Federal Accounting Standards Advisory Board

May 4, 2006

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Comes, Executive Director

Subject: Application of the Liability Definition[1] – Tab C

At the March 29, 2006, board meeting, staff presented the board members with a copy of the packet that was sent to individuals in the federal financial management community, inviting them to participate in a task force on liability classification. The task force was approved by the Board as part of the revised project plan presented at the January 2006 board meeting. The task force invitation packet was sent to members of the Federal Financial Management Council and Financial Statement Audit Network, as well as several independent public accountant (IPA) firms. Staff received a fairly good response rate, with representation from 13 agencies and three IPAs.

To keep you informed of progress on the project, staff has attached a high-level summary of the kickoff meeting that was held on April 12, 2006 as Attachment C1. In general, the participants indicated that they have not had any implementation difficulties using the current liability standards. There was unanimous agreement that the classification structure (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) has worked well over the years. When asked which specific areas participants felt FASAB should address, the following six issues topped the list: (1) Intragovernmental Reconciliation; (2) Leases; (3) Social Insurance; (4) Cleanup Costs; (5) Judgment Fund; and (6) Selective Interpretation of the standards. Specific comments by agency/firm are included as Attachment C1a; a working draft of the task force objectives document is included as Attachment C2 for your reference.

The next meeting of the task force will be held on Thursday, May 11, 2006. Staff will provide the Board members with a brief update on the progress of the task force at the May 24, 2006 Board meeting. If you have any questions or comments, please contact me by telephone at 202-512-7377 or by e-mail at ranaganj@fasab.gov.

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

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TASK FORCE ON LIABILITY CLASSIFICATION
Summary of April 12, 2006 Meeting

Participants:

Linda Hoogeveen App	US Department of Agriculture/Food and Nutrition Service (FNS)
Doug Bennett	Veterans Administration (VA)
Bill Boutboul	Government Accountability Office (GAO)
Earl Cherry	Health and Human Services (HHS)
Monica Congleton	VA
Paul Cullinan	Congressional Budget Office (CBO)
Maryla Engelking	Department of Defense (DOD)
Bill Garay	Defense Information Systems Agency (DISA)
Phil Howland	Treasury
Kimberly Jackson	VA/Veterans Benefits Administration (VBA)
Carol Johnson	Office of Management and Budget (OMB)
Sophila M. Jones	Department of Justice (DOJ)
John Lynskey	National Science Foundation (NSF)
Susan Mata	GAO
Laura Price	KPMG
Eric Rivera	Nuclear Regulatory Commission (NRC)
Alan Rosenthal	Cotton & Co.
Thomas Schweinefuss	Cotton & Co.
Mitchel Sturm	VA/VBA
Philip Streit	DOD
Judy Twitty	Social Security Administration (SSA)
Marvin Washington	Pricewaterhouse Coopers (PWC)
Wendy Comes	FASAB
Julia Ranagan	FASAB

Introduction/Background

Staff briefly explained the current progress on the three liability-related projects currently underway (Conceptual Framework/Elements, Social Insurance, and Application of the Liability Definition) and the purpose of the task force. Staff indicated that the primary purpose of the task force is to obtain feedback from the federal financial management community on how the liability standards and classes have been working over the last ten years and if there have been any implementation difficulties that should be addressed going forward.

General Comments About the Liability Standards

All of the participants indicated that they have not had any implementation difficulties using the current liability standards. There was unanimous agreement that the classification structure (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) has worked well over the years. See specific comments by agency/firm at Attachment C1a.

Summary of April 12, 2006 Meeting

Specific Issues or Areas the Participants Felt that FASAB Should Address

The following topics were identified by more than one participant as specific issues or areas that the participants feel could use additional guidance from FASAB (the number of times mentioned by participants is included in parentheses after the title of each issue). See specific comments by agency/firm at Attachment C1a.

