



April 10, 2018

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

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

Subj: Evaluation of Existing Standards--Assigning Liabilities **Tab A**¹

MEMBER ACTIONS REQUESTED:

- Respond to staff question (p.11) by April 23rd
- Prepare to approve staff recommendation or provide alternatives

MEETING OBJECTIVES

The objective of this session is to consider the issue of assigning liabilities and whether additional flexibilities or guidance should be provided in a GAAP document.

BRIEFING MATERIAL

The staff analysis is attached along with a summary of the questions for the Board on page 11. You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>. Appendices immediately follow.

BACKGROUND

As you may recall, at the June 2017 Board meeting, the Board considered a new request for guidance from the Department of Defense (DoD) regarding the need for certain flexibilities. Staff provided the Board with a “strawman draft” of an exposure draft (ED) that would have provided certain flexibilities to the DoD. After deliberation, the Board concluded the provisions should not be limited to DoD and that if permitted, the provisions should be applied government-wide.

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.

Further, it would be best (if permitted) to handle each of the issues in separate, appropriate GAAP-level documents. To date, the Board has addressed topics in the following documents:

- Technical Bulletin 2017-1, *Intragovernmental Exchange Transactions*
- Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*
- PROPOSED Statement of Federal Financial Accounting Standards Statement 55, *Amending Inter-Entity Cost Provisions* [currently under sponsor review, anticipated to be issued May 31, 2018]

This topic ‘assigning liabilities’ addresses the last issue area previously presented at the June 2017 meeting.

NEXT STEPS

The next steps will depend on the Board’s answers to the staff questions. Staff has included a discussion of various examples presented by DoD that may require additional guidance. Staff does not believe the “liability issue” should be addressed by providing broad flexibility as provided with assets. Instead, each specific example should be considered and assessed on a case by case basis. Staff’s recommendation for each example is included in the attached analysis.

MEMBER FEEDBACK

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

Attachment A- Staff Analysis

As noted in the cover memo, this memo and analysis addresses the last area previously presented at the June 2017 Board meeting. The Board requested staff to handle each of the issues in separate, appropriate GAAP-level documents. Specifically, this topic relates to providing flexibility regarding assignment of liabilities within a reporting entity.

Staff believes the assessment of this last area must be considered with the knowledge, understanding and intent of the 2 most recent pronouncements under this umbrella request (now the project Evaluation of Existing Standards). Specifically, staff is referring to:

- 1) Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*
- 2) PROPOSED Statement of Federal Financial Accounting Standards Statement 55, *Amending Inter-Entity Cost Provisions* [currently under sponsor review, anticipated to be issued May 31, 2018]

TB 2017-2 provided that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. Once issued, SFFAS 55 will restore paragraphs 110 and 111 of SFFAS 4, as amended, to their original language prior to the issuance of SFFAS 30. Recognition of inter-entity costs by activities that are not business-type activities is not required with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by the Office of Management and Budget. Notwithstanding the absence of a requirement, non-business-type activities may elect to recognize imputed cost and corresponding imputed financing for other types of inter-entity costs. However, the standards were adjusted to require business-type activities to recognize inter-entity costs.

Staff points this out because these pronouncements facilitate reporting for large and complex organizations so that reporting is better aligned with their operations and results in less costly financial reporting by permitting the reporting entity to align reporting with established funding and governance structures. It appears that liabilities associated with such organizations may need to be assessed to determine if any flexibility should be provided. However, it may be that with the previous two pronouncements certain issues that existed may have been resolved. For example, with SFFAS 55 no longer requiring inter-entity costing and TB 2017-2 providing the flexibility to assign assets, some issues that previously existed in the liability area may have been resolved.

Based on feedback, most agree the liabilities would follow the funding or asset involved (if applicable) of the particular reporting entity responsible and there isn't a particular void in the standards, but there may be a need to clarify certain aspects and to ensure that complex scenarios are adequately addressed.

Outreach in Previous Exposure Draft

During the exposure draft of Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*, staff included a question related to this topic to solicit feedback from the community. Specifically, it explained that staff planned to develop guidance regarding assignment of liabilities to components within a larger reporting entity. It explained that the specific types of liabilities identified where it may be helpful to provide additional guidance are liabilities related to assets such as clean-up costs and possibly all government related events. It asked if there were other types of liabilities for which guidance would be helpful.

Several respondents did not have specific comments on the topic and others agreed with the liabilities associated with clean-up and government-related events and possibly others. However, the comments were at a very general level and no general consensus of additional liabilities to be considered was gathered from the feedback.

