# Memorandum

**Commitments**

February 10, 2024

To: Members of the Board

From: Sherry L. Lee, Senior Analyst

Thru: Monica R. Valentine, Executive Director

Subject: **Commitments** (Topic B)

## INTRODUCTION

At the December 2023 meeting, the Board reviewed the staff research on whether commitments meet the liability definition in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* and liability recognition criteria in SFFAS 5, *Accounting for Liabilities of The Federal Government*. Although commitments do not meet either the liability definition or liability recognition criteria, due to the potential significant effect on the federal government's future financial position and condition, the Board agreed that there is a need for level A guidance on commitments, potentially as an amendment to SFFAS 5, to ensure future budgetary integrity and transparency about the federal government's financial condition.

Staff prepared the attached Staff Analysis and is seeking the Board's feedback on the questions.

## REQUEST FOR FEEDBACK BY February 16, 2024

Please review the attached Staff Analysis on commitments. Staff requests responses to the ensuing question in the Staff Analysis by **February 16, 2024.**

Please submit responses to Sherry L. Lee at LeeSL@fasab.gov with a cc to Monica Valentine at ValentineM@fasab.gov.

## NEXT STEPS

Staff will continue the research on the topic of commitments.

## ATTACHMENTS

Attachment 1: Staff Analysis

# Staff Analysis

**Topic B**: **Commitments**

February 10, 2024

## INTRODUCTION

At the April 2023 meeting, Chairman Scott and Mr. Dacey noted that, while reporting on commitments is currently required by the Office of Management and Budget (OMB) Circular A-136 for fair presentation of financial statements, commitments are not specifically defined or described in FASAB guidance. At the August 2023 meeting, the Board reviewed the pre-research material on commitments during the technical agenda review session and agreed to add the topic of commitments as a research project.

At the December 2023 meeting, the Board reviewed the staff research on whether commitments meet the liability definition in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* and liability recognition criteria in SFFAS 5, *Accounting for Liabilities of The Federal Government*. Due to the potential significant effect on the federal government's future financial position and condition, the Board agreed that there is a need for level A guidance on commitments, possibly as an omnibus amendment to SFFAS 5, to provide consistent reporting of commitments. Members suggested clearly differentiating between contingencies and commitments.

The below staff analysis discusses the similarities, differences, and relationship between commitments and contingencies, and prompts the Board to consider these characteristics when developing reporting guidance for federal financial commitments.

## SUMMARY OF ANALYSIS AND RECOMMENDATION

Commitments and contingencies may seem similar but are difference concepts that should be treated differently. Commitments are not liabilities of the entity because the "past transactions" criteria required for liability recognition is not met. Due to similarities between commitments and contingencies, entities may apply the guidance inappropriately. As the Board considers options for proposing guidance on commitment, staff asks the Board to consider clearly differentiating between these two concepts to help federal entities in determining the appropriate guidance to apply to activities.

## STAFF ANALYSIS AND RECOMMENDATIONS

To differentiate between commitments and contingencies, staff performed the following steps:

- STEP 1: Compare definitions.

- STEP 2: Identify characteristics.
- STEP 3: Identify similarities.
- STEP 4: Identify differences.
- STEP 5: Illustrate the two concepts in the liability recognition process.
- STEP 6: Analyze and recommend course of actions.

## STEP 1 – Compare Definitions

**What are commitments?**

Commitments are binding agreements (e.g., promises, pledges, guarantees, contracts) to enter into **future** transactions **if** conditions specified in the agreement are met.

Please refer to Appendix A for a sample listing of commitments based on staff's research to-date.

**What are contingencies?**

According to SFFAS 5, a contingency is as an existing condition, situation, or set of circumstances involving uncertainties 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

## STEP 2 – Identify Characteristics

Staff identified the characteristics associated with commitments and contingencies based on the definitions to help identify the similarities and differences between the two concepts.

**Characteristics of Commitments**

Staff identified the following characteristics related to commitments:

1. Commitments are **existing** binding agreements.
    - There is an agreement in place and the entity is obligated to enter into future transactions if conditions specified in the agreement are met.
    - Existing agreement does **not** mean existing transaction or event.
2. The agreement is to enter into **future** transactions.