- **Intragovernmental Reconciliation (5 Participants)** – Additional guidance to assist with the intragovernmental reconciliation issue. Several participants mentioned that there should be one centralized system with specifically required fields (e.g., document number, description, etc.) such as a clearinghouse or website for intragovernmental transactions. In addition, one participant noted that the standards should allow more flexibility regarding full accruals so that agencies can cut down on the number of agencies to which year-end accruals need to be attributed (e.g., spreading accruals to the top ten or top 20 major ones rather than every agency involved). Staff note: this brings up the issue of what is immaterial to one agency may be material to another.
- **Leases (5 Participants)** – Additional guidance on determining capital versus operating leases.
- **Social Insurance (3 Participants)** – There was an extensive discussion of accounting for social insurance and whether it should be recorded as a liability on the balance sheet. During the discussion on these comments, some participants supported greater liability recognition while others opposed it. Since the discussion was not intended to focus on social insurance issues, no formal poll was taken. Staff explained the board's current position on the issue and redirected the participants to the specific tasks to be discussed.
- **Cleanup Costs (3 Participants)** – Additional guidance on when to recognize asbestos-related and other cleanup costs.
- **Judgment Fund (2 Participants)** – Additional guidance on who is responsible for recording potential liabilities that are paid out of the judgment fund. Some agencies have argued that they are not the ones that pay the judgments and should not have to record the liability on their books.
- **Selective Interpretation (2 Participants)** – The standards are selectively interpreted by agencies on a case-by-case basis.

In addition to the issue areas above, participants also noted concerns related to the following:

- the need to educate agencies as to what should be on a financial statement;
- the need to estimate the FECA liability for smaller agencies for which the Department of Labor no longer provides an actuarial figure;
- inconsistent communication between general counsel and accountants regarding potential contingencies and liabilities;
- when to recognize a liability for subsidy payments that are based on meeting future eligibility requirements;
- the concepts could provide more guidance into what the objective is behind recognition and measurement;
- measurability aspect of probable versus reasonably possible with regard to litigation;
- general counsel's discomfort with recognizing the full liability for government-related events that have not yet been fully acknowledged;
- accounting for general fund benefit programs (due and payable) should not change;

- discount rates used for the VA actuarial compensation liability results in huge fluctuations from year to year;
- VA health care benefits should not be recorded on the financial statements because it is discretionary funding;
- concern about off budget expenses that may need to be looked at as liabilities (structures such as one year leases set up to avoid budget scoring);
- SFFAC 2 should better define what an entity is and what should be included in the financial statements;
- differences in opinion about what is exchange versus nonexchange;
- ensuring adequate disclosures;
- how the current progress in redefining the financial statement elements will affect recognition of environmental liabilities;
- better definition of the difference between contingencies and uncertainties;
- what constitutes adequate disclosures for legal liabilities related to unasserted claims and pending or threatened litigation;
- liability reporting for long-term service contracts at year-end;
- FOIA concern over legal letter disclosures; could put government at a disadvantage;
- clarification on booking liabilities for adjudicated and unadjudicated claims (inconsistent practice); and,
- concern about maintaining the integrity of the financial statements (not putting anything on the balance sheet that does not qualify as a legal liability or a commonly recognized accounting liability).

Next Steps

The next meeting of the task force will be on Thursday, May 11, 2006 in room 5N30. Staff will be requesting feedback on staff's proposed enhancements to the definitions of the four classes (Task III) and the completeness of the liability sub-classes within each of the liability classes (Task IV).

