



Federal Accounting Standards Advisory Board

July 13, 2006

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Comes, Executive Director

Subject: Application of the Liability Definition¹ – Tab F

At the May 24, 2006, board meeting, staff presented a status report on the project, stating that the liability classification task force had held two meetings – the first on April 12 and the second on May 11 – and briefly summarizing the results of the two meetings. Staff recommended to the board that it take the input from the task force, update the class definitions and the subclasses, and then create a survey of five or six questions for wider distribution to the federal community for comment.

As there were no objections by the members to staff's recommendation, staff developed a survey and circulated it to the federal community to solicit feedback on the enhancements to the class definitions drafted by staff and the completeness of the liability sub-classes based on the feedback from the task force. A copy of the survey is included as Attachment F3. Results from the survey will be communicated to the board at the September board meeting.

To keep you informed of progress on the project, staff has attached a high-level summary of the second meeting that was held on May 11, 2006 as Attachment F1. Specific comments by topic are included as Attachment F1a; a working draft of the task force objectives document is included as Attachment F2 for your reference.

Staff will provide the Board members with a brief update on the status of the project at the July 27, 2006 Board meeting. If you have any questions or comments, please contact me by telephone at 202-512-7377 or by e-mail at ranaganj@fasab.gov.

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.

TASK FORCE ON LIABILITY CLASSIFICATION

Summary of May 11, 2006 Meeting

PARTICIPANTS:

Linda Hoogeveen App	US Department of Agriculture/Food and Nutrition Service (FNS)
Doug Bennett	Veterans Administration (VA)
Bill Boutboul	Government Accountability Office (GAO)
Whitney Brooks	Defense Information Systems Agency (DISA)
Earl Cherry	Health and Human Services (HHS)
Paul Cullinan	Congressional Budget Office (CBO)
Joe Doyle	Department of Defense (DOD)
Kimberly Jackson	VA/Veterans Benefits Administration (VBA)
Carol Johnson	Office of Management and Budget (OMB)
Sophila M. Jones	Department of Justice (DOJ)
Christina Lilly	Social Security Administration (SSA)
John Lynskey	National Science Foundation (NSF)
Susan Mata	GAO
Laura Price	KPMG
Eric Rivera	Nuclear Regulatory Commission (NRC)
Alan Rosenthal	Cotton & Co.
Thomas Schweinefuss	Cotton & Co.
Philip Streit	DOD
Dan Waugh	Treasury
Wendy Comes	FASAB
Julia Ranagan	FASAB

AGENDA ITEM – TASK III: PROVIDE FEEDBACK ON STAFF’S PROPOSED ENHANCEMENTS TO THE DEFINITIONS OF THE FOUR CLASSES

FASAB staff briefly explained the proposed enhancements to the definitions of the four classes (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) and requested feedback on the suggested enhancements. Participants noted difficulty with the following areas:

- Differentiating between exchange and nonexchange;
- Determining whether an event is government-related or government-acknowledged; and,
- Establishing a consistent definition of “similar value.”

In addition, participants provided many other comments worthy of consideration related to the following topics:

- Expense versus revenue classification;
- Structure of new liability standards;
- Role of the balance sheet versus the budget;
- Liabilities not covered by budgetary resources;
- Entity cannot have a liability to itself;

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- Whose books would the liabilities be placed on;
- Misperception about booking all future flows;
- What will be the debit if there is a credit to liability;
- Service versus warranty treatment;
- Matching principle;
- Determining the obligating event;
- Changes to standards should be useful, rather than merely an accounting exercise; and,
- Changes to standards should have decisional value to users.

Specific comments related to each of the above issues are included at Attachment F1a.

Participants' Views on the Four Liability Classes:

At the initial task force meeting on April 12, 2006, participants had unanimously approved the four liability classes. However, at the second task force meeting, after the participants became more involved in trying to classify actual transactions and events, they encountered some of the difficulty that the board and staff have faced in trying to fit certain events and transactions into specific categories. A poll of participants around the table at the May 11, 2006, task force meeting resulted in twelve participants voting to maintain the four classes (6 of the 12 noted that significant modification and/or clarification is needed), five stating that the classes should be revised, and one having no strong opinion.

In Favor of the Four Classes:

- I think we need them.
- I would say that they provide benefit.
- I support them. I think, given the myriad of the unique things we find in the government, all the programs and so forth, that it is beneficial.
- I have no problem with the existing four categories.
- I do not have a problem with the four categories.
- I think the new categories are definitely beneficial. There are certainly going to be many questions as different scenarios pop up, but I think case studies can be done and the questions resolved. It will take time, but it is going to work.

In Favor of the Four Classes with Enhancements and/or Modifications:

- I think they provide benefit, although I think that if we are going to give examples, maybe we could give specific examples in each one.
- I support them, but if it is the intent to keep the four categories, then I think you would need a very strict definition of what goes into each category and everyone has to conform to it, regardless of whether they think it does or not.
- I agree exactly with [the above comments]. I think that sums up my thoughts, too.
- I agree with the four categories. I think it is a good concept. I think you need significant clarification.
- I agree with what everybody else has said. I think that the categories should remain. Again, you need to be very specific of what goes under each category, regardless of what agencies think. I mean, you take into consideration what they think, and you are going to have

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disagreements, but you are going to have to be more specific.

- I would follow up on that; the guidance has to be as clear and distinct as possible, such that everybody widely recognizes that, regardless of whether they like the classification, that is where it is going to be placed.

Not in Favor of the Four Classes:

- I see no value in the difference between an exchange and nonexchange transaction. It is a transaction; you are going to report it. I really do not care whether the government received a similar value or dissimilar value. We have entered into the transaction. It does not matter. In relation to government-related events and government-acknowledged events, I do see value in the issue of the legal driver. Regardless of which event it is classified as, my opinion is that once you acknowledge the event, then it should be accrual anyway. I am not sold on the value of the exchange versus nonexchange transaction at this time.
- I agree with [the above comments].
- I am a big fan of simplicity. I think that, in the end, once these things hit the statements, an exchange transaction is going to be accounted for exactly like a nonexchange transaction. Why make our lives harder? If there is going to be a significant difference -- accrual versus cash-basis or the way we treat these things -- then I agree with most of the room, but we are beating ourselves in the head if the final number on the balance sheet is going to be the same once these things are rolled up.
- I have a hard time justifying any benefit to the exchange and nonexchange categories. Also, I even start to get confused. As for our own programs, my gut reaction is, in our grant programs, we are feeding hungry people, it is a nonexchange thing. Then I realize, well, actually, our grants go to the states and we give money to the states in exchange for them giving the grants. Maybe that is exchange. I do not know. Does it matter? I do not think so. Therefore, it seems irrelevant. The government-related versus government-acknowledged, I can see how maybe those phrases might help in the definition of when to recognize a liability, that it could be helpful, but I do not know if, as a category, it is necessary.
- I think it is going to cause a lot of confusion and time trying to classify everything and maybe it does not matter. So, I would disagree.

No Opinion:

- I do not really have an opinion personally as to the four categories.

