



Federal Accounting Standards Advisory Board

**GUIDANCE ON RECOGNIZING
LIABILITIES INVOLVING MULTIPLE
COMPONENT REPORTING ENTITIES:**
AN INTERPRETATION OF SFFAS 5

Interpretation of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by January 17, 2019

October 17, 2018

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB 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.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. FASAB publishes the proposed standards in an exposure draft for public comment. In some cases, FASAB publishes a discussion memorandum, invitation for comment, or preliminary views document on a specific topic before an exposure draft. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information and other items of interest are available at www.fasab.gov:

- [Memorandum of Understanding](#) among the Government Accountability 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
- [Mission statement](#)
- [Documents for comment](#)
- [Statements of Federal Financial Accounting Standards and Concepts](#)
- [FASAB newsletters](#)

Copyright Information

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from FASAB. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

Contact Us

Federal Accounting Standards Advisory Board
441 G Street, NW
Suite 1155
Washington, D.C. 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov



Federal Accounting Standards Advisory Board

October 17, 2018

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) requests your comments on the exposure draft of a proposed Interpretation, entitled *Guidance on Recognizing Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*. Specific questions for your consideration appear on page 6, but you are welcome to comment on any aspect of this proposal. If you do not agree with specific matters or proposals, your responses will be most helpful to the Board if you explain the reasons for your positions and any alternatives you propose. Responses are requested by January 17, 2019.

All comments received by FASAB are considered public information. Those comments may be posted to [FASAB's website](#) and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Please provide your comments by email to fasab@fasab.gov. If you are unable to email your responses, we encourage you to fax comments to 202-512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at 202-512-7350 to determine if your comments were received.

FASAB's rules of procedure provide that the Board may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. FASAB will publish notice of the date and location of any public hearing on this document in the Federal Register and in its newsletter.

Sincerely,

D. Scott Showalter
Chair

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

With the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 47, *Reporting Entity*, SFFAS 55, *Amending Inter-entity Cost Provisions*, and Technical Bulletin 2017-2, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of identified general liability standards and principles at the component reporting entity level.

This Interpretation is intended to provide clarification and guidance regarding contingent liabilities¹ and cleanup costs when multiple component reporting entities are involved. Specifically, this Interpretation would provide clarification for contingent liabilities when one or more sub-component reporting entities within a single component reporting entity are designated to manage litigation and/or pay any resulting liabilities on behalf of one or more other sub-component reporting entities. This Interpretation would also provide guidance regarding cleanup cost liabilities when the component reporting entity responsible for reporting on an asset during its useful life is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that asset.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This proposal would facilitate reporting by component reporting entities by better aligning reporting with their operations. Given the complex responsibilities and relationships among the components of large departments, this proposal would result in less costly financial reporting by aligning reporting with established funding and governance structures. This proposal would also reduce the barriers to and cost of adopting generally accepted accounting principles.

MATERIALITY

The provisions of this Interpretation need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

¹ The discussion of contingent liabilities in this Interpretation relates to those due to litigation. Other contingent liabilities may be considered if appropriate and reasonable.

TABLE OF CONTENTS

Executive Summary	4
WHAT IS THE BOARD PROPOSING?.....	4
HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?.....	4
Questions for Respondents	6
Proposed Interpretation	9
SCOPE.....	9
INTERPRETATION	9
EFFECTIVE DATE	12
Appendix A: Basis for Conclusions	13
BACKGROUND	13
Appendix B: Abbreviations	19

QUESTIONS FOR RESPONDENTS

The Federal Accounting Standards Advisory Board (FASAB or “the Board”) encourages you to become familiar with all proposals in the Interpretation before responding to the questions in this section. In addition to the questions below, the Board also welcomes your comments on other aspects of the proposed Interpretation. Because FASAB may modify the proposals before a final Interpretation is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views are especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have regarding implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at <http://www.fasab.gov/documents-for-comment/>. Your responses should be sent to fasab@fasab.gov. If you are unable to respond by email, please fax your responses to 202-512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 1155
Washington, D.C. 20548

All responses are requested by January 17, 2019.