Agency/ Firm	General Comments about Standards	Specific Issues or Areas that Participants Felt that FASAB Should Address	Some examples of government events and transactions and surrounding issues
Cotton & Company	• Have not had a lot of difficulty applying the standards. • Standards are fairly clear.	• Responsibility to record judgment fund liabilities • The need to educate clients (lawyers more so than accountants) as to what should be on a financial statement • FECA liability for smaller clients for which DOL does not provide the number • Inconsistent communication between general counsel and accountants regarding potential contingencies and liabilities	• HUD subsidized housing – government provides housing for citizens who cannot otherwise afford housing on their own but the exchange is with the landlord and not the actual recipients of the service • Grant programs where the grantee submits a report at some point to say they have spent the money but the money is actually disbursed way ahead of time and sometimes it is not determined if the money was spent in accordance with the grant until an audit years later
KPMG	• No comment	• Additional guidance on when to recognize a liability for subsidy payments that are based on meeting future eligibility requirements • Additional guidance on determining capital versus operating leases • Applicability of FIN 47 and FAS 143 with respect to asbestos remediation • The concepts could provide more guidance into what the objective is behind recognition and measurement.	• Grant programs – The incurred but not reported piece of a grant; when should it be reported and how should it be computed.
NSF	• Overall, the liability standards have worked well.	• Measurability aspect of probable versus reasonably possible with regards to litigation • Intragovernmental reconciliation issue, especially with regards to year-end accruals that must be broken out by agency • General Counsel's discomfort with recognizing the full liability for government-related events that have not yet been fully acknowledged	• Helicopter crash in the Arctic during research being conducted as a direct result of a grant from the federal government. Before we can recognize as a government-related event, we have to formally acknowledge our share of the event.
USDA/ FNS	• Have not had any issues with the current liability standards as they are now; they seem to be working really well.	• Accounting for general fund benefit programs should not change.	• School lunch program – at the beginning of the school year, children are certified as being eligible for either free or reduced price lunches. They remain eligible for the entire school year unless they become ineligible as a result of a change in status determined through self-reporting or spot verification. The federal government reimburses the states for actual lunches eaten by the children and costs are recorded as incurred. There is no

			forward-looking liability based on the number of eligibles that have been verified for the school year.
VA/VBA	• Most of the standards are pretty clear and we pretty much identify the liabilities.	• Discount rates used for the actuarial compensation liability that result in huge fluctuations	• Veteran home loan guarantee program – the government agrees to guarantee a portion of a bank loan for veterans and active service members. A discounted liability is booked based on estimated foreclosure rates for the duration of the guarantee (i.e., 30 years). • It could be argued that the service member has an option to exercise the guarantee; is the obligation when the option is made or exercised (if 90 percent exercise the option, it might be a different story than if only 15 percent do)?
VA/OFP	• No comment	• Future veterans' health care benefits should not be recorded on the financial statements because it is not measurable. Veterans entitled to health care are separated into 8 categories, based upon specific criteria, e.g., service-connected disabilities. The categories that are entitled to health care vary annually, since those categories funded are contingent upon the amount of the annual appropriation (VA medical services appropriation is discretionary funding). • Concern about off budget expenses that may need to be looked at as liabilities (structures such as one year leases set up to avoid budget scoring) • SFFAC 2 should better define what an entity is and what should be included in the financial statements.	• Barter transactions – VA does a substantial number of barter transactions with DOD and other institutions (e.g., medical schools) for pints of blood, medical services, etc. It is difficult to estimate fair value of the goods and services exchanged. • Veterans' health care – will reimburse veterans in a small town that is not near a VA hospital or clinic that go to see a regular doctor. Do not record the liability and expense until the claim is adjudicated.
GAO	• The standards are for the most part clear. • The current four classes of liabilities in SFFAS 5 are appropriate; there is now a substantial history and body of experience among practitioners that are familiar with that framework.	• The standards are selectively interpreted by agencies as they go along. • Differences of opinion about what is an exchange versus nonexchange • There should not be a liability for social insurance reported on the balance sheet; to do so would distort the operating performance due to the significance of the dollars. Now that SOSI is a basic financial statement subject to	