Issue & Specific Examples

Staff has held several meetings and conference calls with DoD to discuss where clarification may be needed in the area of liabilities. At various points, different examples have been provided. Briefly, the issue relates to liabilities from events caused by one component entity of a large department but paid for by another component. DoD is seeking guidance that allows liabilities that meet established standards to be reported at the consolidated financial statement level but that reporting entities have the flexibility to assign liabilities to their component reporting entities on a rational and consistent basis similar to the guidance provided in TB 2017-02 regarding the reporting of assets. The list below provides these examples. Position papers provided by DoD are referenced and included as Exhibits to this paper.

Contingent Liabilities Adjudicated by a Single Service **(See Appendix 1 for DoD prepared paper)**

A Navy service member is sued for damages he caused to a home and other property in Afghanistan while in a government vehicle. The Army has geographic responsibility for Afghanistan thus will manage the claim and pay out any judgment resulting from the case on behalf of Navy using Army funds.

The DoD assigns responsibility for adjudicating overseas claims in a given country to a single service (Department of the Army, Navy, or Air Force) such that the service assigned responsibility in that country adjudicates claims for all the Military Departments in that country. The ongoing practice has been that the service assigned responsibility for adjudicating claims in a given country pays for the claims, even those claims due to the actions of another service. The adjudicating service does not seek reimbursement for claims paid on behalf of other services. Likewise, the service on whose behalf the claim is adjudicated, respectively, does not recognize an imputed cost.

Staff comments & recommendation:

Staff believes this issue gets complex as you work through the existing guidance and consider new pronouncements as follows:

SFFAS 5, *Accounting for Liabilities of the Federal Government*, provides 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.

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.” However, SFFAS 55 (when issued) will make clear that inter-entity costs are not required to be imputed in this case.

TB 2002-1, *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government* (which was issued in 2002) provides the general principle “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.” (emphasis added) The focus of the general principal in TB 2002-1 is the entity that *contributed to the claim*. In considering the example under only TB-2002-1, staff would consider (Navy is different than Army) and Navy caused the claim, it should have the liability.

However, staff also notes that slightly different from our discussion in SFFAS 47, TB 2002-1 explains the term “component entity” is used to distinguish between the U. S. Federal government and its components. It also expanded in the Basis for Conclusions by stating “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.”

When SFFAS 55 is issued, SFFAS 30 and Interpretation 6 will be rescinded; therefore the requirement to impute costs for these activities will be eliminated. However, the requirements for SFFAS 5 have not changed – a liability exists when there is a probable future outflow. TB 2002-1 explained that a component entity other than the U. S. Federal government as a whole should first recognize a liability. This guidance uses the term “component entity” in a somewhat different way than the SFFAS 47 definition. Staff believes there should be some additional judgement allowed in application of TB 2002-1. Specifically, it appears the intent of the Board in this

particular example with TB 2002-1 was that as long as the liabilities are included within DoD's consolidated financial statements, it would be consistent with GAAP.

Staff believes that TB 2002-1 may need to be updated to be consistent with more recent pronouncements. However, staff does not believe additional guidance is necessary.

Question 1- Does the Board believe this issue needs further clarification within TB 2002-1 and that there is no need for other guidance?

**DoD Paper: Research and Recommendation Paper
DLA E&DL Reporting Responsibilities
(See Appendix 2 for DoD prepared paper)**

Environmental Liabilities- Shared Responsibilities

A fuel tank farm is on an Army base where DLA provides the fuel and services but Army provides sustainment, restoration, and modernization funding to maintain the physical tanks over time. While the Army receives funding for the maintenance and sustainment of the tanks, DLA receives the appropriation for the clean-up cost related to environmental spills.

Several issues have been associated with this example including both entities report the asset on their financial statements, both reporting the Environmental Closure Requirement E&DL on their financial statements, neither reporting the asset or E&DL on their financial statements (assuming the other is doing so), and; one of them reporting the asset and associated E&DL on their financial statements, inconsistently.

In simple terms, this issue relates to when the owner of a fuel tank differs from the owner of the land it resides on and who has responsibility for reporting the environmental and disposal liability (ED&L) with a tank leaks. Meaning, the entity responsible for financially reporting the asset is different from the entity who will eventually be responsible for disposal of that asset (i.e., SOCOM has the financial reporting responsibility for special equipment assets they use in performing special operations missions but the Military Service has the responsibility to manage the disposal of that asset upon its retirement).

