Statement of Federal Financial Accounting Standards 30: Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts

Status

Issued	August 15, 2005
Effective Date	For reporting periods beginning after September 30, 2008.
Interpretations and Technical Releases	Interpretation 6, *Accounting for Imputed Intra-departmental Costs;* TR 8, Clarification of Standards Relating to Inter Entity Costs
Affects	• SFFAS 4
Affected by	None.

Summary

This standard requires full implementation of the inter-entity cost provision in Statement of Federal Financial Accounting Standards (SFFAS) 4, Managerial Cost Accounting Standards and Concepts. By fully implementing the provisions in SFFAS 4 (issued in July 1995) this standard will require the following for inter-entity cost:

> Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.
>
> Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity. (Text preceding paragraph 105 of SFFAS 4)

This standard requires full implementation for reporting periods beginning after September 30, 2008.

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Introduction

1. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. SFFAS 4 provided for gradual implementation because recognition of the full cost of goods and services provided by one federal entity (the providing entity) to another federal entity (the receiving entity) (1) required adequate cost accounting systems and (2) engaged all federal agencies in identifying the costs of under-reimbursed goods and services.

2. Thus, an orderly means for consistently implementing the standard was viewed as necessary. The Board's implementation guidance provided "the Office of Management and Budget [OMB], with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs."[1] The inter-entity costs were to be specified in accordance with SFFAS 4, including the recognition criteria.[2] It was anticipated that the largest and most important inter-entity costs would be identified first.

3. OMB requested that the Accounting and Auditing Policy Committee (AAPC) provide assistance in developing the guidance anticipated by SFFAS 4. The AAPC Inter-entity Cost Task Force (task force) was formed and initial research was conducted beginning in July 2000. The task force reported its research findings and recommendations to the AAPC at its May 2003 meeting. The task force noted that the current limitation[3] on recognizing inter-entity costs was an impediment to progress towards full costing. However, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.

4. This standard follows the extensive research and recommendations by the AAPC task force addressing inter-entity cost guidance. Although the task force report acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing, it

[1] SFFAS 4, par. 110

[2] See SFFAS 4 par. 111-113 for recognition criteria

[3] To date, OMB has issued guidance for recognizing the following specific inter-entity costs: (1) employees' pension, post-retirement health and life insurance benefits, (2) other post-employment benefits for retired, terminated, and inactive employees, which includes unemployment and workers compensation under the Federal Employees' Compensation Act, and (3) losses in litigation proceedings. The guidance further states that to ensure consistency, agencies should not recognize costs other than those listed until further guidance is provided. See Section 4.3 of OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.*

recommended continued deferral of SFFAS 4's inter-entity cost requirements while encouraging reimbursable agreements for inter-entity provision of goods and services.

5. This standard is intended to balance the concerns expressed by the task force and the ultimate goals of SFFAS 4 related to full cost. SFFAS 4 clarified that full cost was intended to relate resources to outputs regardless of the funding source:

The full cost of a responsibility segment's output is the total amount of resources used to produce the output. This includes direct and indirect costs that contribute to the output, regardless of funding sources. It also includes costs of supporting services provided by other responsibility segments or entities. (SFFAS 4, par. 89)

6. Ultimately, attaining full cost is critical to improving performance measurement. SFFAS 4 states:

Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to ". . .improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results." (SFFAS 4, par. 34)

Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness. Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show "cost-effectiveness." Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:

(1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;

(2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and

(3) Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness. (SFFAS 4, par. 35, emphasis added)

Thus, …, performance measurement requires both financial and non-financial measures. **Cost is a necessary element for performance measurement, but is not the only element.** (SFFAS 4, par. 36, emphasis added)

7. This standard establishes a date certain—reporting periods beginning after September 30, 2008—for full cost accounting by federal reporting entities. This standard affords time to provide needed guidance before the effective date. The Board anticipates the release of one or more Technical Releases that will address implementation issues during this time. Entities may also use the time period between the issuance of this standard and the actual effective date to establish reimbursable agreements, seek implementation guidance on specific issues if necessary, and develop internal guidance on recognizing inter-entity costs.

Standards of Federal Financial Accounting

Amendments to SFFAS 4

Amendments to Existing Standards

8. Statement of Federal Financial Accounting Standard (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*, Inter-Entity Costing, par. 110 is rescinded.