		audit, you provide the transparency and the information about the financial condition of the government. • Determining capital versus operating leases • An enhancement to the standards to require that all intragovernmental accruals are recorded would be very beneficial.	
DOJ	• We do not really have a problem with understanding the standards; I think everybody pretty much understands the standards.	• Determining capital versus operating leases • Ensuring adequate disclosures • Identifying cleanup costs	• Grant liability – trying to determine when the funds have been expended by the grantee so that the department can appropriately recognize liabilities.
HHS	• The liability standards that we have now work pretty well.	• Disagree with the concept of putting the liability for social insurance on the balance sheet • Responsibility to record judgment fund liabilities	• Medicare – transactions have occurred that the federal government will have to pay for that have not yet been reported (IBNR); there is a lot of back and forth between the auditors and the department.
SSA	• We have not noticed any problems with the current standards; they seem to fit purposes and are understandable.	• The biggest issue would be with the social insurance standards that are being discussed elsewhere	• Supplemental Security Income – The participant is paid on a monthly basis until deemed ineligible, either by self-reporting or spot verification; the only liability on the books is an actuarial estimate for adjudicated and unajudicated claims.
PWC	• We do not foresee any problems right now; our clients are becoming very educated in terms of issues that are systemic throughout their organization and putting together workgroups. • From our standpoint, from our clients, things seem to be working fine.	• No comment	• Medicare – Includes a sophisticated model for estimating the liability, which captures (1) participants that are currently in the doctor's office right now; (2) participants that have visited the doctor's office but not yet submitted a claim; (3) claims that have been submitted but have not gone through all of the edits yet; and (3) claims that have gone through the edit process but have not been paid. History is used to make a determination as to the number that turn out to be ineligible. • Medicaid – the federal government pays the states through matching grants. If the state fails to pay for a service and then gets sued by a hospital, does the federal government have any responsibility for matching that?
Treasury	• To my knowledge, there have not been any problems with the classification or the definition of liability.	• No comment	

CBO	• No comment	• Determining capital versus operating leases • The issue of selective interpretation of the standards	
NRC	• For the most part, we are pleased with the standards; we have not had major issues with the standards.	• Determining capital versus operating leases • FASAB should look at the standards and see where they can be more involved and address the issue with intragovernmental reconciliations because the current process is not working.	
DOD	• For the most part, we see the standards as adequate; we are able to figure out the four classes and how our transactions fit into them.	• How the current progress in redefining the financial statement elements will affect recognition of environmental liabilities • FAS 143 and the impact for nonfriable asbestos • Better definition of the difference between contingencies and uncertainties • What constitutes adequate disclosures for legal liabilities related to unasserted claims and pending or threatened litigation • More work on the intragovernmental issue	
DISA	• No issues with the liability standards themselves.	• Liability reporting for long-term service contracts at year-end • Intragovernmental reconciliation issue	• In previous experience with FEMA IG, FEMA made grants to the states to deal with Presidentially declared disasters. The money is spent and it is difficult to account for how the money was spent. There is a question of how the advances should be treated.
OMB	• I cannot say that we have identified any problems with the existing standards.	• Concerned with maintaining the integrity of the financial statements and really concerned about expanding the definition of a liability to put anything on the financial statements that does not qualify as a legal liability or a commonly recognized accounting liability • We think the commitments under current law should be recognized but not on the financial statements; they can be part of the financial report but we are really nervous about calling something a liability on the balance sheet that is not really a liability from a legal perspective or an accounting perspective.	

Federal Accounting Standards Advisory Board
Task Force on Liability Classification

Introduction

The Federal Accounting Standards Advisory Board (FASAB) is the source of generally accepted accounting principles for financial reporting in the federal government. The Board issues its guidance through a range of vehicles such as Statements of Federal Financial Accounting Concepts and Standards (SFFAC and SFFAS), Interpretations, Technical Bulletins, Technical Releases of the Accounting and Auditing Policy Committee, and Implementation Guides published by FASAB staff. Since its inception, FASAB has issued several standards related to accounting for federal liabilities (see text box at left).