Staff comments & recommendation:

SFFAS 6, *Accounting for Property, Plant, and Equipment*, as amended provides guidance for recognizing liabilities for cleanup costs and SFFAS 5 provides guidance for

recognizing liabilities from government-related events such as cleanup of environmental damage. Additional guidance has been provided in this area through several technical releases- TR 2, 10, 11 and 12.

Assets may be owned by one component of a larger reporting entity, such as a department, but used and/or funded by another component of the same entity. This is especially challenging for large, complex departments, such as the Department of Defense, that have numerous components and sub-components.

With DoD's complex environment and shared common mission, often the reporting entity using the asset may not be the reporting entity responsible for disposal. Given the complex responsibilities and relationships among the components of large departments, staff believes paragraph 91² of SFFAS 6 may be resulting in unintended consequences for component entity reporting if additional explanation is not provided:

91. The recognition and measurement standards provided in this standard are subject to the criteria for recognition of liabilities included in SRAS no. 5. That is, liabilities shall be recognized when three conditions are met:

- a past transaction or event has occurred,
- a future outflow or other sacrifice of resources is probable,⁶⁷ and
- the future outflow or sacrifice of resources is measurable.⁶⁸

⁶⁷ Probable means that the future confirming event or events is more likely than not to occur.

⁶⁸ The unit of analysis for estimating liabilities can vary based on the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, an estimate of the cleanup costs could be made on a facility by facility basis, or an entity by entity basis.

Specifically, the second bullet "a future outflow or other sacrifice of resources is probable" appears to be the item within the standard that is causing issue for DoD and prevents them from consistent, accurate and meaningful application of the standards. Much of this is due to DoD's complex structure and results when the entity responsible for financially reporting the asset is different from the entity who will eventually be responsible for disposal of that asset. To include environmental costs, thus the liability presented on the using entity's statement during the asset's life could be construed as misleading since it doesn't truly represent a future outflow of resources to them.

Staff believes it is important to recognize when SFFAS 55 is issued, SFFAS 30 and Interpretation 6 will be rescinded; therefore the requirement to impute costs for these activities will be eliminated. Further, the Board's intent with TB 2017-2 was to provide flexibility with asset assignment. Considering these facts and the complexities of DoD structure, staff believes an interpretation should be written regarding the application of the second bullet of par. 91 at the component reporting entity level. Per the rules of procedures, Interpretations "clarify SFFAS provisions."

The interpretation would provide context around the meaning of "a future outflow or other sacrifice of resources is probable" at the component reporting entity level where

² Paragraphs 85-111 of SFFAS 6, as amended address Cleanup Costs.

multiple sub-components of a large department have distinct responsibilities for an asset and for settling the related liability.

Question 2- Does the Board agree that paragraph 91 of SFFAS 6, as amended needs to be clarified through an Interpretation?

**DoD Paper: Research and Recommendation Paper
Chemical Weapons Disposal Paper
(See Appendix 3 for DoD prepared paper)**

The expected future environmental liabilities associated with the Assembled Chemical Weapons Alternatives (ACWA) and Chemical Materials Activity (CMA) programs are reported on Consolidated Financial Statements for the reporting entity "Army General Fund" while other transactions are included elsewhere.

United States Code 50, Section 1521 outlines each of these two programs, which govern the management of the construction, operation, and closure, and any contracting relating thereto, of chemical demilitarization activities for the destruction of the United States' stockpile of lethal chemical agents and munitions. Specifically, it outlines the details in paragraph g as follows:

- (1) In carrying out this section, the Secretary of Defense shall provide for a management organization within the Department of the Army. The Secretary of the Army shall be responsible for management of the destruction of agents and munitions at all sites except Blue Grass Army Depot, Kentucky and Pueblo Chemical Depot, Colorado*
- (2) The program manager for the Assembled Chemical Weapons Alternative Program shall be responsible for management of the construction, operation, and closure, and any contracting relating thereto, of chemical demilitarization activities at Blue Grass Army Depot, Kentucky, and Pueblo Army Depot, Colorado, including management of the pilot-scale facility phase of the alternative technology selected for the destruction of lethal chemical munitions. In performing such management, the program manager shall act independently of the Army program manager for Chemical Demilitarization and shall report to the Under Secretary of Defense for Acquisition, Technology, and Logistics*
- (3) The Secretary of Defense shall designate a general officer or civilian equivalent as the director of the management organization established under paragraph (1). Such officer shall have –*
 - a. Experience in the acquisition, storage, and destruction of chemical agents and munitions; and*
 - b. Outstanding qualifications regarding safety in handling chemical agents and munitions.*

- c. *Identification of funds*
- d. *Funds for carrying out this section, including funds for military construction projects necessary to carry out this section, shall be set forth in the budget of the Department of Defense for any fiscal year as a separate account. Such funds shall not be included in the budget accounts for any military department.*

Staff comments & recommendation:

It appears this issue can be addressed by ensuring there is a complete understanding of the reporting entities. Meaning, staff believes a liability [a probable future outflow or other sacrifice of resources as a result of past transactions or events...] exists but the question relates to which reporting entity should include the liability.