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AGENDA ITEM – TASK IV: PROVIDE FEEDBACK ON THE COMPLETENESS OF THE LIABILITY SUB-CLASSES WITHIN EACH OF THE LIABILITY CLASSES

As indicated in the above section, the majority of participants were generally in favor of the four liability classes, while suggesting that some additional clarification and modification was definitely needed. They also felt that the sub-classes captured the majority of federal activity; however, they suggested a couple of additional items for staff to consider:

- Explicit mention of environmental and disposal liabilities in each of the four categories;
- Documentation of exceptions directly in the standards;
- Better definition of what is included in each of the sub-classes;
- Explicit mention of litigation and other contingencies; and,
- Proper placement of contract financing payments and take or pay contracts.

Next Steps:

FASAB staff will update the proposed definitions of the liability classes and sub-classes and distribute to the task force for comment. Staff will then prepare a survey to seek further feedback on the proposed definitions from the federal community [staff note: This has been completed; see Attachment F3].

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TASK III: PROVIDE FEEDBACK ON STAFF'S PROPOSED ENHANCEMENTS TO THE DEFINITIONS OF THE FOUR CLASSES

Staff's Proposed Enhancements (for the May 11, 2006 task force meeting):¹

- **Exchange Transactions** – an exchange transaction arises when each party to the transaction directly sacrifices value and directly receives similar value in return. There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources of similar value in the future (e.g., the federal government purchase of goods or services at market value from a vendor).

Excerpt from SFFAS 5, par. 22 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

- **Nonexchange transactions** – a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising similar value in return or one party to a transaction gives or promises value without directly receiving similar value in return. In a nonexchange transaction, there is either no reciprocal or two-way flow of resources or of promises to provide resources or the transaction is not direct and of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).

Excerpt from SFFAS 5, par. 24 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

- **Government-related Events** – government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place on federal property (e.g., accidental damage to nonfederal property caused by federal operations).

Excerpt from SFFAS 5, par. 27 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

- **Government-acknowledged Events** – government-acknowledged events are nontransaction-based events that are not the result of federal operations and do not directly involve the federal government but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

Excerpt from SFFAS 5, par. 30 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

¹ Note: Staff's proposed enhancements only address the definition piece and not the additional discussion on recognition. Staff is currently seeking feedback on the classification of liabilities and the definitions of the classes, not on the recognition of liabilities.

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Participant Comments on Task III:

Differentiating between exchange and nonexchange

- I think of an exchange transaction as a two party transaction, an exchange of assets for goods or services. If the government is going around buying light bulbs, it is exchanging cash for an asset, the light bulb. That is an exchange transaction. It is buying a product or service. It is a little bit different when the government is giving out a grant and then that grant is that somebody is going to use that money to give a benefit to the citizens. I agree, indirectly there is a benefit to the government, but I do not really see that as the exchange transaction. For example, if the government gives out a grant to find a cure for cancer, that would probably be a nonexchange transaction. On the other hand, if the government gives out a grant to find a cure for cancer and the government obtains the rights to the patents for the drug and the profits from sales of that drug, then it would probably be an exchange transaction.
- There are three different main types of grants. You have entitlement grants, which are for programs that the government has. There are block grants that are mainly passing money to states. Then there is the third type, which is for direct research or medical grants where the government usually receives a research report or even a patent in return. I think different types of grants can possibly fall into different types of transactions, depending on what the grant is for.
- Maybe you could parenthetically note or footnote that there may be exceptions, that not all grants are going to be nonexchange.
- Benefit programs are included in nonexchange transactions with social insurance, which personally I feel is an exchange transaction.

Staff Recommendation: We will need to determine how to address transactions that could be considered either exchange or nonexchange. Some participants suggested parenthetically noting that there will be exceptions; others felt that instructions that are more explicit should be provided.

Determining whether an event is government-related or government-acknowledged

- General Counsel feels some discomfort with recognizing a liability for government-related events without a formal acknowledgement of responsibility.
- Does government-related refer to past federal operations as well as current federal operations? Current federal operations – I do not think anybody really has a big issue. The past federal operations are where we are having a problem. Items resulting from past federal operations have transferred from government agency to government agency, depending on who is responsible at the time. Until the government decides to do something about it, there still is kind of an acknowledgement piece for past federal operations, because nobody may have responsibility. In most cases, it may just pass around until somebody gets money to do something about it.
- We have encountered environmental liability issues with things that have occurred outside the CONUS in foreign operating locations, prior to any environmental laws coming onto the books. U.S. federal government operations may have caused it, but due to the existing sovereignty

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between nations and the fact that there was no agreement back then regarding the issue, there are no legal drivers for recording a liability. Our lawyers tell us that there has to be government-acknowledgment first. There is no potential liability until such time that congress formally recognizes the issues and at least appropriates funding. We take it a little bit further in recognition of the exchange and nonexchange transactions, but that is a very important issue. Yes, it probably was caused by government-related operations, but there is no legal driver.

- The word “acknowledge” seems to be the sticking point here. I know these terms have been used for a while now, but if you did something simple like government-related events and non-government-related events, might that clear up a lot of the issues, especially, with general counsel? That word has a lot of general meaning that the legal community and I think the public as well is going to imply, that we might not necessarily mean from a liability standpoint.
- If there is no requirement to do anything for things outside the United States, and it falls into the government-related, and it is something from the past, if the government does want to do something, how do we then move to recognition? There are many things that nobody has responsibility for; they are just there. What happens when you do want to do something, or you do get funding to do something? How do we make that switch now to the things that we want to do something for -- and the definition really does not get you there -- if you want to stay within government-related and not move to government-acknowledged? The definition says that you are required to do something by statute or something, but if you want to do something or the government decides it wants to do something and you get an earmark to do it, how do you move then? The definition says you still do not have to do it even if you want to have an obligation.
- Hurricane Katrina is not an act caused by the federal government, of course, but somebody has to step in and take care of it. Some of it is going to come from private dollars, charities coming in doing relief work, but at some point, the federal government is going to step in and take charge and remediate the problems. Is that a liability? At what point is that a liability? I am assuming that once the government accepts responsibility, that they are going to step in and they are going to remediate the problems, that there is a liability on the part of the government at that time. Is it only a liability to the extent services have been performed and therefore a liability exists to pay the contractors who did those services? Is the fact that there is a probable future outlay, that assets have been impaired? There is a probable future outlay by the government? Assuming you can measure it, you know, you can estimate in the billions of dollars. Should there be a liability recorded on the federal government's balance sheet at that time to show those costs.

Staff Recommendation: The definition of government-related needs to clarify that an acknowledgement of responsibility would still be part of the process of determining the amount and timing of a government-related event. Staff will consider removal of the use of government-acknowledged as the contrasting terminology and perhaps use a more simplistic term such as non-government-related. In addition, the issue of whether government-related addresses both current and past federal operations as well as events for which there is no underlying law should be addressed.