SFFAS 1, Accounting for Selected Assets and Liabilities (1993)

- Accounts Payable
- Interest Payable
- Other Current Liabilities

SFFAS 2, Accounting for Direct Loans and Loan Guarantees (1993)

- Loan Guarantees

SFFAS 5, Accounting for Liabilities of the Federal Government (1995)

- General Principles (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events)
- General Fund Benefit Programs
- Employee Benefits
- Insurance and Guarantees
- Capital Leases
- Federal Debt
- Contingencies

SFFAS 6, Accounting for Property, Plant, and Equipment (1995)

- Cleanup Costs

SFFAS 12, Recognition of Contingent Liabilities from Litigation (1998)

- Litigation

SFFAS 1, *Accounting for Selected Assets and Liabilities,* which was issued in March 1993, established accounting standards for liabilities of the federal government arising from accounts payable, interest payable, and other current liabilities. SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, which was issued in August 1993, established accounting standards for liabilities arising from loan guarantees. SFFAS 5, *Accounting for Liabilities of the Federal Government*, which was issued in September 1995, established accounting standards for liabilities of the federal government not covered by SFFAS 1 and SFFAS 2. SFFAS 5 defines the recognition points for liabilities associated with different classes of events and transactions – exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events. In addition to discussing the general liability recognition principle, SFFAS 5 includes specific liability accounting standards for contingencies; capital leases; federal debt; pensions, other retirement benefits, and other postemployment benefits; and, insurance and guarantee programs. SFFAS 6, *Accounting for Property, Plant, and Equipment*, which was issued in November 1995, provides additional guidance on the recognition of cleanup costs over the life of the related property, plant, and equipment and supplements the accounting requirements for liabilities in SFFAS 5. SFFAS 12, *Recognition of Contingent Liabilities from Litigation*, which was issued in December 1998, amended the contingent liability criteria in SFFAS 5 and applies to the evaluation, accounting recognition, and disclosure of the future outcome of litigation.

Generally speaking, SFFAS 5 requires that the liability for a nonexchange transaction be recognized for any unpaid amounts due as of the reporting date (due and payable) and the liability for an exchange transaction be recognized when goods or services have been provided. SFFAS 5 further requires that the liability for government-related events be recognized when the event occurs if the future outflow of resources is probable and measurable and the liability for government-acknowledged events be recognized when and to the extent that the federal government formally acknowledges financial responsibility for the event and an exchange or nonexchange transaction has occurred.

In August 2003, FASAB began an extensive review of the "elements of financial reporting," including liabilities. As part of that Elements project, FASAB has tentatively agreed[1] upon a revised definition and essential characteristics of a liability of the federal government (see text box at right). More information on the history and status of the Elements project is currently located on the FASAB website at http://www.fasab.gov/projectselements.html.

> "A liability is a present obligation[5] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand…A liability of the federal government has two essential characteristics. First, it constitutes a present obligation to provide assets or services to another entity. Second, the federal government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur."
>
> *Staff Draft of a Proposed Concepts Statement on "Definition and Recognition of Elements of the Financial Statements,"* March 10, 2006
>
> [5] The term *obligation* is used with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

Also in August 2003, FASAB renewed deliberations on accounting for social insurance (e.g., Social Security and Medicare). As part of the ongoing Social Insurance Liabilities Project, FASAB has tentatively agreed to begin recognizing a liability for individuals who have accumulated 40 quarters of work in covered employment, thereby abandoning "due and payable" as the default recognition point for nonexchange transactions. More information on the history and status of the Social Insurance project is currently located on the FASAB website at http://www.fasab.gov/projectssocialinsurance.html.

In March 2004, FASAB initiated a project titled, "Research into the Application of the Liability Definition," as a companion project to the Elements and Social Insurance projects. The purpose of this project is to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for obligations of the federal government that could potentially result in a net outflow of resources (other than social insurance). Some such obligations may not currently be recognized as liabilities on the balance sheet while others may be recognized based on "due and payable" concepts. The focus of this project is on both (1) how to recognize, measure, and display obligations that meet the revised definition of a liability and (2) how (and whether) to disclose information about obligations that do not meet the revised definition of a liability. More information on the history and status of the "Application of the Liability Definition" project is currently located on the FASAB website at http://www.fasab.gov/projectsresearch.html.