Staff could not readily identify an account labeled “Other 97 Funds Provided to the Army by OSD” in the President’s Budget. However, staff believes a thorough analysis should be done based on the principles established within SFFAS 47, *Reporting Entity*. Staff believes that it would be important to consider the section “Identifying Organizations for Which Component Reporting Entities are Accountable” of SFFAS 47 that includes a discussion regarding administrative assignments to component reporting entities in paragraphs 56-65.

Staff believes once the reporting entity /component reporting entity boundary has been established, the liability issue will naturally be resolved.

Question 3- Does the Board agree that this issue (Chemical Weapons Disposal Paper) should be resolved by applying the reporting entity criteria and no further action is necessary?

CONCLUDING STAFF RECOMMENDATION & QUESTION FOR THE BOARD:

In summary, staff does not believe the “liability issue” should be addressed by providing broad flexibility as provided with assets. Each of the issues above, are somewhat different and may resolve on their own or may need specific clarifications if the Board agrees.

As explained with the recent issuance of TB 2017-2 *Assigning Assets to Component Reporting Entities* and the DRAFT Statement of Federal Financial Accounting Standards Statement 55, *Amending Inter-Entity Cost Provisions* [currently under sponsor review, anticipated to be issued May 31, 2018] these will facilitate reporting for large and complex organizations so that reporting is better aligned with their operations

and results in less costly financial reporting by permitting the reporting entity to align reporting with established funding and governance structures.

Question 4- Does the Board agree with the staff recommendations in questions 1-3 and that no further actions are required? Alternatively, if members disagree, what alternatives do you prefer to address the issue?

Summary- Questions for the Board

- 1. Does the Board believe this issue needs further clarification within TB 2002-1 and that there is no need for other guidance?**
- 2. Does the Board agree that paragraph 91 of SFFAS 6, as amended needs to be clarified through an Interpretation?**
- 3. Does the Board agree that this issue (Chemical Weapons Disposal Paper) should be resolved by applying the reporting entity criteria and no further action is necessary?**
- 4. Does the Board agree with the staff recommendations in questions 1-3 and that no further actions are required? Alternatively, if members disagree, what alternatives do you prefer to address the issue?**

APPENDICES 1-3
DoD Prepared Papers

APPENDIX 1

*Research and Recommendation Paper
Contingent Liabilities Arising From Litigation,
Reporting Entity OCONUS Claims Adjudicated by Another Military Department
Issue 50*



Description of the Issue

Navy Financial Management & Comptroller (FM&C) requested guidance on procedures to report contingent loss liabilities for Navy claims arising overseas that are adjudicated and settled by other Military Departments.

DoDI 5515.08, *Assignment of Claims Responsibility*, assigns the responsibility for adjudicating overseas claims in a given country to a single service (Department of the Army, Navy, Air Force) such that the Military Department assigned responsibility for that country adjudicates claims for all the Military Departments and USSOCOM in that country. According to DoD Office of General Counsel (OGC), ongoing practice has been that the Service assigned responsibility for adjudicating claims in a given country pays for the claims, even those claims due to the actions of another Service – the “single service” claims concept. The adjudicating Service does not seek reimbursement for claims paid on behalf of other Services or USSOCOM. Likewise, the Service and USSOCOM on whose behalf the claim is adjudicated, respectively, does not recognize an imputed cost.

A contributing factor for not accounting for intra-departmental imputed costs is lack of awareness of Federal Accounting Standards Advisory Board (FASAB) accounting guidance by those in OSD who are outside of the Financial Management community. The issue had not been previously brought to DoD OGC’s attention. However, when informed of the FASAB guidance, DoD OGC discussed the matter with fellow Service OGCs and stated that the extra effort involved to account for claims paid by one Service for another was most likely not worth the costs involved to report. Also, OGC raised questions regarding the practicality of identifying the responsible Service in a joint-Service activity.

We understand the Services do not track overseas claims paid on behalf of other Services. Therefore, we did not attempt to contact the OGCs of the Services to determine the dollar amount of such cases. Given the nature of overseas claims we would not expect the dollar value to be material to the financial statements. We are aware that the Services each have their own claims tracking systems, but did not attempt to determine whether claims paid on behalf of other services could be identified in those tracking systems. DoD OGC informed us that a DoD-wide claims tracking system does not exist.

Issue Implications

Currently, the cost of overseas claims adjudicated by one Service on behalf of another Service are reported as costs of the Service adjudicating/settling the claim rather than the Service that caused the incident that gave rise or contributed to the claim. However, FASAB Technical Bulletin 2002-1: *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government*, 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. Also, Statement of Federal Financial Accounting Standard (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*, states that reporting entities should report the full costs of outputs in general purpose financial reports. ... and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities. Further, FASAB Interpretation of Federal Financial Accounting Standards 6: *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4* states that entities should recognize imputed intra-departmental costs in accordance with the full cost provisions of SFFAS 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.

Authoritative Guidance

- **SFFAS 4** – *Managerial Cost Accounting Standards and Concepts* (FASAB Handbook v.15 (06/16))
- **SFFAS 5** – *Accounting for Liabilities of the Federal Government* (FASAB Handbook v.15 (06/16))
- **SFFAS 12** – *Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government* (FASAB Handbook v.15 (06/16))

APPENDIX 1

*Research and Recommendation Paper
Contingent Liabilities Arising From Litigation,
Reporting Entity OCONUS Claims Adjudicated by Another Military Department
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- **SFFAS 30 – Inter-Entity Cost Implementation:** Amending SFFAS 4, *Managerial Cost Accounting Standards and Concepts* (FASAB Handbook v.15 (06/16))
- **Technical Bulletin 2002-1:** *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government* (FASAB Handbook v.15 (06/16))
- **Interpretation of Federal Financial Accounting Standards 2:** *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5* (FASAB Handbook v.15 (06/16))
- **Interpretation of Federal Financial Accounting Standards 6:** *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* (FASAB Handbook v.15 (06/16))
- **DoDI 5515.08,** *Assignment of Claims Responsibility* (August 30, 2016)

Options Considered

Option 1: Fully implement the full cost provisions in SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.

- The Services recognize imputed intra-departmental costs of adjudicating/settlement of overseas claims in accordance with the full cost provisions of SFFAS 4, e.g., Department of the Army reports claims it adjudicates and pays on behalf of the Air Force in Germany to the Department of the Air Force.
 - Each Service and USSOCOM recognizes the full cost of claims adjudication services that it receives from the Services. The Service providing the goods or services is responsible for providing the entity Service with information on the full cost of such goods or services either through billing or other advice.
 - Recognizes material intra-departmental costs that are not fully reimbursed that:
 - are significant to the receiving entity,
 - form an integral or necessary part of the receiving Service’s output, and
 - can be identified or matched to the receiving Service with reasonable precision.
- Enhances and expands the tracking of overseas claims armed forces-wide through the Service adjudicating the claim providing the other Service with data needed to identify the supporting services received.

Option 2: Continue the current practice of tracking and reporting these contingent legal liabilities according to DoDI 5515.08 (“single service” claims concept) while ODCFO works with FASAB to develop a potential new accounting standard that aligns with this practice.

- FASAB has discussed with ADCFO its intent to allow DoD the flexibility to recognize and assign intra-departmental costs among DoD reporting entities instead of imputing them as long as the consolidated DoD financial results include all costs.
- Services assigned claims responsibilities under DoDI 5515.08 should evaluate their processes and controls to ensure the completeness of their reporting of all contingent legal liabilities for DoD claims occurring OCONUS.

Recommendation(s) and Basis for Recommendation(s)

We recommend Option #2:

- Option #2 would permit the Services to continue with their current practice, the “single service” claims concept, for reporting claims arising in overseas areas or pursuant to international treaties in accordance with DoDI 5515.08. At the same time, the Services would be responsible for evaluating their processes

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Issue 50*



and controls surrounding the completeness of claims reporting and ODCFO would continue to work with FASAB.

DASB Approvals of Recommendation:

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DASB Co-Chair (Alaleh A. Jenkins, ODCFO/ADCFO)

Date

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**DASB Co-Chair (Andrew S. Haeuptle, ODCMO/Director,
Defense Business Management, Analysis, and Optimization)**

Date

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APPENDIX 2

Research and Recommendation Paper: Issue-10168-16 DLA E&DL Reporting Responsibilities



Description of the Issue

The Defense Logistics Agency (DLA) received a finding during their audit of Environmental & Disposal Liabilities (E&DL) that related to defining the policy and rule set associated with reporting E&DL when the ‘owner’ of a fuel tank differed from the ‘owner’ of the land asset where the fuel tank resided. DLA also asked a question around who has the responsibility for reporting E&DL associated with a tank leak under the same scenario where the ‘owner’ of the fuel tank differed from the ‘owner’ of the land asset where the fuel tank resides.

Issue Implications

Clarification is needed to ensure that DLA and the Services are properly accounting for and presenting financial information in accordance with Department policy on E&DL. Failure to resolve this issue will negatively impact accuracy of financial data reported by one or all parties – specifically, fuel tank E&DL could be reported by more than one organization or by no organization.

Authoritative Guidance

Identify authoritative guidance researched, including:

- OUSD(C) Policy Memo entitled, *Strategy for Environmental & Disposal Liabilities Audit Readiness* issued on September 30, 2015

The *Strategy for Environmental & Disposal Liabilities Audit Readiness* memo outlined the considerations applicable to determining which reporting entity has the E&DL obligations at a given date. Specifically, it referenced that “The DoD entity having responsibility (by law, authorized legal agreement, or DoD policy) for funding the environmental and disposal liability shall report the associated costs and liability in its financial statements.” It also addressed instances where the entity responsible for funding the E&DL may not be the entity responsible for estimating, tracking, revising, and monitoring the liability. “The DoD entity responsible for the physical cleanup and disposal shall be the entity that estimates, tracks, revises, and monitors the liability. In most instances this will be the same entity as the entity with the responsibility for funding the environmental and disposal liability. If that is not the case, then the “non-funding” entity shall provide the cost and liability information to the funding entity for recording in the funding entity’s financial statements.”

However, the written policy does not address specific treatment of future environmental liabilities based on the distinction between ‘asset-driven’ and ‘event-driven’ scenarios, which are different by nature and present challenges to financial statement reporting and subsequent audit scenarios.

There are two issues involved with DLA’s audit findings and follow-up questions. (1) Event-Driven: If a tank spills, who is responsible for reporting the EL – the asset user or the land owner? (2) Asset-Driven: Who accrues future disposal EL costs for assets – the land owner or the asset user?

For Issue 1, Defense Environmental Restoration Program (DERP) funding is directed to DLA for the purpose of addressing environmental clean-up associated with event-driven liabilities in accordance with DERP policy. In this scenario, DLA is the entity having responsibility for funding the environmental and disposal liability and shall report the associated costs and liability in its financial statements.

For Issue 2, DLA operates and maintains several assets that support mission operations. In some instances, DLA reports the asset on their financial statements and in other instances the Services report the asset on their financial statements. Additionally, DLA acts as a Working Capital Fund (WCF) organization and builds rates associated with the fuel services they provide to the Services that could include both product and non-product costs. The rates developed could include the price of the fuel, the costs associated with getting the fuel from the refinery to the tanks in operation on installations, the tank

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maintenance costs, the environmental permit costs, and the unique disposal requirements that typically constitute an environmental liability.

Options Considered

The solutions referenced in the OSD memos above are consistent with applicable Federal Accounting Standards Advisory Board (FASAB) pronouncements including: SFFAS 1, 5, 6, and 23; Technical Release 2, 10, 11, and 14; and Technical Bulletin 2006-1 and 2011-2. As such, solution options are dictated by authoritative guidance.

Recommendation(s) and Basis for Recommendation(s)

After reviewing applicable guidance and inspecting the relationships, roles, and responsibilities inherent to fuel services managed by DLA, recommend that for Issue 1 (event-driven), DLA continue to report that future estimated clean-up on their financial statements in accordance with the policies and procedures currently in place. For Issue 2 (asset-driven), the entity reporting the asset on their financial statement should also report the future environmental disposal liability. At disposal, if another entity is responsible for disposing of the asset, recommend transferring both the asset and liability to the disposal entity to initiate the disposal process. If the disposal costs are included in the WCF rate-setting process, both the asset and the liability should be reported by the WCF entity and no transfer at disposal should be executed as the costs of that disposal action are included in the WCF rate-setting process.

