



Federal Accounting Standards Advisory Board

**ASSIGNING TO COMPONENT ENTITIES COSTS AND LIABILITIES THAT
RESULT FROM LEGAL CLAIMS AGAINST THE FEDERAL GOVERNMENT**

Technical Bulletin 2002-1

July 2002

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

The Federal Accounting Standards Advisory Board has authorized its staff to prepare FASAB Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with section III. I. 5 of the Board's rules of procedure, as amended and restated through October 1, 1999 and the procedures described in FASAB Technical Bulletin 2000-1, "Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance." The provisions of Technical Bulletins need not be applied to immaterial items.

Additional background information is available from the FASAB or its website:

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal government Accounting Standards and a Federal Accounting Standards Advisory Board," Amended January 11, 2002.*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

Exposure drafts, Statements of Federal Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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Executive Summary

1. This technical bulletin is intended to clarify the required reporting of costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government. Standards issued by FASAB have precedence over other authoritative guidance for Federal entities. This technical bulletin supplements any relevant Federal standards, but is not a substitute for and does not take precedence over the standard.
2. This technical bulletin requires that all liabilities and costs related to legal claims (i.e., judgments and settlements) must be attributed to the component entities responsible for the programs or activities that contributed to the claims, or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity.

Introduction

Purpose

3. Some Federal entities have requested guidance on assigning costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government when one or more Federal entities are involved in the litigation. General guidance for the accounting and reporting of costs and liabilities resulting from legal claims against the Federal government is provided in Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (SFFAS 4) and Statement of Federal Financial Accounting Standards Number 5, *Accounting for Liabilities of the Federal Government* (SFFAS 5).

Effective Date

4. This technical bulletin is effective for periods beginning after September 30, 2001.

Background

5. This issue is based primarily on the provisions required in the following Federal standards:
SFFAS Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and
SFFAS Number 5, *Accounting for Liabilities of the Federal Government*.

6. SFFAS 4 provides a full cost standard that states: "Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities." SFFAS 4 also provides a costing methodology standard which states in part, "The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are most appropriate to the segment's operating environment and should be followed consistently." In discussing cost assignment, SFFAS 4 provided the following principles in the order of preference:
- (a) Directly tracing costs wherever economically feasible;
 - (b) Assigning costs on a cause-and-effect basis; and
 - (c) Allocating costs on a reasonable and consistent basis.
7. SFFAS 5 requires that entities recognize a liability for a past event or exchange transaction that has occurred when a future outflow or other sacrifice of resources is probable and the future outflow or sacrifice of resources is measurable. "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, "probable" implies that the future confirming event or events are likely to occur. [As amended by paragraphs 10 and 11 of SFFAS 12, *Recognition of Contingent Liabilities arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*]. SFFAS 5 also requires that contingent liabilities be recognized when probable and measurable.

Technical Guidance

Issue

8.

What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (a) the actions of Federal component entities¹ contribute to a legal claim having been filed against the Federal government or (b) a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government?

General Principles

9. All liabilities and costs must be attributed to the component entities responsible for the programs or activities that contributed to the claims or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity.

Implementation

10. The following hierarchy of cost assignment principles should be applied when the actions of one or more Federal component entities contribute to a legal claim having been filed against the Federal government or when a Federal component entity disputes

¹ The term "component entity" is used to distinguish between the U. S. Federal government and its components. The U. S. Federal government is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into sub organizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, *Entity and Display*, paragraphs 11-12) Use of "component entity" in this technical bulletin is only intended to distinguish between the U.S. Federal government's consolidated financial statements and financial statements of its components.

that its actions contributed to the legal claim having been filed against the Federal government and it is not clear where the liability and cost should be reported.

- a. The component entities should apply the cost methodology principles provided in SFFAS 4 in the following order of preference:
 - (1) Directly tracing costs wherever economically feasible;
 - (2) Assigning costs on a cause-and-effect basis; and
 - (3) Allocating costs on a reasonable and consistent basis.

The component entities should seek advice from the appropriate legal counsel (Office of the General Counsel, Department of Justice, etc.) about pertinent legal matters and other factors that could be relevant to assigning costs. The management of the component entities involved should work together to resolve the issues before moving on to step (b.) below.