Tentative results from current FASAB deliberations on the definition of a liability and accounting for social insurance indicate that it will be necessary to revisit the current liability standards in SFFASs 1, 2, 5, 6, and 12 to ensure that they align with FASAB's vision for more transparency in federal financial reporting. With regard to the liability classification structure, FASAB has

[1] Official positions of the FASAB, whether proposed or final concepts or standards, are presented in FASAB publications issued in accordance with our "Rules of Procedure" and "Memorandum of Understanding." "Tentatively agreed" refers to working majority views conveyed to staff at public meetings. These agreements sometimes change before an official position is taken.

tentatively agreed to maintain the four classes of events and transactions from SFFAS 5 – exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events. A majority of the FASAB members believe that it is important to maintain the four classes, rather than develop new ones, because the federal financial community is already familiar with these classes that have been in use for over a decade.

Task Force Objectives

Task forces play an important role in the accounting standard-setting process. Task force members provide expert views and recommend solutions to accounting issues or problems. Task force members can also be instrumental in proactively raising potential issues before a standard gets too far in the standard-setting process. As part of the Board's project to update the Concepts, a different approach to liability recognition is being considered that could require major changes to or abandonment of the existing four classes of events and transactions (exchange transactions, nonexchange transactions, government-related events and government-acknowledged events). Relevant insights from representatives of the federal financial management community are important to the development of standards that cover the broad range of government programs.

The objective of this particular task force is to provide feedback from the perspective of preparers and auditors in the following four areas:

1. Provide feedback on whether the four classes of liabilities established in SFFAS 5 (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) have proven useful to federal preparers and auditors in determining how to appropriately apply liability definition, recognition, and measurement criteria across a broad spectrum of federal events and transactions. Discuss specific challenges and successes encountered while following the standards in SFFASs 1, 2, 5, 6, and 12.

2. Describe common relationships and key events among different federal events and transactions that serve to either support the current liability classification structure (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events) or suggest that a different classification structure may be more appropriate.

3. If the four classes of liabilities established in SFFAS 5 are deemed appropriate, provide feedback on whether the enhancements to the definitions of the four classes proposed by staff serve to clarify some of the application difficulties that may have arisen over the years since SFFAS 5 was implemented. If not, suggest alternative solutions.

4. If the four classes of liabilities established in SFFAS 5 are deemed appropriate, provide feedback on the completeness and usefulness of the proposed classes, sub-classes, and relationships against knowledge of current practice, including whether each sub-class is operationally distinct. If not, suggest alternative solutions.

The feedback received from task force members will be utilized by FASAB staff to develop new federal liability standards.

Specific Tasks to be Accomplished

I. Provide Feedback on the Liability Classification Structure Established by SFFAS 5 and Overall Satisfaction with the Level of Liability Guidance Provided by SFFASs 1, 2, 5, 6, and 12

Discuss your overall experience with classification, recognition, and measurement of federal liabilities based on the guidance in SFFASs 1, 2, 5, 6, and 12. Specifically discuss your overall experience implementing the liability classes[4] in SFFAS 5 for purposes of establishing when an obligating event has occurred and applying recognition and measurement criteria in a consistent manner (see excerpt in text box at right).

> A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize[2] probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.[3]
>
> *SFFAS 5, par. 19*

- What has worked particularly well?
- What could be improved?
- Have any transactions, events, or circumstances arisen that should cause the Board to reconsider the current liability classification structure?
- How would you characterize the level of guidance that is provided by SFFASs 1, 2, 5, 6, and 12 in regard to overall classification, recognition, and measurement of federal liabilities (too much guidance, too little guidance, or just right)?