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Establishing a consistent definition of “similar value”

- One of the concerns I have in terms of similar value is measurement. For example, consider a private sector entity that is providing printing services for 90 cents, and internally we can do it for 80 cents. We may very well be exchanging similar value because the private sector is building in profit and other costs, taxes, and other things we do not factor in. I wonder if, in trying to get similar value, we start endeavoring into a very detailed cost accounting scheme in an area that is fraught with a lot of judgment calls, what costs are direct costs of producing this, what are indirect, what should be measured and what should be assigned to the item. That is a difficulty I see in using terms such as similar and nonsimilar.
- Every one of us would probably have a different answer as to what is similar; it would be a judgment call. I would argue, in the example of the printing, whether it was 90 cents in the private sector and 80 cents in-house, it would be similar value. My printing is costing me 80 cents. That is what they have priced it to me as. Arm's length is already a fairly well defined accounting term.
- Can you use some sort of qualifier, such as approximate, that would allow for wiggle room?
- It sounds like the similar value might present a problem when people try to define what exactly similar value is. It is one thing to you, something different to someone else. Maybe the concept of arm's length should be considered instead of the value.
- The concept of similar value has thrown me off a little bit, too. The underlying nature of the transaction is what differentiates between exchange and nonexchange. If there is a relationship where the two parties agree to provide whatever they pay for, that is clearly what establishes exchange or not.
- I think the arm's length mentioned earlier is probably better than using similar value. For example, say we are going to give a grant to a person to open up a school in New York City, or provide day care for working mothers, et cetera. The government represents the people of the United States, and how can the people of the United States get a benefit. They get a benefit from working mothers having a place to drop off their children. Although we cannot quantify it, they are getting a benefit. So, in a sense, there is an exchange transaction occurring, but we cannot measure that benefit. We do not know what it is. We can say it is an arm's length. Maybe that person in New York City is competing for that grant money with people in Baltimore, in San Diego, all over. We, as a government, are trying to come up with the best deal for this social benefit. I think arm's length really gets to that much more than saying similar value, because you can never measure the true value of so many kids getting day care, or so many schools, or a zoo, or the good will by building an embassy in some country. If we use arm's length transaction, I think we have something easier that we can all come to agreement on.
- The value may be in how many people you induced to engage in the activity, not everybody you paid.
- The individual that does not appear to be getting “like value” has a choice to enter into the transaction or not. You have an arm's length. There is no one forcing that individual, or either party, to accept an agreement. I do not believe that “similar” belongs in the definition.

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- Let me provide an example with insurance – ship owners during World War I would not ship goods overseas to supply France and Britain in the war because it was too risky. So, the United States said, “we will offer you war risk insurance. We will take the risk. In return, you will ship goods.” The ship owners said, “You insure it and then I will go and provide the service. If you do not insure it, I will not provide the service.” So, in that situation, I think there is an exchange transaction. The United States made the decision to offer that insurance because it benefited from having goods shipped overseas; it could be looked at as an arm’s length transaction in a sense.
- Have you considered whether the transaction is entered into voluntarily or not? Instead of saying similar value, if you said the transaction was entered into voluntarily, would that achieve a similar result?
- I want to bring up one more point on similar value. What I have seen in authorization and appropriation bills recently is an increased requirement that some level of funding be obtained from outside government. It is basically saying, if the government puts up X, you have to put up X amount of money to participate in this program. How would that be taken into consideration of similar value? I am not saying that similar value should be in or out, but I think that how you look at similar value, there are many ways to look at similar value.
- How would a bargain price transaction be characterized using the proposed definitions? If there is an exchange transaction in which each party directly sacrifices value and directly receives value in return, but the value is not similar, where would that transaction fall in the four classes?

Staff Recommendation: It seems that either we need to explain more about how to apply similar value, or we need to find a different way to describe the exchange that is going on. If using similar value, we need to consider things such as bargain priced transactions and matching funds. Several of the participants felt very comfortable with the concept of arm’s length; we need to determine if there is something akin to “arm’s length” that can be reasonably applied in the federal sector.

Other Specific Comments

- Expense versus revenue classification – Earned (exchange) revenue offsets expenses on the Statement of Net Cost. Nonexchange revenue does not show up on the Statement of Net Cost. Consideration needs to be given as to whether a transaction should remain classified as an exchange because it should be offsetting an expense on the Statement of Net Cost.
- Structure of new liability standards – I was sitting here wondering why we cared about these four categories if we were going to be using one liability definition. Then I noticed that [the liability classification structure] makes it clear that you are going in the direction of writing standards by these four categories, and that did not hit me until just this moment. I may not be the only one so I thought I would clarify that is the direction you are headed.
- Role of the balance sheet versus the budget –The budgeting process is the way that we determine we are going to do something; isn't that the proper domain of budgeting – on the budgetary side? We have a statement on budgetary resources. On the liability side, it would seem like the establishment of comprehensive payments would be the recognition of the liability

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at that time.

- Liabilities not covered by budgetary resources – Oftentimes congress will authorize an activity but not appropriate funds for it. What does that mean? Do we have a liability? They say, “VA, go rebuild this hospital,” but they did not give us any money to do it. I cannot take money from other places. What does that mean?
- Entity cannot have a liability to itself – The draft liability definition states that you do not have a liability if the entity owes unto itself. In essence, right now, many of our environmental liabilities are, in fact, the government owing itself. It is on an installation, it is contained, it is not damaging anybody else, and it is a commitment based on law, which is owed to itself. Eventually, we will enter a contract in which we will owe somebody else for cleaning it up. Right now the liability, until we get around to getting the funding and so forth, is a liability that is owed within the entity.
- Whose books would the liabilities be placed on – We are not talking about putting this liability [clearing waterway from Hurricane Katrina-related damage] on the Army Corps of Engineers’ books? I mean, their job is to do these things. It is a matter of their operations. It just does not seem like that liability attaches to the Army Corps of Engineers.
- Misperception about booking all future flows – I am starting to get nervous about the company I am keeping here, in my group. I can see this going down the path of looking for liabilities for environmental stuff and for social insurance and the other things. These general fund benefit programs, I look at them more as just operational. Every year the general fund takes in money, we pay some out. We may not be able to afford these programs at these levels in the future. There is no obligation, certainly, to keep paying them. I can see, if we have environmental stuff in the same category that my programs are in, I can see that stuff getting booked because that stuff is there, something is damaged, it needs to be fixed. We are recognizing those kinds of liabilities, but I would hate to see 75 years worth of food stamps put on the books.
- What will be the debit if there is a credit to liability? – If you are going to credit the liability, what are you going to debit? Maybe you really do not want to go down this path if you do not have an answer for the debit side of the transaction.
- Service versus warranty treatment – The federal government, after those kids are certified, has no control over what it spends on the school lunch program. That is determined by how many kids show up at school, how many plop down their fraction of the meal that they have to do. That is exactly like a warranty. You have certified these people. There is very little re-certification that goes on in the child nutrition programs. So, at the end of September, it is just an estimating question as to how much you are ultimately going to spend. Yes, you might not have an appropriation, but that does not mean that they do not have a legal claim when they submit those reports back for reimbursement. That is a question of how it gets liquidated.
- Matching principle - I think the concept on a practical level, matching revenues and expenses for the reporting period, is critical, getting back to your comment about year to year to year. That is a very fundamental accounting concept. To me, it seems like it is very good to try to recognize and get the full condition and financial position and everything, but I like simplicity, too. Maybe I am too simple-minded, but it just seems like the lunch program or food stamps or whatever, well, let's just recognize the expenses and/or related liability for those goods and services that have been provided up and through that reporting date, and that is where you stop

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reporting and recognizing and accounting for liability. Anything that is going to go into the future, well, that is the future.

- Determining the obligating event – The event is the serving of the lunch, not being certified.
- Changes to standards should be useful, rather than merely an accounting exercise – I would hope that the standards that end up are of practical use to the agencies, and do not become simply an accounting exercise that we go through every September to decide how much the numbers should be.
- Changes to standards should have decisional value to users – It is hard to envision what decisional value would be made if school lunch liability were on the books. Well, so what? Congress is going to do what congress is going to do. The program is going to be there. What was gained by going through all this ...