- b. If a reasonable cost assignment or allocation cannot be determined, as outlined in step (a.) above, the component entities should seek guidance from OMB's Office of Federal Financial Management (or its successor division) and recognize costs and liabilities as directed by OMB. In addition, all component entities involved should disclose the information concerning the nature of the costs and/or liability², the problems of assigning the costs to the component entities involved, and the estimated total liability among all the component entities involved.

² See specific disclosure requirements in Interpretation 2 paragraph 3 and SFFAS 5 paragraphs 40-42.

APPENDIX A: Basis for Conclusions

11. This appendix summarizes some of the considerations deemed significant in reaching the conclusions in this technical bulletin. It includes the reasons for accepting certain approaches and rejecting others. Some factors had greater weight than other factors.

12. The issue raised in this technical bulletin is:

What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (i) the actions Federal component entities contribute to a legal claim having been filed against the Federal government or (ii) a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government?

13. The Accounting and Auditing Policy Committee (AAPC) of FASAB originally proposed that in those rare instances, when allocating to one or more specific entities does not appear to be appropriate, OMB could allocate the costs directly to the consolidated financial statements of the U.S. government. However, a majority of the Board did not agree with the AAPC proposal and concluded that all costs and liabilities must be reported at the component level before flowing into the consolidated statements. Thus, the AAPC's proposed guidance was not issued as a technical release.

Appendix A: Basis for Conclusions

14. This Technical Bulletin exposure draft was issued in March 2002. During the 30-day comment period 12 comment letters were received. Eight of the respondents either said they agreed with or had no comment on the proposed guidance. Three other respondents commented on specific sections of the guidance and one additional respondent disagreed with the proposed guidance. The respondents' comments are summarized below. The Board does not simply rely on the number of respondents in favor of or opposed to a given position. The Board considers the arguments in each response and weighs the merits of the points raised. Information about respondent's views is provided only as a means of summarizing the comments.

	Federal	Non-federal
Users, academics, and others	2	1
Auditors	6	
Preparers and financial managers	3	

Respondents made the following individual comments:

- a) the initial assessment of the probability of a legal liability should be made by the respective legal counsel but legal counsel should not make accounting decisions;

- b) the attribution of liabilities to existing agencies for the activities of long-defunct federal instrumentalities, like the WWII entities, will overstate the apparent cost associated with that agency or its programs.

Based on the respondent's comment letters the Board reiterated the following conclusions.

With regard to the concern that legal counsel would not be in the position of offering accounting advice to agencies with respect to appropriate cost accounting methodology, the TB directs the component entities only to consult with legal counsel on information that may be relevant to determining the cost assignment.

With regard to legal costs of long-defunct Federal entities, the TB specifically states that component entities be responsible for their own claims as well as those of their successor component entities and that in those cases where the entities no longer exist, footnote disclosures are available for further explanations.

15. The Board's position is that all costs and liabilities must be attributed to component entities; that is, entities other than the U. S. Federal government as a whole. In general, the Board believes that the consolidated financial statements of the U. S. Federal government are a summation of component entity financial statements with appropriate intragovernmental eliminations.

16. Staff reviewed with the Board the possibility of reporting those unassigned costs and liabilities on the Treasury Judgment Fund (TJF)³ financial statements. Staff and the Board believe TJF should not bear the responsibility of recording all unassigned legal costs, as each component entity should accumulate and report the costs of its own activities. In addition, the TJF is merely the funding mechanism for many of the legal settlements and judgments against the Federal government.

³ In 1956, Congress enacted a permanent, indefinite appropriation ("the Judgment Fund") for the payment of final judgments that were "not otherwise provided for" (i.e. which cannot legally be paid from any existing appropriation or fund). Payments from the judgment appropriations may be made only upon certification by Financial Management Service, Department of the Treasury. Treasury's role is to "oversee" the use of this appropriation.

17. Therefore, staff concluded that entities should first apply the cost methodology principles provided in SFFAS 4 and that all legal costs must be allocated to a component entity, whether those costs are paid by the entity or by the Treasury Judgment Fund. This principal is consistent with those outlined in the Interpretation 2, *Accounting for Treasury Judgment Fund Transactions*. However, in instances when it is impossible for component entities to agree on a reasonable cost assignment or allocation basis, the entities should recognize costs and liabilities as directed by OMB. In addition, the Federal entities involved will be required to fully disclose all pertinent information related to the legal costs.

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