Status: Completed; see summary at Attachment C1 and C1a.

II. Describe the Common Relationships and Key Events Among Federal Events and Transactions

There is broad and general agreement among FASAB Board members that establishing liability classes would result in a more consistent application of the liability definition without the need for step-by-step rules on how to apply the definition to each government program as it comes into being. The classification structure established in SFFAS 5 is but one way to group federal transactions and events to promote a common application of liability recognition and measurement criteria (see text box below). Discuss the common relationships and key events among all federal events and transactions.

- Do the common relationships and key events among federal events and transactions, or lack thereof, support the current liability classification structure or suggest that a different classification structure may be more appropriate?
- Do you believe that there are other relationships or key events that might do a better job of distinguishing between different types of federal events and transactions? If so, provide alternative suggestions.

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[2] SFFAS 5, footnote 16: Recognition means reporting a dollar amount on the face of the basic financial statements.

[3] SFFAS 5, footnote 17: This document uses the term "nonexchange transaction" in a way similar to FASB's "nonreciprocal transfer." That is, it implies a one-way flow of resources, services, or promises between two parties. "Transaction" in the phrase "nonexchange transaction" does not include reclassification, closing, and similar "internal" entries to the accounting records, though some accountants use the term in that broader sense. "Probable" means more likely than not. "Measurable" means reasonably estimable.

[4] A class is a "group, set, or kind sharing common attributes" (characteristics) as defined by Merriam-Webster Online at www.webster.com.

Exchange transactions – arises when each party to the transaction sacrifices value and receives value in return.

- Involves two parties;
- There is a two-way flow of resources or of promises to provide resources of equal value; and,
- A liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.
- An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs (in the period the employee works). The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.
- A second example of an exchange transaction occurs when the federal government orders goods or services from a vendor. An exchange transaction occurs because both parties (the federal government and the vendor) receive and sacrifice value. The expense is recognized in the period that the exchange occurs (in the period that the federal government accepts the delivery of goods or services). The liability includes the amount due to the vendor for the cost of goods or services received and accepted in the current period.

Nonexchange transactions – arises when one party to a transaction receives value without directly giving or promising value in return.

- Involves two parties;
- There is a one-way flow of resources or promises to provide resources;
- One party to a transaction receives value without directly giving or promising value in return; and,
- A liability is recognized for any unpaid amounts due as of the reporting date.
- Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

Government-related events – nontransaction-based events that involve interaction between the federal government and its environment.

- Involves two parties (the federal government and some aspect of its environment);
- The event is of financial consequence to the federal government because it is directly involved during the course of federal operations;
- May or may not be beyond the control of the federal government;
- A liability is recognized on the same basis as those that arise in exchange transaction; and,
- Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.
- Government-related events include cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations to clean up, accidental damage to nonfederal property caused by federal operations, and other damage to federal property caused by such factors as federal operations or natural forces.
- Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy make it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably.

Government-acknowledged events – nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event.

- Involves two parties;
- The event is not directly related to federal operations;
- The event is of financial consequence to the federal government only because it chooses to respond to the event; and,
- A liability is recognized when (1) The federal government has formally acknowledged financial responsibility for the cost of the event through an appropriation or authorization from Congress, and (2) an exchange occurs.
- Events, such as tornado damage to a U.S. town, would create a liability when (1) Congress appropriates funds, and (2) transactions resulting from the appropriations, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or nonexchange transactions.

(definitions from SFFAS 5, pars.22, 24, 27, and 30; common relationships and key events are mainly from SFFAS 5, pars. 20 – 32)

Status: Completed; see summary at Attachment C1 and C1a.

III. Provide Feedback on Staff's Proposed Enhancements to the Definitions of the Four Classes

Staff drafted proposed revisions to the four liability class definitions from SFFAS 5 to apply the word "direct" more consistently and to more appropriately clarify the distinction between a government-related event and a government-acknowledged event (denoted by underlined additions in each of the four text boxes below). Provide feedback on whether the proposed enhancements to the definitions of the four classes would serve to clarify some of the application difficulties that may have arisen over the years since SFFAS 5 was implemented.