- This means that the actual transactions **have not occurred**.

- The entity’s future actions are transaction-based.

- The transactions are either exchange or non-exchange transactions. *Please refer to Appendix B for an analysis of exchange/non-exchange transactions of significant federal commitments*.

3. Commitments’ future transactions are **conditional**.

   - The future transactions would occur **only if** conditions specified in the agreement are met.

   - In other words, **unless** the conditions specified in the agreement are met, the government is under no obligation to enter into future transactions.

The following are a few examples of commitments:

- Treasury enters into senior preferred stock purchase agreement (SPSPA) with each government-sponsored enterprises (GSE), Fannie Mae and Freddie Mac. The SPSPAs requires Treasury to disburse funds to the GSE if, at the end of any quarter, the liabilities of either GSE exceed its assets. Treasury is obligated to provide funding only if either GSE’s liabilities exceeds its assets.

- Treasury’s callable capital subscriptions for multilateral development banks (MDB). Treasury subscribes to shares of certain MDB, which are international financial institutions that finance economic and social development projects in developing countries. Some shares represent commitments that are callable under certain limited circumstances to meet the obligations of the respective MDB. According to Treasury’s 2023 Agency Financial Report, there has never been a call and none is anticipated.

- Undelivered orders unpaid. The entity is not obligated to pay the vendors until goods or services are delivered.

**Characteristics of Contingencies**

Staff identified the following characteristics associated with contingencies:

1. A contingency is an **existing** condition, situation, or circumstance.

   - Condition, situation, and circumstance are associated with **events**.

   - Existing means the event **has occurred**.

- Events are **non-transaction based**.

- Contingencies are **government-related** events because they are non-transaction-based events that involve interactions between the entities and their environment.

2. The uncertainty as to possible loss or gain will ultimately be resolved by the outcome of a future event.

    - The likelihood of the outcome of the future event may be estimated based on experience or facts of the circumstances.

    - Liability could be recognized if likelihood is probable and amount is measurable.

The following are examples of contingencies:

- An entity is being sued by the public for oil spills.

- An entity is involved in contract disputes with the vendor.

### STEP 3 – Identify Similarities

Based on the definitions, staff identified the similarities between commitments and contingencies in Table 1.0.

**Table 1.0**
**Similarities Between Commitments and Contingencies**

| Characteristic | Commitments | Contingencies |
|---|---|---|
| **1. Existing "component"** | Existing binding agreement | Existing condition, situation, circumstances |
| **2. Future "component"** | Future **transactions** (related to entity actions) | Future **events** (related to outcome of resolution) |
| **3. Uncertainties** | Uncertain when conditions specified in the agreement are met | Uncertain about outcome of the (e.g., legal) actions |

| | | |
|---|---|---|
| 4. **Resolution of uncertainties** | Resolved **if** conditions specified in the agreements are met or failed to be met. | Resolved **when** one or more future events occur or fail to occur. |

### STEP 4 – Identify Differences

Based on the characteristics of commitments and contingencies, staff identified the differences between the two concepts in Table 2.0.