9. The sentence "Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above" is rescinded from par. 111 of SFFAS 4.

Effective Date

10. This standard is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provision of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. 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 statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

Introduction

11. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. However, SFFAS 4 provided for gradual implementation of the inter-entity cost provision.

12. In 1995, the Board provided implementation guidance stating:

    Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget [OMB], with assistance from the FASAB staff, should **identify the specific inter-entity costs** for entities to begin recognizing. OMB should then issue guidance identifying these costs. **These particular inter-entity costs should be specified in accordance with this standard including the recognition criteria presented below.** The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards. (SFFAS 4, par. 110, emphasis added)

13. OMB requested that the AAPC provide assistance in developing the guidance anticipated by SFFAS 4, par. 110. The AAPC inter-entity cost task force was formed and initial research was conducted beginning in July 2000. The task force, chaired by James Taylor, Deputy Chief Financial Officer of the Department of Commerce, reported the task force research findings and recommendations to the AAPC at its May 2003 meeting. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.

14. The task force recommended no changes to the current limitations on application of SFFAS 4 inter-entity costs provisions. The task force found:

    The current implementation guidance (limitation on recognizing inter-entity costs) is an impediment to progress towards full costing.

While there likely is under-recognition of costs, government-wide guidance for any individual cases is not warranted.

Full costing should be accomplished by encouraging reimbursable agreements.

15. Before implementation of any revision or removal of the limitation on recognition of inter-entity costs, the task force believed that:

a. There should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. For example, guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued.

b. There should be established policies and procedures for the providing agency to submit necessary data to the receiving agency (for the receiving agency's evaluation and/or calculation of inter-entity costs). A particular concern is the "providing" agencies' ability and/or willingness to provide the "receiving" agency with needed data, and the availability to the receiving agency of alternate data when the providing agency cannot or will not provide data to the receiving entity.

c. There should be adequate consultation among Federal agencies and the Federal audit community about the revision or removal of the OMB restriction prior to implementation.

16. The Board appreciates the considerable talents and time volunteered by the AAPC task force. The findings and recommendations of the task force suggest that the gradual implementation planned for SFFAS 4's inter-entity cost provisions is or will be unnecessary with time due to reimbursable agreements. The task force found that inter-entity costs are increasingly being reimbursed at full cost. Further, the task force believes that entities should continue to increase the use of full-cost reimbursable agreements. With these actions, the task force believes the need for implementation guidance would be minimized because costs would be captured based on transactions.

17. While federal entities may continue to pursue reimbursable agreements, the Board does not wish to rely solely on that mechanism. The Board does not believe the existence of reimbursable agreements for all material[4] inter-entity costs at a point in time would be a permanent resolution of the issue. In addition, because there is no guarantee that reimbursable agreements would be universally obtainable and consistently pursued over

[4] SFFAS 4 addresses materiality at length in par. 112 and 113. Nothing in this standard or the AAPC task force report alters that guidance. Therefore, terms such as "materiality" and "significance" should be evaluated in the context established by SFFAS 4, par. 112 and 113.

time, the barrier to full implementation currently provided in SFFAS 4 must be removed. The Board believes that establishing a date for the removal of the barrier is appropriate.

18. The Board believes the task force's proposal would (1) defer action to an unspecified time and (2) still require future action by FASAB to remove the barrier to full implementation of the inter-entity cost to ensure full costing is implemented over time.

19. Since SFFAS 4 – excluding the inter-entity cost provisions -- was effective in fiscal year 1998 and the implementation guidance has not progressed, the Board believes establishing a date certain for full implementation is appropriate. The task force expressed concerns regarding competing priorities for scarce resources and inter-entity cost implementation should not begin at this time. Therefore, the implementation date of this standard is sufficiently distant to alleviate the concerns expressed by the task force.

20. The Board believes that establishing a date certain for implementation of the inter-entity cost provisions of SFFAS 4 would be a more effective and permanent resolution of the issue. Acting soon after the task force's surveys would ensure that deferral of action does not result in a need for further surveys or for future action by the Board to remove the barrier. In addition, this standard affords time to provide needed guidance (See Additional Guidance below).

21. This standard balances the concerns raised by the task force regarding current priorities and resource constraints, and the goals of SFFAS 4. This standard establishes a date certain for full cost accounting by federal reporting entities. Further, by permitting early implementation entities would be afforded the opportunity to improve full cost recognition sooner. For those entities receiving material amounts of non-reimbursed or under-reimbursed inter-entity goods and services, full implementation would enhance the completeness and comparability of cost information.