- Q1. The proposed Interpretation provides additional guidance regarding contingent liabilities when multiple component reporting entities are involved. Specifically, it provides clarification when one or more sub-component reporting entities are designated to manage litigation and/or pay any resulting liabilities on behalf of one or more other sub-component reporting entities. For example, a sub-component reporting entity may be designated to manage litigation of a certain type or within a certain geographic region for other sub-component reporting entities. The same or a different sub-component reporting entity may be designated to pay any resulting liabilities. In such cases, not all involved sub-component reporting entities would have the information needed to apply the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*.

Generally, the sub-component reporting entity responsible for managing litigation would have the information needed to recognize contingent liabilities and should report information in accordance with SFFAS 5. Other involved sub-component reporting entities, including the sub-component reporting entity whose actions gave rise to the litigation, should not report information on contingent liabilities managed by another sub-component reporting entity.

Once a settlement is reached or a judgment ordered by a court, the liability should be removed from the financial statements of the sub-component reporting entity designated

to manage the litigation and recognized in the financial statements of the sub-component reporting entity designated to pay the liability.

- a. **Do you agree or disagree with the guidance? Please provide the rationale for your answer.**
- b. **Alternatively, do you believe the sub-component reporting entity whose actions gave rise to the litigation should be permitted to report the information in accordance with SFFAS 5? Please provide the rationale for your answer.**

Q2. The proposed Interpretation provides additional guidance regarding cleanup costs when multiple component reporting entities are involved. Specifically, for the purpose of meeting the SFFAS 5 liability recognition criterion that “[a] future outflow or other sacrifice of resources is probable,” the criterion should be considered met by the component reporting entity that recognizes the general property, plant, and equipment (PP&E) during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup.

Do you agree or disagree with the guidance? Please provide the rationale for your answer.

Q3. The proposed Interpretation provides clarification and guidance regarding contingent liabilities and cleanup costs when multiple sub-component reporting entities are involved. When multiple sub-component reporting entities are involved, a component reporting entity may designate one or more sub-component reporting entities as responsible for various aspects (for example, management, payment) related to liabilities on behalf of one or more other sub-component reporting entities. As demonstrated with contingent liabilities and cleanup costs, not all involved sub-component reporting entities are likely to have the information needed to apply the provisions of SFFAS 5. Therefore, one sub-component reporting entity may be designated certain responsibilities (for example, management, payment) and should recognize and disclose information in accordance with SFFAS 5. In some instances, another sub-component reporting entity may be subsequently designated to recognize and disclose information in accordance with SFFAS 5 (for example, when another sub-component reporting entity becomes responsible for settling the liability).

- a. **Do you believe there are liability situations or examples when a similar condition occurs, other than contingent liabilities and cleanup costs? Please be specific and describe the situations or examples that should be addressed through additional guidance. Please provide the rationale for your answer.**
- b. **Do you believe an additional general principle should be included to allow for cases other than contingent liabilities and cleanup costs in which a decision needs to be made regarding which component reporting entity should recognize the liability? If so, do you believe the general principle should read, “For liabilities involving multiple sub-component reporting entities, the liability should be recognized by the sub-component reporting**

entity designated to handle various aspects (for example, management, payment) on behalf of sub-component reporting entities”?

Q4. Do you have any other comments or suggestions on the Interpretation? Please provide the rationale for your answer.

PROPOSED INTERPRETATION

SCOPE

1. This Interpretation applies when a component reporting entity is presenting general purpose federal financial reports (GPFFRs) in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

INTERPRETATION

General Principles for Component Reporting Entities

2. SFFAS 5, *Accounting for Liabilities of the Federal Government*, paragraph 19 states, “A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.”
3. Paragraphs 56-57 of SFFAS 47, *Reporting Entity*, provide that component reporting entities’ GPFFRs must include all consolidation and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities.