DASB Approvals of Recommendation:

_____	_____
DASB Co-Chair (Alaleh A. Jenkins, ODCFO/ADCFO)	Date
_____	_____
DASB Co-Chair (Andrew S. Haeuptle, ODCMO/Director, Defense Business Management, Analysis, and Optimization)	Date

DASB Staff Point of Contract

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APPENDIX 3
Research and Recommendation Paper
Chemical Weapons Disposal
FY 17-DoD Wide-DCFO Issue 40

Description of the Issue

During the entrance conference of the Army Audit Agency's (AAA) Audit of the Army Environmental Liabilities, Existence and Completeness, Valuation (A-2017-FMR-0024.000), questions were raised related to the Assembled Chemical Weapons Alternatives (ACWA) and Chemical Materials Activity (CMA) programs. Currently, budgetary transactions appropriated for activities associated with ACWA and CMA are recorded on Consolidated Financial Statements for the reporting entity "Other 97 Funds Provided to the Army by OSD" while the expected future environmental liabilities associated with the ACWA and CMA programs are recorded on Consolidated Financial Statements for the reporting entity "Army General Fund."

United States Code 50, Section 1521 outlines each of these two programs, which govern the management of the construction, operation, and closure, and any contracting relating thereto, of chemical demilitarization activities for the destruction of the United States' stockpile of lethal chemical agents and munitions. CMA includes both the Recovery of Chemical Warfare Material (RCWM) and the Chemical Stockpile Emergency Preparedness Program (CSEPP). Specifically, United States Code 50, Section 1521 outlines management organization details in paragraph g as follows:

- (1) In carrying out this section, the Secretary of Defense shall provide for a management organization within the Department of the Army. The Secretary of the Army shall be responsible for management of the destruction of agents and munitions at all sites except Blue Grass Army Depot, Kentucky and Pueblo Chemical Depot, Colorado
- (2) The program manager for the Assembled Chemical Weapons Alternative Program shall be responsible for management of the construction, operation, and closure, and any contracting relating thereto, of chemical demilitarization activities at Blue Grass Army Depot, Kentucky, and Pueblo Army Depot, Colorado, including management of the pilot-scale facility phase of the alternative technology selected for the destruction of lethal chemical munitions. In performing such management, the program manager shall act independently of the Army program manager for Chemical Demilitarization and shall report to the Under Secretary of Defense for Acquisition, Technology, and Logistics
- (3) The Secretary of Defense shall designate a general officer or civilian equivalent as the director of the management organization established under paragraph (1). Such officer shall have –
 - a. Experience in the acquisition, storage, and destruction of chemical agents and munitions; and
 - b. Outstanding qualifications regarding safety in handling chemical agents and munitions.
 - c. Identification of funds
 - d. Funds for carrying out this section, including funds for military construction projects necessary to carry out this section, shall be set forth in the budget of the Department of Defense for any fiscal year as a separate account. Such funds shall not be included in the budget accounts for any military department.

Specific questions raised by AAA in relation to the ACWA and CMA programs sought to address which Component financial statement should include ACWA and CMA related financial transactions. Financial transactions include those related to executing and carrying out the ACWA and CMA program objective; and, recording/financial reporting of the environmental liability associated with these programs. As a result of the Recommendation included within this document, specific responses to AAA inquiries are outlined in Appendix A.



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Issue Implications

The ACWA and CMA programs represent significant and material balances for both Defense-wide and/or Army financial statements. OUSD(C) FIAR’s feedback is required to help ensure that these financial statement amounts are properly recorded on Component financial statements in accordance with applicable accounting standards and guidelines, which includes consideration of applicable federal regulations.

Authoritative Guidance

- Statement of Federal Financial Account Standards (SFFAS) 5: *Accounting for Liabilities of the Federal Government*
- Statement of Federal Financial Accounting Concepts (SFFAC) 2: *Entity and Display*
- Office to the Under Secretary of Defense (Comptroller) / Chief Financial Officer (OUSD(C) / CFO) *Financial Improvement and Audit Readiness (FIAR) Guidance, April 2017*
- 50 U.S.C. & 1521 – *U.S. Code – Unannotated Title 50. War and National Defense & 1521. Destruction of existing stockpile of lethal chemical agents and munitions*
- DoD Directive 5101.17E – *Roles and Responsibilities Associated with the Recovery of Chemical Warfare Material*
- Memorandum for Secretary of the Army 23 February 2012, *Memorandum of Agreement (MOA) on Management and Execution of the Assembled Chemical Weapons Alternatives (ACWA) Program*

At issue is OUSD(C) FIAR’s decision on which Component financial statements (Army or Defense-wide) should include ACWA and CMA activities based on an analysis of applicable accounting standards and information made available by key stakeholders.

Consideration of Accounting Standards and Other Guidance

As outlined in SFFAS 5, “a liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events...” This issue paper assumes that the activities included in the ACWA and CMA programs constitute a liability in accordance with SFFAS 5. This definition is being listed to help focus on the clause “outflow or other sacrifice of resources” as it will be important to consider when determining financial reporting responsibility. Additionally, it is important to note that Congressional funding for the ACWA and CMA programs are reported under the Reporting Entity “Other 97 Funds Provided to the Army by OSD.” Even though funds associated with these programs are initially provided to OUSD (AT&L) before OUSD (AT&L) allocates those funds to the Army (which is consistent with DoD Directive 5101.17E and the MOA between OUSD (AT&L) and Army on management of the ACWA program), the funding details are still maintained under the Other 97 Funds Provided to the Army by OSD reporting entity which ultimately rolls up under the Defense-wide financial statements as described previously.

In addition, U.S. Code Title 50, Section 1521 explicitly states that, “the Secretary of Defense shall, in accordance with the provisions of this section, carry out the destruction of the United States’ stockpile of lethal chemical agents and munitions.” While there are provisions within U.S. Code Title 50, Section 1521 and subsequent DoD Directives and agreements that outline shared responsibilities between OSD and the Department of Army, the initial receipt of funding and ultimate responsibility for destruction of existing stockpiles rests with OSD.

Options considered include:

1. Move budgetary transactions from Other 97 Funds Provided to the Army by OSD to Army General Fund.



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2. Move the ACWA and CMA program environmental liability balances from Army General Fund to Other 97 Funds Provided to the Army by OSD, with the understanding that the Department of Army would have significant input on year-end financial statement reporting processes, to include the internal controls and key supporting documentation in place to support those year-end procedures.

Recommendation(s) and Basis for Recommendation(s)

Move the environmental liability balance currently reported on Army General Fund to Other 97 Funds Provided to the Army by OSD.

The issue is not whether the ACWA and CMA programs should be reported on Consolidated DoD financial statements, but where specifically (Defense-wide or Army) those program balances should reside. Based upon these facts: (1) U.S. Code 50, Section 1521 establishes primary responsibility to be with OSD, and (2) budget funding for the programs are directed to OSD initially, with all financial statement activity associated with that funding currently reported on the Other 97 Funds Provided to the Army by OSD Component financial statement, the recommendation is to align environmental liability balances on Defense-wide financial statements moving forward.

DARWG Approvals of Recommendation:

DARWG Co-Chair (Alaleh A. Jenkins, ODCFO/ADCFO)	Date
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DARWG Co-Chair (Jeffery R. Curtis, OCMO/ Acting Director, Defense Business Management, Analysis, and Optimization)	Date
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Appendix A -- Specific Responses to AAA Inquiries

Question 1: What roles do the Army and OSD play in the derivation/origin of the CMA and ACWA liability estimates?

Response to Question 1: The OSD CAPE office developed the initial estimates for the ACWA program, which is included in estimates being used today on Army financial statements. However, the Army is responsible for managing and monitoring execution activities associated with the program and provides annual budget submissions to OSD for review and approval ahead of Congressional submission. Even though the recommendation provided is to report the environmental liability in the future on Defense-wide financial statements, the Army would continue to play a significant role in the development of future program cost estimates (to include internal control activities or key supporting documentation associated with producing those estimates).

Question 2: What guidance has or is being reviewed / interpreted to determine the reporting responsibility of CMA and ACWA? (i.e., is it more appropriate for OSD or the Army to report and be able to pass future financial statement audits?)

Response to Question 2: SFFAS 5 and SFFAS 2 were heavily considered when determining (1) that the ACWA and CMA programs should be considered an environmental liability, and (2) which entity specifically from a reporting entity perspective should report the liabilities based on ACWA and CMA future estimates.

Question 2a: Has an objective decision matrix been developed to assess and weigh all relevant factors for determining who should report the liabilities? And if so, can it be shared?

Response to Question 2a: Yes, this document serves as the decision matrix developed to weigh relevant factors for determining which entity should report the liabilities.

Question 3: Regarding which entity's financial statements the liabilities should be reported on, are there specific decision points that haven't been agreed to and if so, what are they?

Response to Question 3: No.

Question 4: Has there been or will there be any consultation on this financial statement reporting topic with an outside party (such as FASAB), and if already consulted, what was the result?

Response to Question 4: Yes, we have spoken about this topic with both FASAB and during monthly meetings with our IPA round table that includes representation from many IPA firms. In those discussions, this approach was described and agreed to in principle.