Staff Recommendation: We need to give adequate consideration to the above issues that were raised by participants. There are some preliminary board leanings in many of these areas but they need to be clearly articulated in the standards to avoid confusion and misunderstandings. The reporting objectives should be clearly linked to the proposed accounting standards.

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Agenda Item – Task IV: Provide Feedback on the Completeness of the Liability Sub-Classes Within Each of the Liability Classes

Proposed Liability Classes and Sub-Classes:

Exchange Transactions

- Employee and Veteran Benefit Payments
- Capital Leases
- Federal Debt
- Accounts Payable for Goods and Services
- Interest Payable
- Other (TBD)

Government-Related Events

- Environmental and Disposal
- Damage to nonfederal property caused by federal operations
- Damage to federal property resulting from federal operations or natural disasters
- Other (TBD)

Nonexchange Transactions

- General Fund Benefit Payments
- Insurance and Guarantees
- Grant and Award Payments
- Social Insurance
- Environmental and Disposal
- Other (TBD)

Government-acknowledged Events

- Environmental and Disposal
- Damage to nonfederal property caused by natural disasters
- Other (TBD)

Participant Comments on Task IV:

- Environmental and disposal – I noticed environmental and disposal is listed under nonexchange transactions, but you do not have it listed under exchange transactions as well.
- Lack of agreement – I have some concerns. We have several agencies and firms represented on this task force. As you can see from the discussion that we had the first half of this meeting, we cannot get agreement in just one room on whether grants and social insurance are exchange or nonexchange.
- Exceptions included in standard – From a quality perspective, I think it is probably better to have the exceptions in the documentation, because it is just going to cause other problems, if you do not put the exceptions in the document, and the auditors are looking at the standards to say, this is what you are supposed to be following.
- Strict interpretation – I am also for a more strict interpretation, because you just open yourself up to anything if you do not provide a strict interpretation. All of us in the field have seen anything. It is amazing, the stretches of imagination.
- General fund benefit payments – When you say “general fund benefit payments,” did you have anything in mind, or are you distinguishing between trust fund benefit programs?
- Litigation and contingencies – Where would contractual disputes (asserted and unasserted claims) fall? You have the accrual for accounts payable, but that is different from contractual disputes.

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- Contract financing payments – One more issue that could be discussed is related to contract financing payments; there is a clear division on how it should be treated.
- Take or pay contracts – One item I did not see listed was take or pay contracts. For example, the government buys electricity from a local electricity provider, take or pay. We will pay you X amount whether we take it or not. I could envision that probably happening.

Staff Recommendation: Based on the task force feedback, we need to better define what is included in each sub-class because the terminology may mean different things to different people. We may want to consider using a definition for the sub-classes rather than just a stand-alone label. In addition, we need to consider litigation and other contingencies, take or pay contracts, and contract financing payments because it was not explicitly clear to the participants where these items would be considered.

Federal Accounting Standards Advisory Board Task Force on Liability Classification

Introduction

The Federal Accounting Standards Advisory Board (FASAB) is the source of generally accepted accounting principles for financial reporting in the federal government. The Board issues its guidance through a range of vehicles such as Statements of Federal Financial Accounting

Concepts and Standards (SFFAC and SFFAS), Interpretations, Technical Bulletins, Technical Releases of the Accounting and Auditing Policy Committee, and Implementation Guides published by FASAB staff. Since its inception, FASAB has issued several standards related to accounting for federal liabilities (see text box at left).

SFFAS 1, Accounting for Selected Assets and Liabilities (1993)

- Accounts Payable
- Interest Payable
- Other Current Liabilities

SFFAS 2, Accounting for Direct Loans and Loan Guarantees (1993)

- Loan Guarantees

SFFAS 5, Accounting for Liabilities of the Federal Government (1995)

- General Principles (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events)
- General Fund Benefit Programs
- Employee Benefits
- Insurance and Guarantees
- Capital Leases
- Federal Debt
- Contingencies

SFFAS 6, Accounting for Property, Plant, and Equipment (1995)

- Cleanup Costs

SFFAS 12, Recognition of Contingent Liabilities from Litigation (1998)

- Litigation

SFFAS 1, *Accounting for Selected Assets and Liabilities*, which was issued in March 1993, established accounting standards for liabilities of the federal government arising from accounts payable, interest payable, and other current liabilities. SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, which was issued in August 1993, established accounting standards for liabilities arising from loan guarantees. SFFAS 5, *Accounting for Liabilities of the Federal Government*, which was issued in September 1995, established accounting standards for liabilities of the federal government not covered by SFFAS 1 and SFFAS 2. SFFAS 5 defines the recognition points for liabilities associated with different classes of events and transactions – exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events. In addition to discussing the general liability recognition principle, SFFAS 5 includes specific liability accounting standards for contingencies; capital leases; federal debt; pensions, other retirement

benefits, and other postemployment benefits; and, insurance and guarantee programs. SFFAS 6, *Accounting for Property, Plant, and Equipment*, which was issued in November 1995, provides additional guidance on the recognition of cleanup costs over the life of the related property, plant, and equipment and supplements the accounting requirements for liabilities in SFFAS 5. SFFAS 12, *Recognition of Contingent Liabilities from Litigation*, which was issued in December 1998, amended the contingent liability criteria in SFFAS 5 and applies to the evaluation, accounting recognition, and disclosure of the future outcome of litigation.

Generally speaking, SFFAS 5 requires that the liability for a nonexchange transaction be recognized for any unpaid amounts due as of the reporting date (due and payable) and the liability for an exchange transaction be recognized when goods or services have been provided.

SFFAS 5 further requires that the liability for government-related events be recognized when the event occurs if the future outflow of resources is probable and measurable and the liability for government-acknowledged events be recognized when and to the extent that the federal government formally acknowledges financial responsibility for the event and an exchange or nonexchange transaction has occurred.

In August 2003, FASAB began an extensive review of the "elements of financial reporting," including liabilities. As part of that Elements project, FASAB has tentatively agreed² upon a revised definition and essential characteristics of a liability of the federal government (see text box at right). More information on the history and status of the Elements project is currently located on the FASAB website at <http://www.fasab.gov/projectselements.html>.

Also in August 2003, FASAB renewed deliberations on accounting for social insurance (e.g., Social Security and Medicare). As part of the ongoing Social Insurance Liabilities Project, FASAB has tentatively agreed to begin recognizing a liability for individuals who have accumulated 40 quarters of work in covered employment, thereby abandoning "due and payable" as the default recognition point for nonexchange transactions. More information on the history and status of the Social Insurance project is currently located on the FASAB website at <http://www.fasab.gov/projectssocialinsurance.html>.

In March 2004, FASAB initiated a project titled, "Research into the Application of the Liability Definition," as a companion project to the Elements and Social Insurance projects. The purpose of this project is to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for obligations of the federal government that could potentially result in a net outflow of resources (other than social insurance). Some such obligations may not currently be recognized as liabilities on the balance sheet while others may be recognized based on "due and payable" concepts. The focus of this project is on both (1) how to recognize, measure, and display obligations that meet the revised definition of a liability and (2) how (and whether) to disclose information about obligations that do not meet the revised definition of a liability. More information on the history and status of the "Application of the Liability Definition" project is currently located on the FASAB website at <http://www.fasab.gov/projectsresearch.html>.