56. The government-wide reporting entity is the only federal reporting entity that is an independent economic entity^{25 [footnote omitted]} and the inclusion principles are expressed from the perspective of the federal government. However, GPFFRs for the government-wide reporting entity represent a consolidation of component reporting entity GPFFRs. Therefore, component reporting entities must identify and include in their GPFFRs all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity GPFFRs and government-wide GPFFR are complete.

57. A component reporting entity’s GPFFR should include all organizations that would allow the users to hold the component reporting entity’s management (such as appointed officials or other agency heads) accountable for implementation of public policy decisions. Inclusion would also reveal the risks inherent in component reporting entity operations, and thereby enhance accountability to the public. Each component reporting entity is accountable for all consolidation entities^{26 [footnote omitted]} and disclosure entities administratively assigned to it.

4. SFFAS 47, paragraph 10 defines component reporting entity as follows:

Component Reporting Entity—“Component reporting entity” is used broadly to refer to a reporting entity within a larger reporting entity.⁷ Examples of component reporting entities include organizations such as executive departments, independent agencies,

government corporations, legislative agencies, and federal courts. Component reporting entities would also include sub-components (those components included in the GPFFR of a larger component reporting entity) that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

FN 7 The larger reporting entity could be the government-wide reporting entity or another component reporting entity.

5. In light of SFFAS 5 and SFFAS 47, the following general principles apply for component reporting entities:
 - a. Liabilities generally should be reported by the component reporting entity for which the future outflow or sacrifice of resources is probable and measurable.
 - b. Liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.

Guidance on Contingent Liabilities²

6. SFFAS 5, paragraph 38 states that a contingent liability should be recognized when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable. As noted in paragraph 5, liabilities generally should be reported by the component reporting entity for which the future outflow or sacrifice of resources is probable and measurable and all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.
7. To recognize and disclose contingent liabilities in accordance with SFFAS 5, a component reporting entity must have information about ongoing litigation and be able to exercise judgment regarding the possible outcomes. When a single component reporting entity is the defendant in a case, that entity will likely have the needed information even in the event any ultimate claim will be paid by the Treasury Judgment Fund. Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*, provides guidance regarding recognition in such cases.
8. When multiple sub-component reporting entities are involved, one or more sub-component reporting entities within a single component reporting entity may be designated to manage litigation and/or pay any resulting liabilities on behalf of one or more other sub-component reporting entities. Specifically, sub-component reporting entities within a single component reporting entity may be designated to manage litigation of a certain type or within a certain geographic region for other sub-component reporting entities. The same or a different sub-component reporting entity may be designated to pay resulting liabilities. In such cases, not all involved sub-component reporting entities would likely have the information needed to apply the provisions of SFFAS 5. Generally, the sub-component reporting entity responsible for managing litigation would have the information needed to recognize or disclose

² The discussion of contingent liabilities in this Interpretation relates to those due to litigation. Other contingent liabilities may be considered if appropriate and reasonable.

contingent liabilities and should report information in accordance with SFFAS 5. Other involved sub-component reporting entities should not report information on contingent liabilities managed by another sub-component reporting entity.

9. For example, sub-component reporting entity A is responsible for managing litigation for an entire geographic region even though the litigation may be due to the actions of sub-component reporting entities B and C. Sub-component reporting entity A that is designated to manage the litigation should recognize any resulting contingent liabilities. The sub-component reporting entities B and C whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation.
10. If a sub-component reporting entity is designated to pay claims but not to manage litigation, the general provisions of Interpretation 2 should be extended to the entity designated to pay claims. Once a settlement is reached or a judgment is ordered by a court and a specific sub-component reporting entity is determined to be the appropriate source for the payment of the claim, the liability should be removed and an other financing source recognized in the financial statements of the sub-component reporting entity that managed the litigation. The sub-component reporting entity that will pay the claim would then recognize an expense and liability (or a cash outlay) for the full cost of the loss. The other financing source amount recognized by the sub-component reporting entity that managed the liability and the expense recognized by the sub-component reporting entity that paid the liability would be eliminated at the consolidated report level.

Guidance on Cleanup Costs

11. SFFAS 5, paragraph 19 defines a liability as “a probable future outflow or other sacrifice of resources as a result of past transactions or events.”
12. Paragraph 91 of SFFAS 6, *Accounting for Property, Plant, and Equipment*, provides guidance regarding cleanup costs.³ Cleanup costs are subject to the criteria for recognition of liabilities included in SFFAS 5. Paragraph 91 explains that liabilities should be recognized when three conditions are met:
 - a. A past transaction or event has occurred.
 - b. A future outflow or other sacrifice of resources is probable.
 - c. The future outflow or sacrifice of resources is measurable.
13. SFFAS 6 associates the recognition of cleanup costs with the related general property, plant, and equipment (PP&E). Paragraph 94 provides for the estimation of cleanup costs when the associated general PP&E is placed in service. Paragraph 97 provides for the recognition of a portion of the estimated total cleanup costs as an expense during each period that the general PP&E is in operation. SFFAS 6 guidance presumes the cleanup cost and the associated general PP&E would be recognized by the same component reporting entity.

³ SFFAS 5 applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or when cleanup is an ongoing part of operations.

- 14. Some component reporting entities settle liabilities by transferring general PP&E to another component reporting entity designated by law or administratively to settle the liabilities. Therefore, a component reporting entity that is responsible for recognizing general PP&E during its useful life may differ from the component reporting entity that will eventually be responsible for the environmental remediation upon disposal of that general PP&E. In such cases, the component reporting entity that recognized the general PP&E during its useful life is not responsible for future outflows or other sacrifices of resources required to settle the liability for cleanup costs. Instead, the component reporting entity receiving the asset upon its removal from service⁴ will be responsible for settling the cleanup cost liability.

- 15. When multiple component reporting entities have distinct responsibilities regarding general PP&E and related cleanup costs, information needed to monitor and update cleanup cost liabilities would typically be more readily available to the component reporting entity that reports the related general PP&E. Such component reporting entities will settle the cleanup cost liability by transferring the general PP&E for cleanup. Moreover, the cleanup cost liability may have to be reported over several periods. Until the component reporting entity recognizing the general PP&E transfers the general PP&E, it should also recognize the liability. Upon transferring the general PP&E it should also transfer the associated liability.

- 16. The SFFAS 5 liability recognition criterion that “[a] future outflow or other sacrifice of resources is probable” should be considered met by the component reporting entity that recognizes the general PP&E during its useful life. In that case, the liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E until the general PP&E and the associated liability are transferred to another entity for cleanup. At that time, the general PP&E and the liability should be de-recognized by the component reporting entity that recognized them during the general PP&E’s useful life and recognized by the component reporting entity that will liquidate the liability. De-recognition and recognition of the general PP&E and liability should be performed in accordance with existing standards.

EFFECTIVE DATE

- 17. The requirements of this Interpretation are effective for reporting periods beginning after September 30, 2019. Early implementation is permitted.

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

⁴ Technical Release (TR) 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, provides guidance on the disposal, retirement, or removal from service of general PP&E as well as related cleanup costs. It differentiates between permanent and other than permanent removal from service of general PP&E and delineates events that trigger discontinuation of depreciation and removal of general PP&E from accounting records.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Interpretation. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Interpretation—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

This Interpretation may be affected by later Statements or pronouncements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent pronouncements that amend this Interpretation. Within the text of the documents, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement or other pronouncement for the rationale for each amendment.

BACKGROUND

- A1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) was asked for guidance regarding accounting for liabilities at the component reporting entity level. Specifically, clarifications were requested about the recognition and measurement standards related to contingent liabilities and cleanup costs. The recognition and measurement standards are provided in SFFAS 5 and SFFAS 6.
- A2. With the issuance of recent pronouncements SFFAS 47, SFFAS 55, *Amending Inter-entity Cost Provisions*, and Technical Bulletin (TB) 2017-2, *Assigning Assets to Component Reporting Entities*, there is a need for additional guidance to assist in the application of the general liability standards and principles. This is especially needed when multiple component reporting entities are involved.
- A3. For example, with the issuance of SFFAS 55, SFFAS 30, *Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*, and Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*, are rescinded; therefore, the requirement to impute costs for these activities is eliminated. Further, the Board’s intent with TB 2017-2 was to provide flexibility with respect to asset assignment. SFFAS 47 recognizes the extremely complex organizational structure of the federal government and provides a basis for determining what organizations should be included in the reporting entity’s GPFFRs. It also provides definitions for reporting entity, component reporting entities, and sub-component reporting entities within the federal government.
- A4. Entities requested clarification with respect to the accounting for contingent liabilities when one or more sub-component reporting entities within a single component reporting entity are designated to manage litigation and pay any resulting liabilities on behalf of one or more other sub-component reporting entities.
- A5. Entities also requested guidance regarding cleanup cost liabilities when the component reporting entity responsible for reporting the general PP&E during its useful life is different from the component reporting entity that will eventually be responsible for environmental remediation upon disposal of that general PP&E.

- A6. These types of examples and the issuances of the new pronouncements warrant guidance about how the general liability standards and principles should be applied. Without additional guidance, these situations may lead to inconsistent application of the liability standards and principles.

General Principles for Component Reporting Entities

- A7. Paragraphs 56-57 of SFFAS 47 provide that component reporting entities' GPFFRs must include all consolidation entities and disclosure entities for which they are accountable so that both the component reporting entity and government-wide GPFFRs are complete. The GPFFR for the government-wide reporting entity would be the consolidation of component reporting entity GPFFRs, including information regarding disclosure entities. SFFAS 47 also provides the definition for component reporting entity.
- A8. In light of SFFAS 5 and SFFAS 47, this Interpretation provides general principles that apply for component reporting entities.

Guidance on Contingent Liabilities

- A9. FASAB issued TB 2002-1, *Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government*, in 2002 to provide guidance when one or more federal entities are involved in litigation. It also provides guidance for legal claims related to defunct federal entities (that is, entities that no longer exist) because preparers asked that liabilities be recognized only at the government-wide level. TB 2002-1 (which is considered a staff-level document in the GAAP hierarchy) established two main points:
- a. All liabilities should first be recognized at the component reporting entity level. (The principle provided in this Interpretation is consistent with this principle in TB 2002-1.)
 - b. All liabilities and costs must be attributed to the component reporting entities responsible for the programs or activities that contributed to the claims or to the claims of their successor component reporting entities. (The basis for assigning such costs and liabilities was derived from SFFAS 4, *Managerial Cost Accounting Standards and Concepts*.)
- A10. As noted, this Interpretation is consistent with the principle established in TB 2002-1 that every liability should first be recognized at the component reporting entity level. However, other conclusions and certain language in TB 2002-1 is not consistent with current GAAP based on the following:
- a. Terminology, definitions, and language presented in TB 2002-1 are not consistent with SFFAS 47.
 - b. SFFAS 4, as amended by SFFAS 55, addresses inter-entity costs. 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 (OMB).

- A11. Because of the changes introduced in SFFAS 47 and SFFAS 55, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation.
- A12. Although not all inter-entity costs are recognized by the receiving entity, relationships creating inter-entity costs exist and often involve multiple component reporting entities. As noted in paragraph 5, SFFAS 5 provides that liabilities should be reported by the component reporting entity that will liquidate the liability (that is, has a probable future outflow). GAAP also provides that all liabilities should be recognized by a component reporting entity before being consolidated into the government-wide financial statements.
- A13. To recognize and disclose contingent liabilities in accordance with SFFAS 5, a component reporting entity must have information about ongoing litigation and exercise judgment regarding the possible outcomes. Component reporting entities designated to pay certain liabilities of other federal entities may not have the information needed to determine whether a future outflow is probable and measurable until component reporting entities more directly involved communicate certain determinations to them.
- A14. When a single component reporting entity is the defendant in a case, that entity should have the needed information even in the event any ultimate claim will be paid by the Treasury Judgment Fund. The entity involved in the case should recognize a contingent liability until amounts to be paid by the Treasury Judgment Fund are decided. The Treasury Judgment Fund pays the claims once it is either settled or a court judgment is assessed and the Treasury Judgment Fund is determined to be the appropriate source for payment. The Treasury Judgment Fund is not a party to litigation before it is paid and the cost of each claim relates to another entity's operations. This is consistent with Interpretation 2.
- A15. When multiple sub-component reporting entities are involved, one or more sub-component reporting entities within a single component reporting entity may be designated to manage litigation and/or pay any resulting liabilities on behalf of one or more other sub-component reporting entities. Specifically, sub-component reporting entities within a department may be designated to manage litigation of a certain type or within a certain geographic region for other sub-component reporting entities. The same or a different sub-component reporting entity may be designated to pay resulting liabilities. In such cases, not all involved sub-component reporting entities would have the information needed to apply the provisions of SFFAS 5.
- A16. When such designations of responsibility for managing litigation and settling claims are made within a component reporting entity (such as a department) having multiple sub-component reporting entities, the sub-component reporting entity that manages litigation is responsible for reporting information in accordance with SFFAS 5. The sub-component reporting entity whose actions gave rise to the litigation should not recognize or disclose information regarding the litigation because doing so would unnecessarily complicate consolidation processes and potentially create inconsistent practices.
- A17. For example, if a department assigns responsibility for adjudicating overseas claims in a given country to a sub-component reporting entity, the sub-component reporting entity adjudicates claims for other sub-component reporting entities in that country. The ongoing practice has been that the sub-component reporting entity assigned responsibility for

adjudicating claims in a given country pays for the claims, even those claims due to the actions of another sub-component reporting entity. The adjudicating sub-component reporting entity does not seek reimbursement for claims paid on behalf of other sub-component reporting entities. Likewise, the sub-component reporting entity on whose behalf the claim is adjudicated does not recognize an imputed cost. Clarity regarding which entity should report the liability will ensure the same liability is not recognized twice and that it is recognized in a consistent manner by the sub-component reporting entities of larger reporting entities.

Guidance on Cleanup Costs

- A18. SFFAS 6 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. FASAB has provided guidance in this area through several technical releases (TRs), but additional guidance is necessary in light of recent pronouncements.
- A19. Challenging issues exist in the application of general standards for large, complex departments, such as the Department of Defense, that have numerous components and sub-components. For example, assets may be owned by one component reporting entity but used or funded by another component reporting entity, and the component reporting entity using the asset may not be the component reporting entity responsible for disposal. Given the complex responsibilities and relationships among the components of large departments, the second condition of paragraph 91 in SFFAS 6 is resulting in inconsistent application of the standards. The condition requires that “[a] future outflow or other sacrifice of resources is probable.”
- A20. Additionally, SFFAS 4 addresses inter-entity costs. Recognition of inter-entity costs by activities that are not business-type activities is not required⁵ with the exception of inter-entity costs for personnel benefits and the Treasury Judgment Fund settlements unless otherwise directed by OMB. Further, TB 2017-2 provides flexibility so that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. These new pronouncements provide additional flexibility when considered in conjunction with SFFAS 5 and SFFAS 6.
- A21. SFFAS 6 outlines the requirements for the disposal, retirement, or removal from service of general PP&E. Paragraphs 97 and 98 of SFFAS 6 outline the requirements for recognition and measurement of disposal-related cleanup costs. TR 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, addresses implementation guidance that further clarifies existing SFFAS 6 requirements for the disposal, retirement, or removal from service of general PP&E as well as related cleanup costs. The guidance helps differentiate between permanent and other than permanent removal from service of PP&E assets. The guidance recognizes the many complexities involved in the disposal of PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of PP&E from financial reporting.

⁵ SFFAS 55 provides for the continued recognition of significant inter-entity costs by business-type activities. Non business-type activities may elect to recognize other imputed costs.

- A22. Some general PP&E requiring cleanup is transferred to another component reporting entity after being removed from service. An example would be a military service responsible for reporting the general PP&E that will eventually be transferred to the Defense Logistics Agency for environmental remediation. In such cases, the component reporting entity that recognized the general PP&E during its useful life may not be responsible for future outflows or other sacrifices of resources to settle the liability for cleanup costs. Instead, the component reporting entity receiving the general PP&E upon its removal from service has or assumes that responsibility.
- A23. For the purpose of meeting the liability definition of cleanup costs at the component reporting entity level (when multiple sub-component reporting entities have distinct responsibilities for general PP&E and for settling the related liability), the condition to determine whether “[a] future outflow or other sacrifice of resources is probable” could be considered met as long as the liability is reported with the general PP&E until the general PP&E is removed, contained, or disposed of. At that time, the liability would be transferred with the related general PP&E to the component reporting entity responsible for the liability.
- A24. A general illustration of the entry to recognize the liability for the cleanup cost follows.
- The entity using the general PP&E would recognize the cost as the liability is recorded, just as provided for in SFFAS 6.
- DR. Expense
CR. Liability
- Upon disposal, the entity transfers the liability (and related general PP&E) to the component reporting entity responsible for the liability.
- DR. Liability
CR. Imputed Financing Source

Disclosures

- A25. Although the proposed Interpretation may result in changes in reporting of contingent liabilities and cleanup costs when multiple component reporting entities are involved, existing GAAP provides sufficient guidance to ensure proper disclosures regarding these changes in reporting. SFFAS 55 requires component reporting entities to disclose that only certain inter-entity costs are recognized for goods and services received from other federal entities at no cost or at a cost less than the full cost. Component reporting entities should identify the costs of the providing entity that are not fully reimbursed and the general nature of other imputed costs recognized in their financial statements. Statement of Federal Financial Accounting Concepts 3, *Management’s Discussion and Analysis*, and SFFAS 15, *Management’s Discussions and Analysis*, also provide guidance on information to include in the management’s discussion and analysis if deemed appropriate.
- A26. Given the sufficiency of current disclosure standards and guidance, the Board believes it is not necessary to address disclosure in this proposed Interpretation. Agencies should consider current standards in deciding whether to disclose the nature of changes in reporting resulting from this proposed Interpretation.

Other

A27. As noted in paragraph A11, a TB to rescind TB 2002-1 will be proposed after the issuance of this proposed Interpretation. Because the guidance regarding the application of the general liability standards has been provided through other pronouncements, such as TBs and TRs, additional documents may require updating to ensure conformance and consistency with current GAAP. Therefore, necessary updates will be made to the appropriate documents. Those updates are considered exclusive of the liability issue presented within this Interpretation. Further, those changes or updates must be made in separate GAAP documents to ensure the appropriate level of guidance within the GAAP hierarchy results.

APPENDIX B: ABBREVIATIONS

FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GPFRR	General Purpose Federal Financial Report
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFFAS	Statement of Federal Financial Accounting Standards
TB	Technical Bulletin
TR	Technical Release

FASAB Members

D. Scott Showalter, Chair

R. Scott Bell

Gila J. Bronner

Robert F. Dacey

George A. Scott

Michael H. Granof

Patrick McNamee

Graylin E. Smith

Timothy F. Soltis

FASAB Staff

Wendy M. Payne, Executive Director

Melissa L. Batchelor, Assistant Director

Federal Accounting Standards Advisory Board

441 G Street, NW

Suite 1155

Washington, D.C. 20548

Telephone 202-512-7350

Fax 202-512-7366

www.fasab.gov