

FASAB Exposure Draft: *Guidance on Recognizing Liabilities Involving Multiple Component Reporting Entities: An Interpretation of SFFAS 5*
Questions for Respondents due January 28, 2019

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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.

Majority of the stakeholders agree with the guidance in response to FASAB Question 1a, but stress the importance of communication. Additionally, as the entity responsible for managing the litigation it seems logical they would have all the necessary information to report the liability. Stakeholders provide the following rationales/questions:

1. Recommend clarifying and/or revising paragraph 10 to address the following:

a. What specific paragraphs are considered the “general provisions of Interpretation 2?”

b. Currently, entities recognize an expense and liability at the time they recognize a contingent liability and reverse those entries if the contingent liability is not realized (no payment required). Why would the entity managing the litigation recognize an “other financing source” at the time they remove the liability, in the event a different entity is identified to pay the liability? This guidance does not appear to meet the definition of other financing sources per SFFAS 7, paragraph 70.

c. If the managing entity reports an expense (e.g. general ledger account 679000) at the time they recognize the contingent liability, then subsequently report an “other financing source” upon removal of the liability, this will impact the managing agency’s net cost of operations although the managing entity incurred no actual costs. Instead, reversing the original entry would ultimately result in no impact to the managing entity’s net cost of operations and would not require eliminations between the managing and funding entities for the consolidated report. See SFFAS 7, paragraph 43 related to the components of net cost of operations.

2. The interpretation guidance is based on an assumption there is a lack of available contingent liability information for a subcomponent entity to report liabilities they incurred when multiple subcomponents are involved. However, we recommend the Interpretation address the situation where a subcomponent entity has such information available. For example, multiple DoD entities are sometimes grouped on the Treasury judgment fund website as “Office of the Undersecretary of Defense –Agencies.” The Defense Finance and Accounting Service provides information to DoD subcomponents to identify their portion of litigation under this summary category.

3. Paragraph A17 introduces a separate scenario where the reporting entity managing litigation is also responsible for paying such litigation and does not seek reimbursement for claims paid on behalf of other sub-component reporting entities. We recommend guidance on how this should be reported by

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both involved entities in the “Guidance on Contingent Liabilities” section of the Interpretation.

4. Recommend that FASAB include information related to reporting disclosures in the Interpretation. Per SFFAS 55, “...component reporting entities should identify the costs of the providing entity that are not fully reimbursed...” How does this apply to subcomponent reporting entities? If a subcomponent reporting entity does not have enough information to report a contingent liability, how would they have enough information to report a related disclosure?

5. Consider revising verbiage in SFFAS 5, to clarify the guidance is applied at the component entity level. For example, SFFAS 5, paragraph 19 defines a liability as “a probably future outflow or other sacrifice of resources as a result of a past transaction or event.” If a subcomponent that is managing litigation recognizes the contingent liability, but a different subcomponent ultimately will pay any required liability, then the managing subcomponent will appear to be noncompliant with SFFAS 5 (i.e., no probably future outflow or other sacrifice of resources will be incurred by the subcomponent managing the liability).

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.

Majority of the stakeholders agree with the guidance in response to FASAB Question 1b. Stakeholders provide the following rationales/questions:

1. The key to this proposed interpretation generally relates to the guidance found in SFFAS 5, “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.” OGA thinks that the key to this standard is that all the entities involved (entity managing the claim and the one paying the claim) must communicate with each other to ensure the responsibilities of each entity are clear to avoid inaccurate reporting on the financial statements.

2. If the entity whose action gave rise to the litigation has the necessary information to report the liability, it should be allowed to report the liability on their financial statements. The need for another entity reporting the liability should be lack of information available to report. Communication should be a key when an entity is managing a litigation.

3. Please clarify what “report” means. Does this mean the recognition of the liability/expense in the subcomponent reporting entity’s financial statements or could reporting include a disclosure that existing litigation is managed by another entity, which may ultimately require payment by the subcomponent reporting entity that incurred the liability?

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- 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.

Stakeholders agree with the guidance in response to FASAB Question 2. Stakeholders provide the following rationales:

- 1. The liability should be associated with the actual PP&E until the property has been transferred.**
- 2. This guidance agrees with the DoD Financial Management Regulation, which states that federal government accounting records are not duplicative. Components that possess and control (have preponderant use of) general property, plant and equipment (PP&E) assets that materially contribute to the components mission should maintain accounting and financial reporting for such PP&E regardless of the organization that originally acquired the items or provided the funding for the PP&E. If a component prepares financial statements, such PP&E assets to include cleanup liability related to the general PP&E asset should be reported in its financial statements.**

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.**

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Stakeholder(s) agree with the guidance in response to FASAB Question 3a. Stakeholder(s) provide the following rationale(s):

Workers' compensation claims for other agency's employees when assigned to the Agency.

- 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"?

Stakeholder(s) agree with the guidance in response to FASAB Question 3b.

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

Should the liability be across multiple Federal agencies it would seem that the entity managing the litigation would be the logical agency to report the liability until settlement/judgement has been reached.