Tentative results from current FASAB deliberations on the definition of a liability and accounting for social insurance indicate that it will be necessary to revisit the current liability standards in SFFASs 1, 2, 5, 6, and 12 to ensure that they align with FASAB's vision for more transparency in federal financial reporting. With regard to the liability classification structure, FASAB has tentatively agreed to maintain the four classes of events and transactions from SFFAS 5 – exchange transactions, nonexchange transactions, government-related events, and

"A liability is a present obligation⁵ of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand...A liability of the federal government has two essential characteristics. First, it constitutes a present obligation to provide assets or services to another entity. Second, the federal government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur."

Staff Draft of a Proposed Concepts Statement on "Definition and Recognition of Elements of the Financial Statements," March 10, 2006

⁵ The term *obligation* is used with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

² Official positions of the FASAB, whether proposed or final concepts or standards, are presented in FASAB publications issued in accordance with our "Rules of Procedure" and "Memorandum of Understanding." "Tentatively agreed" refers to working majority views conveyed to staff at public meetings. These agreements sometimes change before an official position is taken.

government-acknowledged events. A majority of the FASAB members believe that it is important to maintain the four classes, rather than develop new ones, because the federal financial community is already familiar with these classes that have been in use for over a decade.

Task Force Objectives

Task forces play an important role in the accounting standard-setting process. Task force members provide expert views and recommend solutions to accounting issues or problems. Task force members can also be instrumental in proactively raising potential issues before a standard gets too far in the standard-setting process. As part of the Board's project to update the Concepts, a different approach to liability recognition is being considered that could require major changes to or abandonment of the existing four classes of events and transactions (exchange transactions, nonexchange transactions, government-related events and government-acknowledged events). Relevant insights from representatives of the federal financial management community are important to the development of standards that cover the broad range of government programs.

The objective of this particular task force is to provide feedback from the perspective of preparers and auditors in the following four areas:

1. Provide feedback on whether the four classes of liabilities established in SFFAS 5 (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) have proven useful to federal preparers and auditors in determining how to appropriately apply liability definition, recognition, and measurement criteria across a broad spectrum of federal events and transactions. Discuss specific challenges and successes encountered while following the standards in SFFASs 1, 2, 5, 6, and 12.
2. Describe common relationships and key events among different federal events and transactions that serve to either support the current liability classification structure (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) or suggest that a different classification structure may be more appropriate.
3. If the four classes of liabilities established in SFFAS 5 are deemed appropriate, provide feedback on whether the enhancements to the definitions of the four classes proposed by staff serve to clarify some of the application difficulties that may have arisen over the years since SFFAS 5 was implemented. If not, suggest alternative solutions.
4. If the four classes of liabilities established in SFFAS 5 are deemed appropriate, provide feedback on the completeness and usefulness of the proposed classes, sub-classes, and relationships against knowledge of current practice, including whether each sub-class is operationally distinct. If not, suggest alternative solutions.

The feedback received from task force members will be utilized by FASAB staff to develop new federal liability standards.

Specific Tasks to be Accomplished

I. Provide Feedback on the Liability Classification Structure Established by SFFAS 5 and Overall Satisfaction with the Level of Liability Guidance Provided by SFFASs 1, 2, 5, 6, and 12

Discuss your overall experience with classification, recognition, and measurement of federal liabilities based on the guidance in SFFASs 1, 2, 5, 6, and 12. Specifically discuss your overall experience implementing the liability classes⁵ in SFFAS 5 for purposes of establishing when an obligating event has occurred and applying recognition and measurement criteria in a consistent manner (see excerpt in text box at right).

A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize³ probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.⁴

SFFAS 5, par. 19

- What has worked particularly well?
- What could be improved?
- Have any transactions, events, or circumstances arisen that should cause the Board to reconsider the current liability classification structure?
- How would you characterize the level of guidance that is provided by SFFASs 1, 2, 5, 6, and 12 in regard to overall classification, recognition, and measurement of federal liabilities (too much guidance, too little guidance, or just right)?

Status: Completed; summary included in March 2006 briefing materials. Additional input will be sought via survey.

II. Describe the Common Relationships and Key Events Among Federal Events and Transactions

There is broad and general agreement among FASAB Board members that establishing liability classes would result in a more consistent application of the liability definition without the need for step-by-step rules on how to apply the definition to each government program as it comes into being. The classification structure established in SFFAS 5 is but one way to group federal transactions and events to promote a common application of liability recognition and measurement criteria (see text box below). Discuss the common relationships and key events among all federal events and transactions.

- Do the common relationships and key events among federal events and transactions, or lack thereof, support the current liability classification structure or suggest that a different classification structure may be more appropriate?
- Do you believe that there are other relationships or key events that might do a better job of distinguishing between different types of federal events and transactions? If so, provide alternative suggestions.

³ SFFAS 5, footnote 16: Recognition means reporting a dollar amount on the face of the basic financial statements.

⁴ SFFAS 5, footnote 17: This document uses the term "nonexchange transaction" in a way similar to FASB's "nonreciprocal transfer." That is, it implies a one-way flow of resources, services, or promises between two parties. "Transaction" in the phrase "nonexchange transaction" does not include reclassification, closing, and similar "internal" entries to the accounting records, though some accountants use the term in that broader sense. "Probable" means more likely than not. "Measurable" means reasonably estimable.

⁵ A class is a "group, set, or kind sharing common attributes" (characteristics) as defined by Merriam-Webster Online at www.webster.com.

Exchange transactions – arises when each party to the transaction sacrifices value and receives value in return.

- Involves two parties;
- There is a two-way flow of resources or of promises to provide resources of equal value; and,
- A liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.
- An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs (in the period the employee works). The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.
- A second example of an exchange transaction occurs when the federal government orders goods or services from a vendor. An exchange transaction occurs because both parties (the federal government and the vendor) receive and sacrifice value. The expense is recognized in the period that the exchange occurs (in the period that the federal government accepts the delivery of goods or services). The liability includes the amount due to the vendor for the cost of goods or services received and accepted in the current period.

Nonexchange transactions – arises when one party to a transaction receives value without directly giving or promising value in return.

- Involves two parties;
- There is a one-way flow of resources or promises to provide resources;
- One party to a transaction receives value without directly giving or promising value in return; and,
- A liability is recognized for any unpaid amounts due as of the reporting date.
- Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

Government-related events – nontransaction-based events that involve interaction between the federal government and its environment.

- Involves two parties (the federal government and some aspect of its environment);
- The event is of financial consequence to the federal government because it is directly involved during the course of federal operations;
- May or may not be beyond the control of the federal government;
- A liability is recognized on the same basis as those that arise in exchange transaction; and,
- Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.
- Government-related events include cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations to clean up, accidental damage to nonfederal property caused by federal operations, and other damage to federal property caused by such factors as federal operations or natural forces.
- Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy make it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably.

Government-acknowledged events – nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event.

- Involves two parties;
- The event is not directly related to federal operations;
- The event is of financial consequence to the federal government only because it chooses to respond to the event; and,
- A liability is recognized when (1) The federal government has formally acknowledged financial responsibility for the cost of the event through an appropriation or authorization from Congress, and (2) an exchange occurs.
- Events, such as tornado damage to a U.S. town, would create a liability when (1) Congress appropriates funds, and (2) transactions resulting from the appropriations, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or nonexchange transactions.

