9. In other cases, sub-component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all sub-components within the department. The same or a different sub-component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved sub-components would have the information needed to apply the provisions of SFFAS 5. Generally, the sub-component responsible for managing litigation would have the information needed to recognize contingent liabilities and should report information in accordance with SFFAS 5. **Other involved sub-components would not have the information needed to recognize contingent liabilities and should not report information on contingent liabilities managed by another sub-component.**

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10. For example, a sub-component reporting entity may be responsible for managing litigation for an entire geographic region even though the litigation may be due to the actions of other

sub-component reporting entities. The sub-component reporting entity designated to manage litigation should recognize any resulting contingent liabilities. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation.

11. If a sub-component is designated to settle claims but not to manage litigation, the general provisions of Interpretation 2 should be applied. ~~Once the claim is either settled or a court judgment is assessed and a specific sub-component is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the sub-component that managed the litigation and recognized by the sub-component that will pay the claim.~~

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Guidance on Cleanup Costs

12. SFFAS 5, paragraph 19 defines a liability as “a probable future outflow or other sacrifice of resources as a result of past transactions or events.”

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13. Paragraph 91 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, as amended, provides guidance regarding cleanup costs.² Cleanup costs are subject to the criteria for recognition of liabilities included in SFFAS 5. Paragraph 91 explains that liabilities should be recognized when three conditions are met:

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- a. A past transaction or event has occurred.
- b. A future outflow or other sacrifice of resources is probable.
- c. The future outflow or sacrifice of resources is measurable.

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14. SFFAS 6 ties the recognition of cleanup costs to the related general property, plant, and equipment (PP&E). Paragraph 94 provides for the estimation of cleanup costs when the associated general P&E is placed in service. Paragraph 97 provides for the recognition of a portion of the estimated total cleanup costs as an expense during each period that the general PP&E is in operation. SFFAS 6 guidance presumes the cleanup cost and the associated general PP&E would be recognized by the same component reporting entity.

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15. Some component reporting entities settle liabilities by transferring general PP&E to another component reporting entity designated by law, or administratively to settle the liabilities. Therefore, a component reporting entity that is responsible for financially reporting general PP&E may differ from the component reporting entity that will eventually be responsible for the environmental remediation upon disposal of that general PP&E. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources required to settle the liability for cleanup costs. Instead, the component reporting entity receiving the asset upon its removal from service will be responsible for settling the cleanup cost liability.

² SFFAS 5 applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or where cleanup is an ongoing part of operations.

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16. Situations where multiple component reporting entities have distinct responsibilities regarding reporting of the general PP&E and related cleanup cost may extend over several reporting periods. In such cases, information needed to monitor and update cleanup cost liabilities would be more readily available to the component reporting the related general PP&E. Such component reporting entities will settle the cleanup cost liability by transferring the general PP&E for cleanup. Until such time, the component reporting entity recognizing the general PP&E also should recognize the liability. Once the specific general PP&E is transferred, the liability is transferred.

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17. The SFFAS 5 liability recognition criterion that "a future outflow or other sacrifice of resources is probable" should be considered met by the component reporting entity that recognizes the general PP&E during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup. At that time, the general PP&E and the liability should be de-recognized by the component reporting entity that recognized them during the general PP&E's useful life and recognized by the component reporting entity that will liquidate the liability. De-recognition and recognition of the general PP&E and liability should be in accordance with existing standards.

EFFECTIVE DATE

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18. The requirements of this Interpretation are effective for reporting periods beginning after September 30, 2019. Early implementation is permitted.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Interpretation. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Interpretation—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

BACKGROUND

- A1. The Federal Accounting Standards Advisory Board (FASAB ~~or "the Board"~~) was asked for guidance regarding accounting for liabilities at the component reporting entity level. Specifically, clarifications were requested about the recognition and measurement standards related to contingent liabilities and cleanup costs. The recognition and measurement standards are provided in ~~SFFAS 5~~ and ~~SFFAS 6~~, as amended.
- A2. With the issuance of recent pronouncements, ~~SFFAS 47~~, ~~SFFAS 55~~, *Amending Inter-Entity Cost Provisions*, and ~~Technical Bulletin (TB) 2017-2~~, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of the general liability standards and principles. This is especially needed when multiple component reporting entities are involved.
- A3. For example, with the issuance of ~~SFFAS 55~~, ~~SFFAS 30~~, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*, and Interpretation 6 *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, ~~are~~ rescinded; therefore, the requirement to impute costs for these activities will be eliminated. Further, the Board's intent with ~~TB 2017-2~~ was to provide flexibility with asset assignment. ~~SFFAS 47~~ recognized the extremely complex organization structure of the federal government and provided a basis for understanding the component reporting entities (and sub-components) within the federal government.
- A4. Entities requested guidance regarding ~~cleanup cost liabilities~~ where the component reporting entity responsible for reporting the general PP&E is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that general PP&E. Also, entities requested clarification for contingent liabilities where a single component reporting entity within a department is designated to manage litigation and settle any resulting liabilities on behalf of all departmental components.
- A5. These types of examples and the issuance of the new pronouncements warrant guidance about how the general liability standards and ~~principles~~ should be applied. Without

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additional guidance, these situations may lead to inconsistent application of the liability standards and principles.

General Principles for Component Reporting Entities

A6. Paragraphs 56-57 of SFFAS 47 provide that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities. SFFAS 47 also provides the definition for component reporting entity.

A7. Considering SFFAS 47 in conjunction with SFFAS 5, the Interpretation provides general principles that apply for component reporting entities

Guidance on Contingent Liabilities

A8. FASAB issued TB 2002-1, *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government*, in 2002 to provide guidance when one or more federal entities are involved in litigation. It also provided guidance for legal claims related to defunct federal entities (that is, entities that no longer exist) because preparers asked that liabilities be recognized at only at the government-wide level. TB 2002-1 (which is considered a staff-level document in the GAAP hierarchy) established two main points:

- a. All liabilities should first be recognized at the component reporting entity level. (The principle provided in this Interpretation is consistent with this principle in TB 2002-1.)
- b. All liabilities and costs must be attributed to the component reporting entities responsible for the programs or activities that contributed to the claims or to their successor component reporting entities. (The basis for assigning such costs and liabilities was derived from SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.)

A9. As noted, this Interpretation is consistent with the principle established in TB 2002-1 that every liability should first be recognized at the component reporting entity level; however, conclusions and other language in TB 2002-1 may be considered inconsistent with current GAAP based on the following:

- a. Inconsistencies with terminology and language as presented in SFFAS 47 and TB 2002-1.
- b. SFFAS 4, as amended by SFFAS 55, addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget (OMB).

A10. Because of these changes, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation.

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<#>Liabilities generally should be reported by the component reporting entity having the probable future outflow.¶
<#>Liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.¶
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A11. ~~Although not all inter-entity costs are recognized by the receiving entity, relationships creating inter-entity costs exist and often involve multiple component reporting entities.~~ As noted above, SFFAS 5 provides that liabilities should be reported by the component reporting entity that will liquidate the liability (that is, has a probable future outflow). GAAP also provides that all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

A12. To recognize and disclose contingent liabilities in accordance with SFFAS 5, as amended, a component reporting entity must have information about ongoing litigation and exercise judgment regarding the possible outcomes. ~~Component reporting entities designated to settle certain liabilities of other federal entities may not have the information needed to determine whether a future outflow is probable and measurable until component reporting entities more directly involved communicate certain determinations to them.~~

A13. Where a single component reporting entity is the defendant in a case, that entity should have the needed information even in the event any ultimate claim will be settled by the Treasury Judgment Fund. The entity involved in the case should recognize a contingent liability until amounts to be settled by the Treasury Judgment Fund are decided. The Treasury Judgment Fund pays the claims after litigation is settled and is not a party to litigation before it is settled and the cost of each claim relates to another entity's operations. This is consistent with Interpretation 2.

A14. In other cases, component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all components within the department. The same or a different component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved components would have the information needed to apply the provisions of SFFAS 5.

A15. When such designations of responsibility for managing litigation and settling claims are made within a component reporting entity (such as a department) having multiple sub-component reporting entities, the sub-component that manages litigation is responsible for reporting information in accordance with SFFAS 5. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation because doing so would unnecessarily complicate consolidation processes and potentially create inconsistent practices.

A16. For example, if a Department assigns responsibility for adjudicating overseas claims in a given country to a single component reporting entity, the component reporting entity adjudicates claims for all the component reporting entities in that country. The ongoing practice has been that the component reporting entity assigned responsibility for adjudicating claims in a given country pays for the claims, even those claims due to the actions of another component reporting entity. The adjudicating component reporting entity does not seek reimbursement for claims paid on behalf of other component reporting entities. Likewise, the component reporting entity on whose behalf the claim is adjudicated does not recognize an imputed cost. ~~Clarity regarding which entity should report the liability will ensure the same liability is not recognized twice and that it is recognized in a consistent manner by the components of larger reporting entities.~~

Guidance on Cleanup Costs

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A17. SFFAS 6, as amended, provides guidance for recognizing liabilities for cleanup costs, and SFFAS 5 provides guidance for recognizing liabilities from government-related events such as cleanup of environmental damage. FASAB has provided guidance in this area through several technical releases, but additional guidance is necessary in light of recent pronouncements.

A18. Challenging issues in the application of general standards exist for large, complex departments, such as the Department of Defense, that have numerous components and sub-components. For example, assets may be owned by one component reporting entity, but used or funded by another component reporting entity, and the component reporting entity using the asset may not be the component reporting entity responsible for disposal. Given the complex responsibilities and relationships among the components of large departments, the second condition of paragraph 91 in SFFAS 6 is resulting in inconsistent application of the standards. The condition requires that "a future outflow or other sacrifice of resources is probable."

A19. Additionally, SFFAS 4, as amended, addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required³ with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Further, TB 2017-2 provided flexibility so that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. These new pronouncements provide additional flexibility when considered in conjunction with SFFAS 5 and SFFAS 6.

A20. Some general PP&E requiring cleanup is transferred to another component reporting entity after being removed from service. An example would be a military service responsible for financially reporting the general PP&E that will eventually be transferred to the Defense Logistics Agency for environmental remediation. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources to settle the liability for cleanup costs. Instead, the component reporting entity receiving the general PP&E upon its removal from service has or assumes that responsibility.

A21. For purposes of meeting the liability definition of cleanup costs at the component reporting entity level (where multiple sub-components have distinct responsibilities for general PP&E and for settling the related liability), the condition to determine whether "a future outflow or other sacrifice of resources is probable" could be considered met as long as the liability is reported with the general PP&E until the general PP&E is removed, contained, or disposed of. At that time, the liability would be transferred with the related general PP&E to the component reporting entity responsible for the liability.

A22. A general illustration of the entry to recognize the liability for the cleanup cost follows.

The entity using the general PP&E would recognize the cost as the liability is recorded, just as SFFAS 6 provides for.

³ SFFAS 55 provides for the continued recognition of significant inter-entity costs by business-type activities. Non business-type activities may elect to recognize other imputed costs.

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DR. Expense
CR. Liability

The liability (and related general PP&E) is transferred to the component reporting entity responsible for the liability.

DR. Liability
CR. Imputed Financing Source

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Other

A23. As noted above, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation. Because the guidance regarding the application of the general liability standards has been provided through other pronouncements, such as technical bulletins and technical releases, additional documents may require updating to ensure conformance and consistency with current GAAP. Therefore, necessary updates will be made to identified documents. Those updates are considered exclusive of the liability issue presented within this Interpretation. Further, those changes or updates must be made in separate GAAP documents to ensure the appropriate level of guidance within the GAAP hierarchy results.

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APPENDIX ~~B~~: ABBREVIATIONS

FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFFR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin

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Federal Accounting Standards Advisory Board

ATTACHMENT B- CLEAN VERSION

GUIDANCE ON IDENTIFIED LIABILITIES INVOLVING MULTIPLE COMPONENT REPORTING ENTITIES:

AN INTERPRETATION OF SFFAS 5

Interpretation of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by [date 90 days after issuance]

October XX, 2018

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- [Memorandum of Understanding](#) among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board
- [Mission statement](#)
- [Documents for comment](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

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Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) requests your comments on the exposure draft of a proposed Interpretation, entitled *Guidance on Identified Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*. Specific questions for your consideration appear on page 6, but you are welcome to comment on any aspect of this proposal. If you do not agree with specific matters or proposals, your responses will be most helpful to the Board if you explain the reasons for your positions and any alternatives you propose. Responses are requested by **DUE DATE**.

All comments received by FASAB are considered public information. Those comments may be posted to [FASAB's website](#) and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Please provide your comments by email to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax comments to 202-512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at 202-512-7350 to determine if your comments were received.

FASAB's rules of procedure provide that the Board may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. FASAB will publish notice of the date and location of any public hearing on this document in the Federal Register and in its newsletter.

Sincerely,

D. Scott Showalter
Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

With the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*, SFFAS 55, *Amending Inter-entity Cost Provisions*, and Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of identified general liability standards and principles at the component reporting entity level.

This Interpretation is intended to provide clarification and guidance regarding contingent liabilities and cleanup costs when multiple component reporting entities are involved. Specifically, this Interpretation would provide guidance regarding cleanup cost liabilities where the component reporting entity responsible for reporting the asset is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that asset. This Interpretation would also provide clarification for contingent liabilities where a single component reporting entity within a department is designated to manage litigation and settle any resulting liabilities on behalf of all departmental components.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This proposal would facilitate reporting by related component reporting entities so that reporting is better aligned with their operations. Given the complex responsibilities and relationships among the components of large departments, this proposal would result in less costly financial reporting by aligning reporting with established funding and governance structures. This proposal would also reduce the barriers to and cost of adopting generally accepted accounting principles.

MATERIALITY

The provisions of this Interpretation need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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QUESTIONS FOR RESPONDENTS

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) encourages you to become familiar with all proposals in the Interpretation before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Interpretation. Because FASAB may modify the proposals before a final Interpretation is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have regarding implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at <http://www.fasab.gov/documents-for-comment/>. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

All responses are requested by **[insert date]**.

Q1. The proposed Interpretation provides additional guidance regarding contingent liabilities when multiple component reporting entities are involved. Specifically, component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all components within the department. The same or a different component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved sub-components would have the information needed to apply the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*. Generally, the sub-component responsible for managing litigation would have the information needed to recognize contingent liabilities and should report information in accordance with SFFAS 5. Other involved sub-components would not have the information needed to recognize contingent liabilities and should not report information on contingent liabilities managed by another sub-component. The component reporting entity designated to manage litigation should report information on contingent liabilities consistent with SFFAS 5. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation.

a. Do you agree or disagree with the guidance? Please provide the rationale for your answer.

b. Alternatively, do you believe the sub-component whose actions gave rise to the litigation also should be permitted to report the information in accordance with SFFAS 5 if it has the information needed to do so? Please provide the rationale for your answer.

Q2. The proposed Interpretation provides additional guidance regarding cleanup costs when multiple component reporting entities are involved. Specifically, for purposes of meeting the SFFAS 5 liability recognition criteria that “a future outflow or other sacrifice of resources is probable,” the criteria should be considered met by the component reporting entity that recognizes the general property, plant, and equipment (PP&E) during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup.

Do you agree or disagree with the guidance? Please provide the rationale for your answer.

Q3. **Do you have any other comments or suggestions on the Interpretation? Please include if you believe there are additional areas that should be addressed. Please provide the rationale for your answer.**

PROPOSED INTERPRETATION

SCOPE

1. This Interpretation applies when a component reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

INTERPRETATION

General Principles for Component Reporting Entities

2. SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 19 states “A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”
3. Paragraphs 56-57 of SFFAS 47, *Reporting Entity*, provide that component reporting entities’ GPFFRs must include all consolidation and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities.

56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity^{25 [footnote omitted]} and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

57. A component reporting entity’s GPFFR should include all organizations that would allow the users to hold the component reporting entity’s management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities^{26 [footnote omitted]} and disclosure entities administratively assigned to it.

4. SFFAS 47, paragraph 10 defines component reporting entity as follows:

Component Reporting Entity—“Component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity.⁷ Examples of component reporting entities include organizations such as executive departments, independent agencies,

government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

^{FN7} The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

5. In light of SFFAS 5 and SFFAS 47, the following general principles apply for component reporting entities:
 - a. Liabilities generally should be reported by the component reporting entity having the probable future outflow.
 - b. Liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

Guidance on Contingent Liabilities

6. SFFAS 5, paragraph 38 states that a contingent liability should be recognized when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable.
7. As noted above, liabilities generally should be reported by the component reporting entity having the probable future outflow, and all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.
8. To recognize and disclose contingent liabilities in accordance with SFFAS 5, as amended, a component reporting entity must have information about ongoing litigation and be able to exercise judgment regarding the possible outcomes. Where a single component reporting entity is the defendant in a case, that entity should have the needed information even in the event any ultimate claim will be settled by the Treasury Judgment Fund. Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*, provides guidance regarding recognition in such cases.
9. In other cases, sub-component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all sub-components within the department. The same or a different sub-component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved sub-components would have the information needed to apply the provisions of SFFAS 5. Generally, the sub-component responsible for managing litigation would have the information needed to recognize contingent liabilities and should report information in accordance with SFFAS 5. Other involved sub-components would not have the information needed to recognize contingent liabilities and should not report information on contingent liabilities managed by another sub-component.
10. For example, a sub-component reporting entity may be responsible for managing litigation for an entire geographic region even though the litigation may be due to the actions of other

sub-component reporting entities. The sub-component reporting entity designated to manage litigation should recognize any resulting contingent liabilities. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation.

11. If a sub-component is designated to settle claims but not to manage litigation, the general provisions of Interpretation 2 should be applied. Once the claim is either settled or a court judgment is assessed and a specific sub-component is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the sub-component that managed the litigation and recognized by the sub-component that will pay the claim.

Guidance on Cleanup Costs

12. SFFAS 5, paragraph 19 defines a liability as “a probable future outflow or other sacrifice of resources as a result of past transactions or events.”
13. Paragraph 91 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, as amended, provides guidance regarding cleanup costs.¹ Cleanup costs are subject to the criteria for recognition of liabilities included in SFFAS 5. Paragraph 91 explains that liabilities should be recognized when three conditions are met:
 - a. A past transaction or event has occurred.
 - b. A future outflow or other sacrifice of resources is probable.
 - c. The future outflow or sacrifice of resources is measurable.
14. SFFAS 6 ties the recognition of cleanup costs to the related general property, plant, and equipment (PP&E). Paragraph 94 provides for the estimation of cleanup costs when the associated general P&E is placed in service. Paragraph 97 provides for the recognition of a portion of the estimated total cleanup costs as an expense during each period that the general PP&E is in operation. SFFAS 6 guidance presumes the cleanup cost and the associated general PP&E would be recognized by the same component reporting entity.
15. Some component reporting entities settle liabilities by transferring general PP&E to another component reporting entity designated by law or administratively to settle the liabilities. Therefore, a component reporting entity that is responsible for financially reporting general PP&E may differ from the component reporting entity that will eventually be responsible for the environmental remediation upon disposal of that general PP&E. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources required to settle the liability for cleanup costs. Instead, the component reporting entity receiving the asset upon its removal from service will be responsible for settling the cleanup cost liability.

¹ SFFAS 5 applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or where cleanup is an ongoing part of operations.

16. Situations where multiple component reporting entities have distinct responsibilities regarding reporting of the general PP&E and related cleanup cost may extend over several reporting periods. In such cases, information needed to monitor and update cleanup cost liabilities would be more readily available to the component reporting the related general PP&E. Such component reporting entities will settle the cleanup cost liability by transferring the general PP&E for cleanup. Until such time, the component reporting entity recognizing the general PP&E also should recognize the liability. Once the specific general PP&E is transferred, the liability is transferred.
17. The SFFAS 5 liability recognition criterion that “a future outflow or other sacrifice of resources is probable” should be considered met by the component reporting entity that recognizes the general PP&E during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup. At that time, the general PP&E and the liability should be de-recognized by the component reporting entity that recognized them during the general PP&E’s useful life and recognized by the component reporting entity that will liquidate the liability. De-recognition and recognition of the general PP&E and liability should be in accordance with existing standards.

EFFECTIVE DATE

18. The requirements of this Interpretation are effective for reporting periods beginning after September 30, 2019. Early implementation is permitted.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Interpretation. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Interpretation—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

BACKGROUND

- A1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) was asked for guidance regarding accounting for liabilities at the component reporting entity level. Specifically, clarifications were requested about the recognition and measurement standards related to contingent liabilities and cleanup costs. The recognition and measurement standards are provided in SFFAS 5 and SFFAS 6, as amended.
- A2. With the issuance of recent pronouncements SFFAS 47, SFFAS 55, *Amending Inter-entity Cost Provisions*, and Technical Bulletin (TB) 2017-2, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of the general liability standards and principles. This is especially needed when multiple component reporting entities are involved.
- A3. For example, with the issuance of SFFAS 55, SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*, and Interpretation 6 *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, are rescinded; therefore, the requirement to impute costs for these activities will be eliminated. Further, the Board’s intent with TB 2017-2 was to provide flexibility with asset assignment. SFFAS 47 recognized the extremely complex organization structure of the federal government and provided a basis for understanding the component reporting entities (and sub-components) within the federal government.
- A4. Entities requested guidance regarding cleanup cost liabilities where the component reporting entity responsible for reporting the general PP&E is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that general PP&E. Also, entities requested clarification for contingent liabilities where a single component reporting entity within a department is designated to manage litigation and settle any resulting liabilities on behalf of all departmental components.
- A5. These types of examples and the issuance of the new pronouncements warrant guidance about how the general liability standards and principles should be applied. Without

additional guidance, these situations may lead to inconsistent application of the liability standards and principles.

General Principles for Component Reporting Entities

- A6. Paragraphs 56-57 of SFFAS 47 provide that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities. SFFAS 47 also provides the definition for component reporting entity.
- A7. Considering SFFAS 47 in conjunction with SFFAS 5, the Interpretation provides general principles that apply for component reporting entities

Guidance on Contingent Liabilities

- A8. FASAB issued TB 2002-1, *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government*, in 2002 to provide guidance when one or more federal entities are involved in litigation. It also provided guidance for legal claims related to defunct federal entities (that is, entities that no longer exist) because preparers asked that liabilities be recognized at only at the government-wide level. TB 2002-1 (which is considered a staff-level document in the GAAP hierarchy) established two main points:
 - a. All liabilities should first be recognized at the component reporting entity level. (The principle provided in this Interpretation is consistent with this principle in TB 2002-1.)
 - b. All liabilities and costs must be attributed to the component reporting entities responsible for the programs or activities that contributed to the claims or to their successor component reporting entities. (The basis for assigning such costs and liabilities was derived from SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.)
- A9. As noted, this Interpretation is consistent with the principle established in TB 2002-1 that every liability should first be recognized at the component reporting entity level; however, conclusions and other language in TB 2002-1 may be considered inconsistent with current GAAP based on the following:
 - a. Inconsistencies with terminology and language as presented in SFFAS 47 and TB 2002-1.
 - b. SFFAS 4, as amended by SFFAS 55, addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget (OMB).
- A10. Because of these changes, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation.

- A11. Although not all inter-entity costs are recognized by the receiving entity, relationships creating inter-entity costs exist and often involve multiple component reporting entities. As noted above, SFFAS 5 provides that liabilities should be reported by the component reporting entity that will liquidate the liability (that is, has a probable future outflow). GAAP also provides that all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.
- A12. To recognize and disclose contingent liabilities in accordance with SFFAS 5, as amended, a component reporting entity must have information about ongoing litigation and exercise judgment regarding the possible outcomes. Component reporting entities designated to settle certain liabilities of other federal entities may not have the information needed to determine whether a future outflow is probable and measurable until component reporting entities more directly involved communicate certain determinations to them.
- A13. Where a single component reporting entity is the defendant in a case, that entity should have the needed information even in the event any ultimate claim will be settled by the Treasury Judgment Fund. The entity involved in the case should recognize a contingent liability until amounts to be settled by the Treasury Judgment Fund are decided. The Treasury Judgment Fund pays the claims after litigation is settled and is not a party to litigation before it is settled and the cost of each claim relates to another entity's operations. This is consistent with Interpretation 2.
- A14. In other cases, component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for all components within the department. The same or a different component reporting entity may be designated to settle resulting liabilities. In such cases, not all involved components would have the information needed to apply the provisions of SFFAS 5.
- A15. When such designations of responsibility for managing litigation and settling claims are made within a component reporting entity (such as a department) having multiple sub-component reporting entities, the sub-component that manages litigation is responsible for reporting information in accordance with SFFAS 5. The sub-component whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation because doing so would unnecessarily complicate consolidation processes and potentially create inconsistent practices.
- A16. For example, if a Department assigns responsibility for adjudicating overseas claims in a given country to a single component reporting entity, the component reporting entity adjudicates claims for all the component reporting entities in that country. The ongoing practice has been that the component reporting entity assigned responsibility for adjudicating claims in a given country pays for the claims, even those claims due to the actions of another component reporting entity. The adjudicating component reporting entity does not seek reimbursement for claims paid on behalf of other component reporting entities. Likewise, the component reporting entity on whose behalf the claim is adjudicated does not recognize an imputed cost. Clarity regarding which entity should report the liability will ensure the same liability is not recognized twice and that it is recognized in a consistent manner by the components of larger reporting entities.

Guidance on Cleanup Costs

- A17. SFFAS 6, as amended, provides guidance for recognizing liabilities for cleanup costs, and SFFAS 5 provides guidance for recognizing liabilities from government-related events such as cleanup of environmental damage. FASAB has provided guidance in this area through several technical releases, but additional guidance is necessary in light of recent pronouncements.
- A18. Challenging issues in the application of general standards exist for large, complex departments, such as the Department of Defense, that have numerous components and sub-components. For example, assets may be owned by one component reporting entity but used or funded by another component reporting entity and the component reporting entity using the asset may not be the component reporting entity responsible for disposal. Given the complex responsibilities and relationships among the components of large departments, the second condition of paragraph 91 in SFFAS 6 is resulting in inconsistent application of the standards. The condition requires that “a future outflow or other sacrifice of resources is probable.”
- A19. Additionally, SFFAS 4, as amended, addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required² with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Further, TB 2017-2 provided flexibility so that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. These new pronouncements provide additional flexibility when considered in conjunction with SFFAS 5 and SFFAS 6.
- A20. Some general PP&E requiring cleanup is transferred to another component reporting entity after being removed from service. An example would be a military service responsible for financially reporting the general PP&E that will eventually be transferred to the Defense Logistics Agency for environmental remediation. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources to settle the liability for cleanup costs. Instead, the component reporting entity receiving the general PP&E upon its removal from service has or assumes that responsibility.
- A21. For purposes of meeting the liability definition of cleanup costs at the component reporting entity level (where multiple sub-components have distinct responsibilities for general PP&E and for settling the related liability), the condition to determine whether “a future outflow or other sacrifice of resources is probable” could be considered met as long as the liability is reported with the general PP&E until the general PP&E is removed, contained, or disposed of. At that time, the liability would be transferred with the related general PP&E to the component reporting entity responsible for the liability.
- A22. A general illustration of the entry to recognize the liability for the cleanup cost follows.
- The entity using the general PP&E would recognize the cost as the liability is recorded, just as SFFAS 6 provides for.

² SFFAS 55 provides for the continued recognition of significant inter-entity costs by business-type activities. Non business-type activities may elect to recognize other imputed costs.

DR. Expense
CR. Liability

The liability (and related general PP&E) is transferred to the component reporting entity responsible for the liability.

DR. Liability
CR. Imputed Financing Source

Other

A23. As noted above, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation. Because the guidance regarding the application of the general liability standards has been provided through other pronouncements, such as technical bulletins and technical releases, additional documents may require updating to ensure conformance and consistency with current GAAP. Therefore, necessary updates will be made to identified documents. Those updates are considered exclusive of the liability issue presented within this Interpretation. Further, those changes or updates must be made in separate GAAP documents to ensure the appropriate level of guidance within the GAAP hierarchy results.

APPENDIX B: ABBREVIATIONS

FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFRR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin

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