22. In addition, this standard is consistent with the initial steps taken by the Board in Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* and resolves concerns expressed by respondents to the exposure draft leading to Interpretation 6. Interpretation 6, issued in April 2003 and effective for periods beginning after September 30, 2004, requires recognition of intra-departmental inter-entity costs. Some respondents to the exposure draft leading to Interpretation 6 expressed concern regarding the inconsistent treatment of inter- and intra-departmental inter-entity costs. The Board then concluded that a gradual reduction of the un-recognized inter-entity costs would be preferable to no action. In addition, the Board opined that the experience gained with respect to intra-departmental inter-entity costs would be useful in addressing inter-departmental inter-entity costs. (See par. 42 of Interpretation 6.)

23. The Board believes that this standard is essential to attaining the full cost accounting envisioned in SFFAS 4. Further, full cost information is essential to effective performance measurement.

Amendments to Standards

24. To require full implementation of the inter-entity cost provision, this standard amends SFFAS 4, *Managerial Cost Accounting Standards and Concepts* by

- Rescinding Inter-Entity Costing, par. 110; and
- Rescinding the sentence "Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above" from par. 111.

Exposure Draft

25. FASAB published the exposure draft (ED) *Inter-Entity Cost Implementation Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts* on April 26, 2004. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, and the *Government Accounting and Auditing Update;* the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past.

26. 21 letters were received from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others		3
Auditors	2	2
Preparers and financial managers	14	

27. A public hearing was held on December 16, 2004. Individuals from the Library of Congress, Department of Interior, and a representative from the Association of Government Accountants Financial Management Standards Board testified at the public hearing.

Responses to the ED

28. Approximately one-half of the respondents agreed with the Board's proposal that the inter-entity cost provisions of SFFAS 4 should be fully implemented. In other words, approximately one-half of the respondents disagreed with the Board's proposal and agreed with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis.

29. Approximately one-half of the respondents believed that there were non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS 4. Additionally, a majority of respondents believed that federal entities would seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.

30. Approximately one-half of the respondents believed that additional guidance was needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity and that additional guidance was needed to apply the broad and general support exception.

Board Consideration of Comments

31. The Board determined the main concerns identified by respondents included (1) the lack of implementation guidance and (2) costs would not be recognized consistently across agencies.

32. The Board noted that the task force acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing. In addition, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. However, the task force did note that some costs could be material for selected agencies. This finding would be consistent with the comment letters to the ED, as approximately one-half of the respondents did believe that material non-reimbursed or under-reimbursed inter-entity costs that meet the recognition criteria do exist.

33. The task force reported that there should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. The task force reported that guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued. It also reported that there should be established policies and procedures for the providing agency to submit necessary data to the receiving agency

(for the receiving agency's evaluation and/or calculation of inter-entity costs). The comment letters to the ED supported the task force recommendations regarding the need for guidance.

34. Therefore, the Board determined that there was a need for additional guidance. The Board believes that with the issuance of additional detailed, practical guidance, agencies will have the tools necessary to implement inter-entity full costing and capture the costs that potentially exist. (See Additional Guidance below.)

35. Several respondents indicated that costs would not be recognized consistently across agencies as reliance on entity's judgment in identifying costs will result in differing interpretations. The Board expects differences will occur as agencies analyze their particular potential inter-entity cost against the recognition criteria because it is likely that certain costs may be material to one agency and not to another agency. This would appropriately occur considering materiality and the recognition criteria. The Board believes such expected differences are likely to occur but should not prevent agencies from informing financial statement users of material costs incurred.

36. Additionally, the Board reiterates that the recognition criteria in par. 112-113 of SFFAS 4 (which provides general criteria to determine which costs should be recognized) apply. The accounting and reporting for inter-entity costs that are recognized should be consistent and in accordance with par. 108-109 and 114-115 of SFFAS 4, which provide specific accounting examples.

Additional Guidance

37. As discussed above, the Board determined that there was a need for additional guidance. Therefore, the task force has been requested to continue its work in this area by developing one or more Technical Releases (TR) that will address implementation issues raised by respondents. The Board has also suggested certain operational guidance be issued by the Office of Management and Budget (OMB). It should be noted that the guidance does offer a venue for agencies to direct agency-specific questions.