(definitions from SFFAS 5, pars.22, 24, 27, and 30; common relationships and key events are mainly from SFFAS 5, pars. 20 – 32)

Status: Completed; summary included in March 2006 briefing materials. Additional input will be sought via survey.

III. Provide Feedback on Staff's Proposed Enhancements to the Definitions of the Four Classes

Staff drafted proposed revisions to the four liability class definitions⁶ from SFFAS 5 to apply the word "direct" more consistently and to clarify the distinction between a government-related event and a government-acknowledged event more appropriately (denoted by underlined additions in each of the four text boxes below). Provide feedback on whether the proposed enhancements to the definitions of the four classes would serve to clarify some of the application difficulties that may have arisen over the years since SFFAS 5 was implemented.

- Are the proposed revisions helpful?
- What could be improved?

Exchange Transactions – an exchange transaction arises when each party to the transaction directly sacrifices value and directly receives similar value in return. There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources of similar value in the future (e.g., the federal government purchase of goods or services at market value¹ from a vendor).

SFFAS 5, par. 22 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

Nonexchange transactions – a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising similar value in return or one party to a transaction gives or promises value without directly receiving similar value in return. In a nonexchange transaction, there is either no reciprocal or two-way flow of resources or of promises to provide resources or the transaction is not direct and of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).

SFFAS 5, par. 24 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

Government-related Events – government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place on federal property (e.g., accidental damage to nonfederal property caused by federal operations).

SFFAS 5, par. 27 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

Government-acknowledged Events – government-acknowledged events are nontransaction-based events that are not the result of federal operations and do not directly involve the federal government but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

SFFAS 5, par. 30 (underlined items indicate proposed clarifications by staff to the class definition only; recognition is not currently being addressed)

⁶ Note: Staff's proposed enhancements only address the definition piece and not the additional discussion on recognition. Staff is currently seeking feedback on the classification of liabilities and the definitions of the classes, not on the recognition of liabilities.

Status: Completed; see summary at Attachment F1 and F1a. Additional input will be sought via survey.

IV. Provide Feedback on the Completeness of the Liability Sub-Classes within Each of the Liability Classes

The sub-classes currently included in SFFASs 1, 2, 5, 6, and 12 do not specifically address all federal events and transactions (see text box at top right). Would you consider a more comprehensive list of sub-classes that addresses all federal events and transactions with specific standards for each one (such as the list in the text box at bottom right) to be more useful for purposes of establishing when an obligating event has occurred and applying recognition and measurement criteria across a broad spectrum of government events and transactions in a consistent manner?

- What has worked particularly well?
- What could be improved?
- Are the sub-classes in the proposed list (see text box at bottom right) operationally distinct?
- Are there additional transactions or events that you believe are not included in the proposed sub-classes (see text box at bottom right)?
- Do you believe there is a more appropriate grouping of liabilities by relationship or key events?

Status: Completed; see summary at Attachment F1 and F1a. Additional input will be sought via survey.

CURRENT

SFFAS 1

- Accounts Payable
- Interest Payable
- Other Current Liabilities

SFFAS 2

- Loan Guarantees

SFFAS 5

- Contingencies
- Capital Leases
- Federal Debt
- Pension/Other Retirement Benefits/Other Postemployment Benefits
- Insurance and Guarantees

SFFAS 6

- Cleanup Costs

SFFAS 12

- Litigation

STAFF DRAFT

Exchange Transactions

- Employee and Veteran Benefit Payments
- Capital Leases
- Federal Debt
- Accounts Payable for Goods and Services
- Interest Payable
- Other (TBD)

Nonexchange Transactions

- General Fund Benefit Payments
- Insurance and Guarantees
- Grant and Award Payments
- Social Insurance
- Environmental and Disposal
- Other (TBD)

Government-Related Events

- Environmental and Disposal
- Damage to nonfederal property caused by federal operations
- Damage to federal property resulting from federal operations or natural disasters
- Other (TBD)

Government-acknowledged Events

- Environmental and Disposal
- Damage to nonfederal property caused by natural disasters
- Other (TBD)

**Survey Responses Requested by August 15, 2006**

July 13, 2006

Memorandum

To: Chief Financial Officers and Inspectors General

From: Wendy M. Comes, Executive Director

Subject: Survey Related to Liability Classification

Since August 2003, the Federal Accounting Standards Advisory Board (FASAB) has undertaken several projects to evaluate current concepts and standards regarding what constitutes a liability of the federal government. These projects – Social Insurance Liability, Elements, and Application of the Liability Definition – are focused on ensuring that federal financial reporting properly reflects liabilities and may result in greater accruals for nonexchange transactions and government-acknowledged events. The concepts and standards being developed as a result of this effort will affect virtually all federal agencies.

On June 7, 2006, FASAB issued an exposure draft of a Proposed Statement of Federal Financial Accounting Concepts related to the “Definition and Recognition of Elements of Accrual-Basis Financial Statements.” Elements of financial statements are the “building blocks” of financial statements—the broad classes of items from which the statements are constructed. This draft concepts statement proposes definitions for the following five elements of accrual-basis financial statements of the federal government: asset, liability, revenue, expense, and net position. These five definitions would be utilized by the board to develop future standards. We encourage you to comment on the proposed definitions and other concepts contained in the exposure draft, which is located at <http://www.fasab.gov/exposure.html>. Comments on the exposure draft on elements are requested by August 5, 2006.

In direct coordination with the concepts project, staff is currently evaluating existing liability standards to determine whether changes would be needed in order to conform with the newly proposed liability definition. The first step in that direction was the formation of a task force on liability classification to assist staff in determining whether changes needed to be made to the liability classification structure established in Statement of Federal Financial Accounting Standard (SFFAS) 5, *Accounting for Liabilities of the Federal Government* (exchange transactions, nonexchange transactions, government-related events and government-acknowledged events). The task force consisted of members representing 13 federal agencies and three public accounting firms. Minutes of the task force meetings are available upon request and will be posted to FASAB’s Active Projects page at <http://www.fasab.gov/projectsresearch.html>.

At the initial task force meeting on April 12, 2006, participants had unanimously approved of the four liability classes that have been in use since SFFAS 5 was implemented in 1997. However, at the second task force meeting on May 11, 2006, after the participants became more involved in trying to classify actual transactions and events, they encountered some of the same difficulty that the board and staff have faced in trying to fit certain events and transactions into specific categories. For example, in certain scenarios, some nonexchange transactions could be classified as exchange or “exchange-like” (e.g., insurance programs where premiums are collected or research grants where the government retains the rights to patents and related future revenues).

However, the main purpose of the four classes is to allow grouping and discussion of common events and relationships within a class that would be relevant to applying the liability definition. Staff believes that over-emphasizing the effect of classification would be unproductive since the Board is applying the same liability definition to all transactions and events. Therefore, the accounting would most likely be the same for these transactions regardless of how they are classified because the underlying substance of the transaction would be the same.