- Are the proposed revisions helpful?
- What could be improved?

Exchange Transactions – an exchange transaction arises when each party to the transaction directly sacrifices value and directly receives similar value in return. There is a reciprocal or two-way flow of resources or of promises to provide resources of similar value. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources of similar value in the future (e.g., the federal government purchase of goods or services at market value[1] from a vendor).

SFFAS 5, par. 22 (underlined items indicate proposed clarifications by staff)

Nonexchange transactions – a nonexchange transaction arises when one party to a transaction receives value without directly giving or promising similar value in return or one party to a transaction gives or promises value without directly receiving similar value in return. In a nonexchange transaction, there is either no reciprocal or two-way flow of resources or of promises to provide resources or the transaction is not direct and of similar value (e.g., grants to state and local governments, subsidies, and other transfer programs for individuals).

SFFAS 5, par. 24 (underlined items indicate proposed clarifications by staff)

Government-related Events – government-related events are nontransaction-based events that are of financial consequence to the federal government because they involve direct interaction between the federal government and its environment, either through the conduct of federal operations or because the events take place on federal property (e.g., accidental damage to nonfederal property caused by federal operations).

SFFAS 5, par. 27 (underlined items indicate proposed clarifications by staff)

Government-acknowledged Events – government-acknowledged events are nontransaction-based events that are not the result of federal operations and do not directly involve the federal government but are of financial consequence to the federal government because it chooses to respond to the event (e.g., damage to nonfederal property caused by a natural disaster).

SFFAS 5, par. 30 (underlined items indicate proposed clarifications by staff)

Status: To be discussed at next meeting of task force on Thursday, May 11, 2006.

IV. Provide Feedback on the Completeness of the Liability Sub-Classes within Each of the Liability Classes

The sub-classes currently included in SFFASs 1, 2, 5, 6, and 12 do not specifically address all federal events and transactions (see text box at top right). Would you consider a more comprehensive list of sub-classes that addresses all federal events and transactions with specific standards for each one (such as the list in the text box at bottom right) to be more useful for purposes of establishing when an obligating event has occurred and applying recognition and measurement criteria across a broad spectrum of government events and transactions in a consistent manner?

- What has worked particularly well?
- What could be improved?
- Are the sub-classes in the proposed list (see text box at bottom right) operationally distinct?
- Are there additional transactions or events that you believe are not included in the proposed sub-classes (see text box at bottom right)?
- Do you believe there is a more appropriate grouping of liabilities by relationship or key events?

Status: To be discussed at next meeting of task force on Thursday, May 11, 2006.

CURRENT

SFFAS 1
- Accounts Payable
- Interest Payable
- Other Current Liabilities

SFFAS 2
- Loan Guarantees

SFFAS 5
- Contingencies
- Capital Leases
- Federal Debt
- Pension/Other Retirement Benefits/Other Postemployment Benefits
- Insurance and Guarantees

SFFAS 6
- Cleanup Costs

SFFAS 12
- Litigation

STAFF DRAFT

Exchange Transactions
- Employee and Veteran Benefit Payments
- Capital Leases
- Federal Debt
- Accounts Payable for Goods and Services
- Interest Payable
- Other (TBD)

Nonexchange Transactions
- General Fund Benefit Payments
- Insurance and Guarantees
- Grant and Award Payments
- Social Insurance
- Environmental and Disposal
- Other (TBD)

Government-Related Events
- Environmental and Disposal
- Damage to nonfederal property caused by federal operations
- Damage to federal property resulting from federal operations or natural disasters
- Other (TBD)

Government-acknowledged Events
- Environmental and Disposal
- Damage to nonfederal property caused by natural disasters
- Other (TBD)