

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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Federal Entity (user)	<input type="checkbox"/>	
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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.

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.

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

The majority of responding HUD components agree with the guidance. As discussed in Appendix A of the proposed guidance, paragraphs A13 and A16, component reporting entities designated to pay certain liabilities of other federal entities may not have the information that the sub-component reporting entity, or entities, whose actions gave rise to the litigation, have at the time that the contingent liability arises. The sub-component entity with the required information available would be more likely to be able to capture the information on a timely basis and be able to provide the required assessments of the documentation to be recorded and audited, if warranted. As these costs are not currently funded, matching of the liability to its funding will occur once settlements occur and the liability is moved to the sub-component responsible. To ensure the timely recording of the contingent liability, the sub-component responsible for litigation should recognize the contingent liability.

Somewhat conversely, HUD OCFO's Office of Accounting expressed some disagreement with the exposure draft's proposal that one component or sub-component reporting entity may record a liability that was caused by, and should be paid by, another component entity, citing apparent contrariness to the sound generally accepted accounting principle in SFFAS 5 guidance which states that liabilities generally should be reported by the component entity for which the future outflow of resources is probable and measurable. However, taking into consideration that it could cause some confusion and, likely, accounting errors when multiple sub component entities are a party to the same litigation which don't have all information and may even be in a different countries, we agree that it would be logical to allow the managing component entity to record the initial liability instead of the sub-component reporting entity whose actions gave rise to the litigation. The accuracy of the financial report is of utmost importance and minimizing confusion and errors is essential.

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.

HUD's component entities expressed some nuance in response to this question. FHA stated that in cases where information is available for the sub-component reporting entity whose actions gave rise to the litigation to apply all provisions of SFFAS 5, that sub-component should recognize the liability, instead of another sub-component that is only responsible for litigation. FHA noted that the only reason why a sub-component not responsible for the actions that gave rise to the litigation from which a liability arose, would record a contingent liability, is if not enough information was available. When that obstacle is removed, it is the sub-component whose actions gave rise to the litigation, and hence the liability, that should ultimately record the liability. GNMA agreed that, in certain situations where information could be provided timely and appropriate judgments

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could be made about the documentation, the sub-component should be permitted to report the information in accordance with SFFAS 5.

As eluded to in response to Q1 (a), HUD OCFO's Office of Accounting stated SFFAS 5 guidance is the GAAP and preferred treatment with liabilities including contingencies due to litigation; doing anything otherwise does gave some pause. However, due to the exceptions and circumstances notes in the exposure draft, the OCFO Office of Accounting agreed with the managing sub-component entity recording the liability versus the component entity which gave rise to the litigation. It is believed that this will minimize confusion among the sub-component reporting entities and eliminate duplications or other errors when multiple entities are involved in one case. Again, the accuracy of the financial report is of utmost importance.

- 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.

HUD generally agrees with the interpretation that the entity that owns the general PP&E should recognize the liability until the PP&E and its associated liability is transferred to another entity for cleanup. Since it is the related PP&E that gave rise to the associated cleanup costs and resulting liability for those cleanup costs, it should be the component reporting entity which carries the PP&E on its balance sheet that should also recognize the associated cleanup liability until transferred. The proposed presentation aligns the asset, liability, expenses in the same component entity prior to and during cleanup ensuring the accuracy of the financial statements for all component entities involved throughout the process.

- 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

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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.**

HUD is not aware of any other liability situations or examples, other than contingent liabilities and cleanup costs presented in this guidance, for which this guidance could apply. It is hypothetically possible that the following instances may create an example, but it not a known past or existing situation at HUD.

- This could possibly apply to any complex or difficult to measure contingent liability arising out of litigation, which may have been due to actions of multiple sub-components in different geographical areas within a larger reporting entity that uses a distinct and separate sub-component to handle litigation for that reporting entity.
- This could possibly apply to situations where the development of systems and related costs may be at the component level with the assets and related depreciation being maintained at the sub-component level. In this case, matching occurs through the consolidation of the component and sub-component during agency-level reporting.

- 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”?**

HUD is of differing opinions on the subject of inclusion of an additional general principal.

- FHA asserts that this guidance would apply to any complex or difficult to measure contingent liability arising out of litigation and which would be due to actions of multiple sub-components in different geographical areas within a larger reporting entity that uses a distinct and separate sub-component to handle litigation for that reporting entity. In that case the general principle quoted in Q3b above, would be appropriate.

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- HUD OCFO's Office of Accounting does not recommend adding a general principle to allow for cases other than contingent liabilities and cleanup costs, stating that the guidance should be linked to very specific exceptions to maintain control of reporting and keep entities in compliance with SFFAS 5 as much as possible. It is believed this will help maintain alignment of financial events to reporting as well as transparency and auditability in the financial reports.
- GNMA believes that sufficient guidance has been provided.

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

HUD has no other comments.