A poll of participants around the table at the second task force meeting resulted in twelve participants voting to maintain the four classes (6 of the 12 noted that significant modification and/or clarification is needed), five stating that the classes should be revised, and one having no strong opinion. Therefore, while a majority of the task force members indicated that they believe the four classifications are helpful in discussing obligating events and recognition points for federal liabilities, a majority of the task force members also believed that the definitions of the classifications needed certain modifications or revisions, primarily to help clarify the distinctions between exchange versus nonexchange transactions and government-related versus government-acknowledged events, as well as to provide a clearer definition of “value.”

The feedback obtained from the task force was consolidated and reviewed by staff and then used to evaluate the existing classification structure. Based on the feedback received from task force members, staff has proposed several enhancements to the liability classification definitions that are now being circulated via survey to obtain additional feedback from the entire federal financial community.

I would like to point out that the changes to the definitions of the liability classifications have not been heavily impacted by the new liability definition proposed in the recent concepts statement exposure draft mentioned earlier. Rather, agencies would more likely see the most impact of the proposed liability definition on the establishment of the obligating event and liability recognition. Staff will address those two areas following its work on the liability classification structure.

Since input from the federal financial management community will be used to develop liability standards that cover the broad range of government programs, we encourage everyone to take the time to respond to this survey, including agencies that had representatives on the liability classification task force. We are requesting your responses be emailed to ranaganj@fasab.gov or faxed to 202-512-7366 by August 15, 2006. Please feel free to contact Julia Ranagan at 202-512-7377 to discuss any questions you may have. Thank you for your time and assistance.

Attachment

FASAB Survey on Liability Classification

Disclaimer: In the course of developing or updating federal accounting standards, FASAB staff periodically utilize task forces, surveys, and other means of communication to solicit feedback from the federal community. The information contained in this survey is intended to assist staff in preparing materials for the Board's deliberations; it is not intended to reflect authoritative or formal views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

1. Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, classified transactions and events into the following four classes of liabilities:

- Exchange Transaction – arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources (excerpt from SFFAS 5, par. 22).
- Nonexchange Transaction – arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises (excerpt from SFFAS 5, par. 24).
- Government-Related Event – nontransaction-based event that involves interaction between the federal government and its environment. The event may be beyond the control of the federal entity (excerpt from SFFAS 5, par. 27).
- Government-Acknowledged Event – nontransaction-based event that is of financial consequence to the federal government because it chooses to respond to the event. The federal government has broad responsibility to provide for the public's general welfare. The federal government has established programs to fulfill many of the general needs of the public and often assumes responsibilities for which it has no prior legal obligation (SFFAS 5, par. 30).

a. In your experience since SFFAS 5 was implemented in 1997, have the above four classes proved useful in helping your agency determine when an obligating event has occurred for purposes of liability recognition?

(Please click on one box)

- Yes
 No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

b. Based on your response in 1a., what is your recommendation regarding the four classes and their role in future development of liability standards:

(Please click on one box)

- Maintain the four classes without any changes or enhancements.
 Maintain the four classes with some changes or enhancements.
 Remove the four classes from use in future development of liability standards.
 Other

Why? (Please click on the grey shading in the box below to begin typing your response)

2. Based on feedback from the task force, staff has proposed the following enhancements to the existing definitions of the four classes:⁷

Exchange Transactions

An exchange transaction arises when an entity ~~each party to the transaction sacrifices value and receives value in return~~ provides assets (cash, cash equivalents, or goods) or services directly to another entity in return for assets or services or promises to provide assets or services in the future. There is a reciprocal or two-way flow of resources ~~assets or services~~ or of promises to provide ~~resources~~ assets or services directly between two entities (e.g., employee salaries and the purchase of goods or services from a vendor).

Excerpt from SFFAS 5, par. 22 (underlined items and strikethroughs indicate proposed clarifications by staff to the class definition only; the statements from par. 22 regarding recognition are not currently being addressed)

- a. Staff has proposed the following changes to the above definition of exchange transactions: (1) removing the phrase “sacrifices value and receives value” and replacing it with “provides assets (cash, cash equivalents, or goods) or services directly to another entity⁸ in return for assets or services or promises to provide assets or services in the future”; (2) inserting the word “directly” into the definition to explicitly state that an exchange is a direct transfer between the provider and the receiver; (3) emphasizing that the two-way flow of assets or services is reciprocal; and (4) providing examples in the definition (“e.g., employee salaries and the purchase of goods or services from a vendor”). Do you agree with the proposed enhancements to the definition of exchange transactions?

(Please click on one box)

- Yes
 No

Why or why not? (Please click on the grey shading in the box below to begin typing your response)

⁷ Note: Staff's proposed enhancements only address the definition piece and not the additional discussion on recognition. Staff is currently seeking feedback on the classification of liabilities and the definitions of the classes, not on the recognition of liabilities.

⁸ A detailed discussion of “entity” is contained in paragraphs 10 through 16 of the Exposure Draft on “*Definition and Recognition of Elements of Accrual-Basis Financial Statements*,” dated June 7, 2006, available at www.fasab.gov/exposure.html.

Nonexchange transactions

A nonexchange transaction arises when an entity ~~one party to a transaction~~ gives assets or services without directly receiving assets or services or the promise of assets or services in return or when an entity receives value ~~assets or services~~ without directly giving or promising value ~~assets or services~~ in return. In a nonexchange transaction, there is either no reciprocal or two-way flow of assets or services or of promises to provide assets or services or the transaction is not direct (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).

Excerpt from SFFAS 5, par. 24 (underlined items and strikethroughs indicate proposed clarifications by staff to the class definition only; the statements from par. 24 regarding recognition are not currently being addressed)

- b. Staff has proposed the following changes to the above definition of nonexchange transactions: (1) removing the term “value” and replacing it with “assets or services”; (2) emphasizing that “in a nonexchange transaction, there is either no reciprocal or two-way flow of assets or services or of promises to provide assets or services or the transaction is not direct”; and (3) providing examples in the definition (“e.g., grants to state and local governments, subsidies, and other transfer programs for individuals”). Do you agree with the proposed enhancements to the definition of nonexchange transactions?

(Please click on one box)

- Yes
 No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

Government-related Events

Government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place on federal property (e.g., tornado damage to a federal facility or accidental damage to nonfederal property caused by federal operations). Government-related events also include events that occurred in the course of federal operations of a former agency or where there was no existing legal requirement at the time provided that existing law or policy has transferred ownership of the obligation to the federal government.

Excerpt from SFFAS 5, par. 27 (underlined items and strikethroughs indicate proposed clarifications by staff to the class definition only; the statements from par. 27 regarding recognition are not currently being addressed)

- c. Staff has proposed the following changes to the above definition of government-related events: (1) explicitly stating that government-related events “are of financial consequence to the federal government” to be consistent with non-government-related events (previously government-acknowledged events); (2) emphasizing that government-related events involve “direct” interaction between the federal government and its environment; (3) emphasizing that government-related events result from “the

conduct of federal operations or because the events take place on federal property”; (4) providing examples in the definition (“e.g., tornado damage to a federal facility or accidental damage to nonfederal property caused by federal operations”); and (5) clarifying that “government-related events also include events that occurred in the course of federal operations of a former agency or where there was no existing legal requirement at the time provided that existing law or policy has transferred ownership of the obligation⁹ to the federal government.” Do you agree with the proposed enhancements to the definition of government-related events?