**Table 2.0**
**Differences Between Commitments and Contingencies**

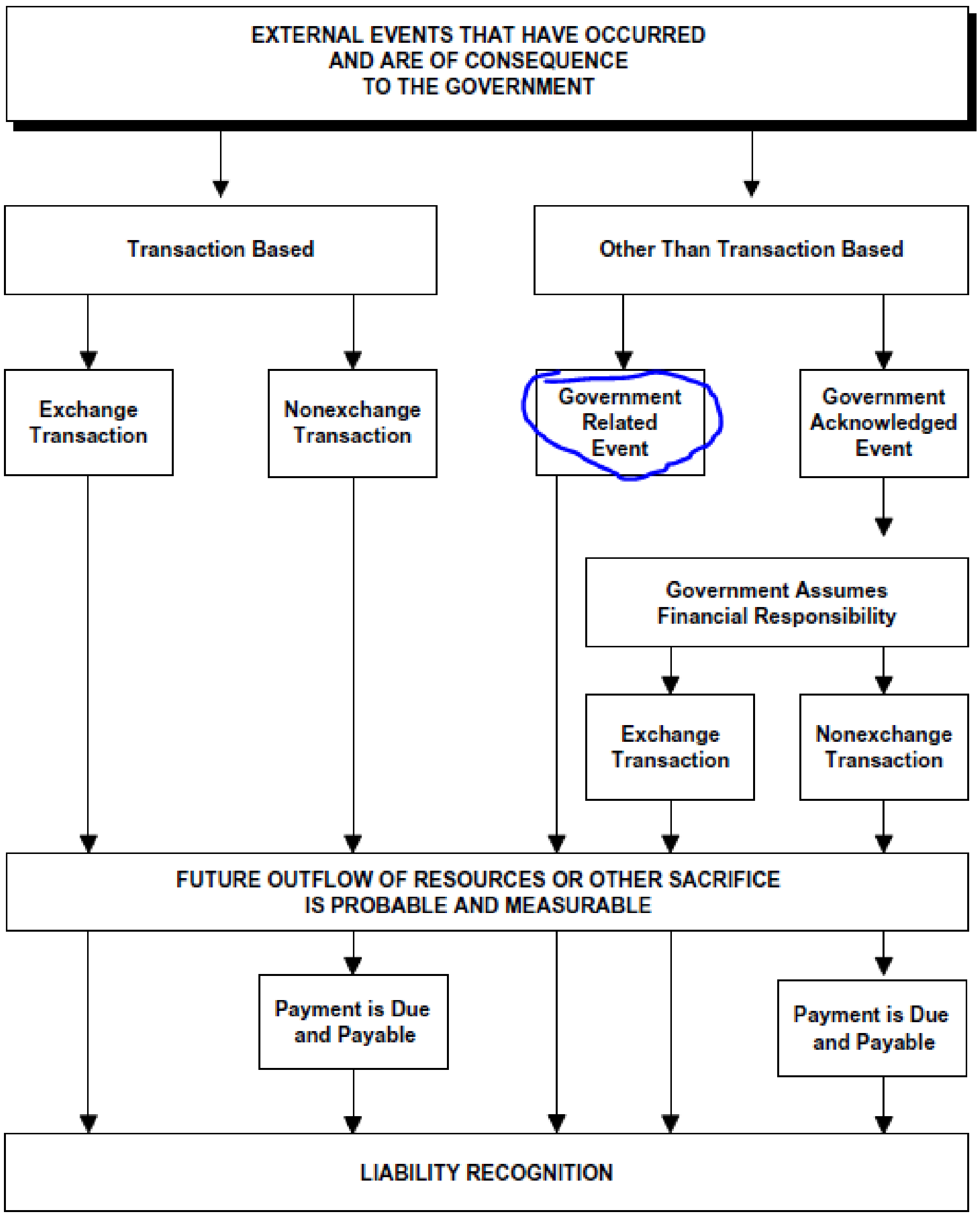
| Characteristic | Commitments | Contingencies |
|---|---|---|
| 1. **Binding agreement to enter future transactions** | Exists | Does not exist |
| 2. **Transaction or event has occurred** | Has not occurred | Has occurred |
| 3. **Likelihood of loss estimable** | N/A | Yes |
| 4. **Liability Recognition** | N/A | Yes, if probable & measurable |

### STEP 5 – Illustrate commitments and contingencies in the liability recognition process

To illustrate the different concepts between commitments and contingencies, staff used the below liability recognition summary from SFFAS 5 and placed commitments and contingencies in the liability recognition process based on the respective characteristics described in STEP 2. "A" (for agreements) represents commitments and "government-related events" represents contingencies.

A

Figure 1: Liability Recognition Summary



## STEP 6 – Analyze and recommend course of actions

For commitments, the key characteristics used to determine the placement in the above chart include:

- A past transactions has **not** occurred,
- When the transactions occur **in the future**, they are transaction-based, either as exchange or non-exchange transactions,
- Liability is recognized when,
  - For exchange transactions, likelihood is probable and amount is estimable.
  - For non-exchange transactions, due and payable at end of the period.

For contingencies, the key characteristics include:

- A past event **has occurred,**
- The event is non-transaction based,
- The event is government-related,
- Liability is recognized when,
  - Likelihood is probable and amount is estimable.

As illustrated,

- commitments are outside of the liability recognition process because the transactions required for liability recognition have not occurred (i.e., no liability associated with commitments). Conversely, and contingencies are within the liability recognition process because a condition, situation, or circumstance has occurred (contingencies exist).
- Future transactions associated with commitments are on **different tracks** than contingencies in the liability recognition process. Commitments are transaction based, and contingencies are non-transaction based.

Based on the above characteristics and supported by staff's analysis of the liability definition SFFAC 5 and liability recognition in SFFAS 5 in December 2023, staff determined that commitments do not result in outflow of financial resources to the federal government **unless** and until the future transactions take place. When the future transactions take place, then the criteria for liability recognition in SFFAS 5 will be applied when determining the liability of the entity.

## Potential problems if differences between commitments and contingencies are not clearly identified

It is important to differentiate between commitments from contingencies due to different accounting requirements associated with the different concepts.

Focusing on the similarities identified in STEP 2 without considering the differences may lead to the perception that both commitments and contingencies derive from similar concepts, and that the basic liability recognition criteria may be applied to both types of activities:

- A past transaction has occurred,
- The likelihood is probable, and
- The amount is estimable.

However, commitments and contingencies should not be treated the same way because for commitments a past transaction has not occurred. An existing agreement does not mean an existing or past transaction.

Some contingencies may arise from commitments or binding agreements, such as contract disputes, but the contingencies are related to the events associated with the commitments (i.e., the breaching of the contract) and the contingencies are not the commitments.

## Recommendations

In summary, commitments and contingencies are similar in some respects, but commitments are not liabilities of the entity unless the condition specified in the agreements are met and when transactions have taken place. Staff recommends the Board to consider clearly differentiating between commitments and contingencies to help entities apply the appropriate accounting and reporting guidance for entity activities related to commitments and contingencies.

**Questions for the Board:**

1. Does the Board agree with staff's analysis of the similarities and differences between commitments and contingencies?

**Questions for the Board:**

2. Would the Board consider rolling the commitments research topic into the SFFAS 5 reexamination project?

**Questions for the Board:**

3. Does the Board have any comments or suggestions on the topic of commitments?

## NEXT STEPS

Depending on the Board’s decision related to question #2, staff will continue its work on commitments as a part of the SFFAS 5 reexamination project.

## Appendix A

## Significant Federal Financial Commitments

The following are descriptions of some of the significant federal government commitments:

- Undelivered orders – unpaid represent goods and services ordered that have not been received or prepaid.

- Congress established Fannie Mae and Freddie Mac as government-sponsored enterprises (GSEs) to provide stability and increase liquidity in the secondary mortgage market and to promote access to mortgage credit in the United States by purchasing and packaging mortgages into securities and sell to investors. In 2008, in response to the financial crisis that threatened the housing market, Congress passed the Housing and Economic Recovery Act (HERA), which provided the Treasury Secretary with certain authorities to ensure the financial stability of the GSEs. Treasury enters into Senior Preferred Stock Purchase Agreement (SPSPA) with each GSE. The SPSPAs, which has no expiration date, requires Treasury to disburse funds to the GSE if, at the end of any quarter, the liabilities of either GSE exceed its assets, to maintain positive net worth, with a fixed maximum funding commitment amount available to each GSE under the agreement.[1]

  The maximum remaining contractual commitment to the GSEs for the remaining life of the SPSPAs totaled $284 billion and $254 billion as of September 30, 2022 and 2021, respectively.[2]

- Treasury, on behalf of the U.S. government, participates in the International Monetary Fund (IMF) through a quota subscription and a borrowing arrangement that supplements IMF resources. U.S. financial commitments to the IMF becomes binding when the U.S. consents to an increase in its participation as an IMF member country and all other conditions to the increase are met.

  - ❖ The outstanding financial commitment in the U.S. quota changes when the IMF draws upon or repays funding it obtained pursuant to a letter of credit established by the U.S. to make domestic currency available to the IMF as needed.

  - ❖ The outstanding financial commitment in the supplemental borrowing arrangement changes when the IMF borrows and repays loans under the related supplemental funding arrangement.

---

[1] Source: Agency Financial Report | U.S. Department of the Treasury .

[2] Source: Financial Report of the United States Government - Financial Statements of the United States Government for the Fiscal Years Ended September 30, 2021, and 2020 (treasury.gov).

The financial commitment under the U.S. quota and borrowing arrangements totaled $146.4 billion and $162.6 billion as of September 30, 2022, and September 30, 2021, respectively.

- Treasury, on behalf of the U.S. government, subscribes to shares of certain multilateral development banks (MDB), which are international financial institutions that finance economic and social development projects in developing countries. Some shares represent capital commitments that are callable under certain limited circumstances to meet the obligations of the respective MDB. Callable capital in the MDBs provide supplemental resources that can be used by the MDBs to obtain favorable financing terms when borrowing from international capital market. There has never been a call and none is anticipated. As of September 30, 2022, callable capital in MDBs totaled approximately $128 billion.

- Fuel purchase obligations

    - Tennessee Valley Authority has fuel purchase obligations which includes commitments to purchase nuclear fuel, coal, and natural gas, as well as related transportation and storage services. As of September 30, 2022, TVA has fuel purchase obligations totaled $5.1 billion ($5,148 million).[3]

- Power Purchase Obligations

    - TVA also has power purchase obligations, which includes commitments for energy and/or capacity under power purchase agreements from coal-fired, hydroelectric, diesel, renewable, and gas-fired facilities, as well as transmission service agreements to support purchase of power from the market. As of September 30, 2022, TVA's total power purchase obligations were $2.6 billion ($2,536 million)[4].

    - The Department of Energy enters into long-term agreements to purchase power for future delivery to cover a potential shortage when the Power Marketing Administrations[5] (PMAs) forecast a resource shortage. The future power purchase obligations or commitments as of September 30, 2022, totaled $645 million.[6]

- Commitments to extend loan guarantees

  Loan guarantee commitments are binding agreements by a federal agency to make a loan guarantee, insurance, or other pledge with respect to the payment

[3] Source: TVA - Financial Information - SEC Filings - Document Details (q4ir.com)

[4] Source: TVA - Financial Information - SEC Filings - Document Details (q4ir.com)

[5] There are four Power Marketing Administrations in the United States, including Bonneville Power Administration (BPA), Western Area Power Administration (WAPA), Southeastern Power Administration, and Southwestern Power Administration that operate electric systems and sell the electrical output of federally owned and operated hydroelectric dams in 34 states.

[6] Source: FY 2022 DOE Agency Financial Report | Department of Energy

of all or a part of the principal or interest on any debt obligation of a non-federal borrower to a non-federal lender when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement.[7] Beginning with fiscal year 1992, the planned level of loan guarantee commitments associated with each appropriation request is included in the president's budget. The authority to incur new loan guarantee commitments or modify outstanding loan guarantee commitments constitutes new budget authority in the fiscal year in which definite authority becomes available or indefinite authority is used.

The Department of Agriculture's commitments to extend loan guarantees are estimated to be $4.6 billion (or $4,605 million) and $5.6 billion (or $5,600 million) in FY 2022 and FY 2021, respectively.[8]

- Grants programs – Airport Improvement Program

  The Department of Transportation's Federal Aviation Administration (FAA) issues letter of intent to enter into annual Airport Improvement Program grant agreements that provide grants for the planning and development of public-use airports that are included in the National Plan of Integrated Airport System. As of September 30, 2022, and 2021, the FAA has letters of intent totaled $260 million and $200 million, respectively.[9]

- Other purchase obligations – USPS, Energy, TVA, DHS,

  - USPS has capital commitments to purchase of equipment, building improvements and vehicles. As of September 30, 2022, USPS has capital commitments totaled $5,613 billion.[10]

  - DOE's WAPA and BPA are required by law to make cash distributions to the Treasury for the portion of BOR's original capital construction costs allocated to irrigation purposes, which were determined by the Secretary of the Interior to be beyond the ability of the irrigation customers to pay. Statutory provisions guide the assumptions related to the amount and timing of the distributions. Future irrigation assistance payments are scheduled for BPA to total $247 million over a maximum of 66 years from the time the irrigation facilities were completed and place in service.

  - To comply with the Northwest Power Act, BPA enters into long-term agreements to protect, mitigate, and enhance fish and wildlife and their habitats to the extent they are affected by the Federal hydroelectric

[7] Federal Credit Reform Act of 1990, Section 502.

[8] Source: Agency Financial Reports (AFR) | USDA at https://www.usda.gov/ocfo/plans-reports/agency-financial-reports.

[9] Source: DOT FY 2022 Agency Financial Report | US Department of Transportation at https://www.transportation.gov/mission/budget/dot-fy-2022-agency-financial-report.

[10] Source: Form 10-K FY 2022 at Financials - What we do - About.usps.com at https://about.usps.com/what/financials/10k-reports/fy2022.pdf

projects on the Columbia River and its tributaries from which BPA markets power. In addition, BPA enters into long-term agreements for power purchases to comply with the Endangered Species Act. As of September 30, 2023, BPA has long-term fish and wildlife agreements with estimated contractual commitments of $373 million.

- Tennessee Valley Authority's other purchase obligations primarily include long-term service contracts, contracts that contain minimum purchase levels for the purchase of limestone along with related storage and transportation, and contractual obligations related to TVA's load control program. As of September 30, 2022, TVA's other purchase obligations totaled $406 million.

- DHS maintains one letter of intent for modifications to airport facilities in which TSA uses cost-sharing agreements with the airports to modify the facilities for checked baggage screen projects. As of September 30, 2022, TSA received documentation for costs incurred totaling $58 million for unpaid invoices. [11]

[11] Source: https://www.dhs.gov/publication/dhs-fiscal-year-2022-performance-accountability-reports.

## Appendix B

## Exchange/Non-exchange Analysis

Staff analyzed various federal government commitments and determined whether the transactions are exchange and non-exchange in the following table:

| Examples of Commitments | Description of Agreement | Exchange/Non-Exchange |
|---|---|---|
| Undelivered Orders (UDO) - Unpaid | Entities enter into agreements to purchase goods or services. UDO unpaid represents value of goods and services ordered that have not yet been received and that have not been prepaid | Exchange |
| Government-Sponsored Enterprises (GSE) Senior Preferred Stock Purchase Agreements | Treasury agrees to disburse funds to the GSE if, at the end of any quarter, the liabilities of either GSE exceed its assets, to maintain positive net worth, with a fixed maximum funding commitment amount available to each GSE under the agreement | Non-exchange |
| U.S. Participation in the International Monetary Fund | U.S. financial commitments to the IMF becomes binding when the U.S. consents to an increase in quota subscription or borrowing arrangement with the IMF and all other conditions to the increase have been met | Non-exchange |
| Callable Capital Subscriptions for Multilateral Development Banks (MDB) | Treasury subscribes to shares of certain MDB that are callable under certain limited circumstances to provide supplemental resources that can be used by the MDBs to obtain favorable financing terms when borrowing from international capital market | Non-exchange |
| Fuel, Power, or Other Purchase Obligations | Agencies enter into binding agreements to purchase fuel, power, or others to comply with various laws and regulations or to share costs. | Exchange |
| Commitments to Extend Loan Guarantees | Loan guarantee commitments are binding agreements by the Department of Agriculture to make a loan guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-federal borrower to a non-federal lender when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement | Non-exchange |
| Grant Programs – Airport Improvement Program | Airport Improvement Program grant agreements that provide grants for the planning and development of public-use airports | Non-exchange |

Commitments do not meet the criteria for liability recognition according to SFFAS 5 because:

1. For exchange type commitments, good or services have not been received or goods or services will be provided in the future, and
2. For non-exchange type commitments, there is no unpaid amount due as of the reporting date.