38. The Board believes that the task force could build upon their already extensive survey results and research, as well as the comment letters and staff analysis in developing the guidance. Specifically, the task force work may include an extensive evaluation of costs to determine which ones may be considered "Broad and General" for all entities and if possible, a list of the costs that should be considered Broad and General for all entities would be included in the TR. The TR may also include additional guidance or discussion on the factors

Directness of relationship to the entity's operations and *Identifiability* as used in determining if a transaction should be considered material to the receiving entity.[5]

39. It is also anticipated that the task force will collect individual inter-entity requests for guidance on specific cases and determine if general guidance in the area can be provided on the issue, and if so, the TR will provide such clarifying guidance. The actual cases will be forwarded to OMB with the task force's recommendation, which will reference the general guidance in the TR. However, final disposition of the individual entity-specific cases will be determined by OMB.

40. The task force could utilize existing guidance related to cost accounting in developing the guidance. Specifically, the CFO Council's Cost Accounting Implementation Guide and the Joint Financial Management Improvement Program's System Requirements for Managerial Cost Accounting, among others, are good sources of information.

41. Additionally, the task force may wish to solicit volunteers from the agencies that provided comments to the ED for assistance. Also, volunteers could be requested from agencies that successfully implement Interpretation Number 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* considering the effective date for this was for periods beginning after September 30, 2004.

Effective Date

42. The proposed effective date in the ED was for periods beginning after September 30, 2007. The Board determined that the effective date of this standard should be delayed to periods beginning after September 30, 2008. The Board delayed the implementation date to allow the AAPC and OMB to develop the additional guidance detailed above.

Board Approval and Dissent

43. This Statement was approved for issuance by eight members of the Board. Mr. Reid dissented. Mr. Anania abstained.

44. Mr. Reid dissents from this Statement because he opposes rescinding paragraph 110. He believes that the inter-entity cost provisions should be implemented on a step-by-step basis. Mr. Reid notes that the basis for conclusions of SFFAS 4 states that the Board has expressed

[5] See SFFAS 4 par. 111-113 for recognition criteria

the need to take a measured, step-by-step, practical approach to implementing the inter-departmental costing standard. He notes that it further explains that the Board recommended that 1) OMB, with assistance from the FASAB staff, should identify those specific inter-departmental, un-reimbursed or under-reimbursed costs that entities should recognize, and 2) OMB should then issue guidance describing those costs. The Board anticipated that the largest and most important inter-departmental costs would be identified first; then other costs would be identified as entities gained experience in the application of the standard. Mr. Reid believes this approach was seen as a practical way to ensure uniformity in the application and implementation of the standard and to allow time and experience for overcoming any other practical problems which arose.

45. Mr. Reid believes that a better way to proceed is found in the procedure set forth in SFFAS 4 for identifying costs to be recognized. He believes that SFFAS 4 never contemplated the discontinuance of the procedure but rather held that specific costs would continue to be identified. Mr. Reid believes it is a far different approach to open the door to all costs. He believes rescinding paragraph 110 of SFFAS 4 defeats the idea set forth in SFFAS 4 that the standard be consistently applied and implemented.

46. Mr. Reid believes that the notion of consistent application is still a valid concern. He noted that when charged with identifying other costs to be imputed the Accounting and Auditing Policy Committee task force could not suggest additional costs to be recognized that were government-wide in nature and met the criteria of SFFAS 4. He believes that opening the door to recognition of inter-departmental costs that are not government-wide in nature is a new approach since such costs, identified on a case-by-case basis, cannot be applied consistently government-wide. Mr. Reid believes that control over the implementation of the standard will be lost and uncertainty will result.

47. Mr. Reid believes that if FASAB is dissatisfied with progress being made to identify additional costs, FASAB itself should identify specific costs to be recognized. SFFAS 4 indicates that FASAB may do this. Such action by FASAB would be compatible with the consistency notion and would not result in loss of control or uncertainty.

48. Mr. Reid believes that losing control over the recognition of inter-departmental costs will result in considerable activity with little or no value as agencies try to comply with a standard open to different interpretations by the preparer and the auditor. This change will expose agencies to possible challenges by auditors over unknown or immaterial costs, that cannot be determined with any certainty. In addition uncontrolled cost imputation will add significantly to the difficulties of eliminating these costs in consolidation.

49. He also believes that this standard will result in uncontrolled imputation of inter-departmental costs and may instigate an iterative process of charges and charge-backs. These multiple rounds of cost imputation will provide little benefit and make it difficult for

agencies to close their books quickly. