
Interpretation of Federal Financial Accounting Standards 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5

Status

Issued	March 12, 1997
Effective Date	For fiscal periods beginning after September 30, 1996
Interpretations and Technical Releases	TR No. 1, <i>Audit Legal Representation Letter Guidance</i>
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 12 affects Interpretation 2 paragraphs 3 and 8 by changing the recognition criteria for liabilities arising from litigation.

Summary

The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

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

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Introduction

1. The Federal Accounting Standards Advisory Board (FASAB) has been asked to clarify Federal accounting standards as they relate to the Treasury Judgment Fund. The Treasury Judgment Fund was established by Congress in the 1950's to pay in whole or in part the court judgments and settlement agreements negotiated by the Justice Department on behalf of agencies, as well as certain types of administrative awards. The Congress established the Judgment Fund as a permanent, indefinite appropriation.
2. The clarification addresses (1) how Federal entities should report the costs and liabilities arising from claims to be paid by the Treasury Judgment Fund and (2) how the Judgment Fund should account for the amounts that it is required to pay on behalf of Federal entities. This interpretation has been prepared on the basis of the following three accounting Standards:
 - Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*
 - Statement of Federal Financial Accounting Standards Number 5, *Accounting for Liabilities of the Federal Government*
 - Statement of Federal Financial Accounting Standards Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

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

Interpretation

Accounting by the Federal Entity

3. SFFAS No. 5 states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is **probable**; and the future outflow or sacrifice of resources is measurable. The Federal entity's management, as advised by the Justice Department, must determine whether it is **probable** that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is **probable** and estimable, the entity would recognize an expense and liability for the full

amount of the expected loss¹. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

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

Accounting by the Treasury Judgment Fund

5. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss. According to SFFAS 4, the imputed financing source amount recognized by the Federal entity and the expense recognized by the Judgment Fund would be eliminated at the Federal consolidated financial report level.

Effective Date

6. This interpretation is effective upon implementation of SFFAS 4 & 5, which become effective for fiscal periods beginning after September 30, 1996.

¹See paragraph 39 in SFFAS #5 for the complete discussion on "Estimating Contingent Liabilities."

²See paragraph 73 in SFFAS #7 for the complete discussion on "Financing Imputed for Cost Subsidies."

Appendix A: Basis For Conclusions

7. This interpretation is primarily based on the principles of SFFAS 5 and SFFAS 4. The following brief discussion explains the basis for the interpretation in terms of those standards which are the foundation for the interpretation.
8. In accordance with the general principles of the liability standard (SFFAS 5), once a legal claim is filed against a Federal entity, the entity's management should determine the likelihood that the Federal entity will incur a loss related to the claim³, regardless of the fact that the payment may be paid in full or in part by the Judgment Fund. The contingencies⁴ section of SFFAS 5 states that if the likelihood of the contingent loss is remote no reporting is necessary; if the likelihood of the loss is reasonably possible and the amount is measurable the estimated loss should be disclosed; and, **if the likelihood of loss is probable (more likely than not which is a greater than 50% chance of occurrence)** and estimable, the estimated loss must be recognized as a liability. If the probability of the loss is changed at any time prior to payment of the claim, the proper adjustments should be recognized [e.g., from disclosure (reasonably possible) to recognition (**probable**)]. If at any time the estimated loss amount changes, the liability and expense should be adjusted to reflect the change.⁵
9. In accordance with the principles of SFFAS 4⁶, a Federal entity incurring a loss or expense must recognize the full cost of the loss [claim], regardless of who is actually paying the [settlement or judgment] amount. The standard requires the Federal entity incurring a loss or expense to use an estimate of the cost if the actual cost information is not provided. The estimate must be reasonable and should be aimed at determining realistic losses expected.

³In most cases this determination involves the U.S. Department of Justice.

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

⁵See paragraphs 35 - 42 in SFFAS # 5 for the complete discussion on "Contingencies."

⁶See paragraphs 89 - 104 and 105 - 115 in SFFAS #4 for the complete discussion on "Full Cost" and "Inter-entity Costs", respectively.

Appendix B: Illustrative Journal Entries

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

Federal entity entries:

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

Entry #1:

DR. Expense
CR. Liability—Legal claims

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

Entry #2:

DR. Liability—Legal claims
CR. Imputed Financing Source—Expenses Paid by Other Entities*

Treasury Judgment Fund entries:

The claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment.

Entry #3:

DR. Expenses Paid for Other Entities*
CR. Cash or Fund Balance with Treasury

*According to the Cost Accounting Standard, the imputed financing source and expenses paid for other entities amounts would be eliminated at the consolidation level.

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