(Please click on one box)

- Yes
 No

Why or why not? (Please click on the grey shading in the box below to begin typing your response)

Government-acknowledged Non-Government-related Events

Government-acknowledged Non-Government-related events are nontransaction-based events that are not the direct result of federal operations and do not take place on federal property but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

Excerpt from SFFAS 5, par. 30 (underlined items and strikethroughs indicate proposed clarifications by staff to the class definition only; the statements from par. 30 regarding recognition are not currently being addressed)

- d. Staff has proposed the following changes to the above definition of non-government-related events: (1) changing the term “government-acknowledged” to “non-government-related” due to the amount of confusion caused by the term “acknowledged.” For example, a government-related event must also be “acknowledged” to the extent that the government determines that the event occurred, it is either the direct result of federal operations or takes place on federal property; it meets the definition of a liability, and a liability amount can be measured; (2) explicitly stating that non-government-related events “are not the direct result of federal operations and do not take place on federal property” to be consistent with the definition of government-related events; and (3) providing an example in the definition (“e.g., damage to nonfederal property caused by a natural disaster”). Do you agree with the proposed enhancements to the definition of non-government-related events?

(Please click on one box)

- Yes
 No

⁹ The term obligation is used with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

3. Staff has proposed sub-classes within each of the four classes to assist staff in determining if it has considered the full population of events and transactions that result in future outflows (provision of assets or services). In addition, staff has included a definition of contingencies that affect all of the classes.

Exchange Transactions – arise when an entity provides assets (cash, cash equivalents, or goods) or services directly to another entity in return for assets or services or promises to provide assets or services in the future. There is a reciprocal or two-way flow of assets or services or of promises to provide assets or services directly between two entities (e.g., employee salaries and the purchase of goods or services from a vendor).

- **Employee and Veteran Salaries and Benefits** – Examples would be employees’ wages, salaries, and bonuses; federal employee pension and other retirement benefits; military pension and other retirement benefits; other post-employment benefits; FECA; and Veterans disability compensation.¹⁰
- **Capital Leases** – Leases that transfer substantially all the benefits and risks of ownership to the lessee;
- **Federal Debt** – Includes Treasury debt to federal agencies, federal agency debt to the Treasury, and federal debt to the public.
- **Accounts Payable for Goods and Services** – Includes goods and services purchased through any means, including contracts, purchase orders, blanket purchase agreements, credit cards, intragovernmental agreements, etc. and for any purpose (e.g., purchase of office supplies or services received from vendor contracted to cleanup environmental and disposal liabilities).
- **Interest Payable** – The amount of interest expense incurred and unpaid. Interest incurred results from borrowing funds from Treasury, Federal Financing Bank, other federal entities, or the public. Interest also should be recorded on late payment of bills by the federal entity.
- **Advances and Prepayments Received** – advances and prepayments received from other entities for goods to be delivered or services to be performed.
- **Treaties and executive agreements** – Includes treaties and binding agreements under international law between two sovereign entities.

- a. Is this a complete listing of exchange transactions that arise in the federal environment?

(Please click on one box)

- Yes
- No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

¹⁰ Disability compensation is paid to veterans who are disabled by injury or disease incurred or aggravated during active military service in the line of duty. The service of the veterans must have been terminated through separation or discharge under conditions that were other than dishonorable. Monetary benefits are related to the residual effects of the injury or disease. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

Nonexchange Transactions - arise when an entity gives assets or services without directly receiving assets or services or the promise of assets or services in return or when an entity receives assets or services without directly giving or promising assets or services in return. In a nonexchange transaction, there is either no reciprocal or two-way flow of assets or services or of promises to provide assets or services or the transaction is not direct (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).

- **Social Insurance** – Specifically limited to five federal programs: Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance.
- **Benefit Payments other than Social Insurance** – Includes various entitlement and other benefit programs such as Supplemental Security Income, Food Stamps, Medicaid, Veterans Administration Pension,¹¹ and Temporary Assistance for Needy Families.
- **Insurance and Guarantees other than Social Insurance**¹² – Federal programs that provide protection to individuals or entities against specified risks. Many of these programs were established to assume risks that private sector entities are unable or unwilling to assume (at least at prices that beneficiaries of the program can afford [in some cases] or want to pay [in other cases]) or to subsidize the provision of insurance to achieve social objectives. Includes such programs as Pension Benefit Guarantee Corporation, Federal Crop Insurance Corporation, National Flood Insurance Fund, Federal Deposit Insurance Corporation, Overseas Private Investment Corporation, the Milk Income Loss Contract Program, Feed Grains Direct and Counter-Cyclical Payment Program, and loan guarantees.
- **Grant and Award Payments**¹³ – an award of financial assistance in the form of money or property. Government grants and awards can be provided under many different scenarios. Some can be provided without any significant requirements (e.g., formula-type grants to states based on population), while others may require specific activities to occur before the funds are available (e.g., the Corporation for National and Community Service’s Service Award Program).

b. Is this a complete listing of nonexchange transactions that arise in the federal environment?

(Please click on one box)

- Yes
- No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

¹¹ This program is an entitlement program that veterans may be eligible for if they have limited income when they have 90 days or more of active military service, at least one day of which was during a period of war. Their discharge from active duty must have been during a period of war. Their discharge from active duty must have been under conditions other than dishonorable. They must be permanently and totally disabled for reasons neither traceable to military service nor to willful misconduct. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

¹² The purpose of the four classes is to allow grouping and discussion of common events and relationships within a class that would be relevant to applying the liability definition. As discussed by the FASAB task force on liability classification, in certain scenarios, some nonexchange transactions could be classified as exchange or “exchange-like” (e.g., insurance programs where premiums are collected or research grants where the government retains the rights to patents and related future revenues). However, staff believes that over-emphasizing the effect of classification would be unproductive since the Board is applying the same liability definition to all transactions and events. Therefore, the accounting would most likely be the same for these transactions regardless of how they are classified because the underlying substance of the transaction would be the same.

¹³ See footnote 12.

Government-Related Events - nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place on federal property (e.g., tornado damage to a federal facility or accidental damage to nonfederal property caused by federal operations). Government-related events also include events that occurred in the course of federal operations of a former agency or where there was no existing legal requirement at the time provided that existing law or policy has transferred ownership of the obligation to the federal government.

- Damage to nonfederal property caused by federal operations
- Damage to federal property resulting from federal operations or natural disasters
- Environmental contamination occurring on federal property or resulting from federal operations

c. Is this a complete listing of government-related events that arise in the federal environment?

(Please click on one box)

- Yes
- No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

Non-Government-related Events - nontransaction-based events that are not the direct result of federal operations and do not take place on federal property but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

- Damage to nonfederal property caused by natural disasters
- Environmental contamination on nonfederal property that is not caused by federal operations

d. Is this a complete listing of non-government-related events that arise in the federal environment?

(Please click on one box)

- Yes
- No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

Contingencies – 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 (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).

- Pending or threatened litigation
- Unasserted claims

4. Do you agree that the sub-classes listed above, as well as the discussion of contingencies, capture all of the major classes of liabilities of the federal government?

(Please click on one box)

- Yes
 No

Why or why not? *(Please click on the grey shading in the box below to begin typing your response)*

Requested Information Regarding Person Completing Survey:

(Please click on each grey box below to input requested information)

**First and Last
Name:**

Agency Name:

Position Title:

Phone Number:

Email Address: