

FASAB Exposure Draft: *Guidance on Recognizing Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*

Questions for Respondents due January 17, 2019

Please select the type(s) of organization responding to this exposure draft. If you are not responding on behalf of an organization, please select "individual."

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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.

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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.

Disagree. The sub-component reporting entity whose actions gave rise to the litigation should be the one to recognize the expense and report information in accordance with SFFAS 5. The sub-component entity responsible for managing the litigation would have the information needed to recognize contingent liabilities and should communicate and share that information with the sub-component reporting entity whose actions gave rise to the litigation for them to report. Conceptually, this is no different than communicating with an external counsel to determine contingent liabilities. The sub-component entity responsible for managing the litigation is working on behalf of the other sub-component but should not be responsible for recognizing the costs in their financial statements. The proposed changes equate fiduciary and/or agency actions with economic events. This is not consistent with the accrual accounting framework and SFFAS 5. The component responsible for the events which give rise to the liability should be responsible for the original recognition. Subsequent transfers of the liability could occur without affecting the integrity of the statement of net costs.

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.

Yes. The sub-component reporting entity whose actions gave rise to the litigation should be permitted to report the information in accordance with SFFAS 5 because it is ultimately their cost to report. See additional discussion in answer to part a. above.

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.

Agree. The liability should be reported on the balance sheet of the component reporting entity recognizing the general PP&E because the liability is part of the cost to use the

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PP&E. The component using the PP&E would also have the best available information to update the liability over the underlying asset's useful life as required by SFFAS 5.

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.**

No. Additionally, we believe that SFFAS 5 provides sufficient guidance if such situations were to arise, and it links the expense/liability recognition with the underlying economic events. See additional discussion in response to Q1.a., above.

- 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"?**

No. The contingent liability is associated with the original contamination, cleanup cost liability or the use of the asset per SFFAS 5. Agency actions (e.g. management, payment) should not drive expense and liability recognition. Underlying economic actions should drive the recognition consistent with the accrual accounting framework. See additional discussion in answer to part a. above. See additional discussion in answer to part a., above.

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

No.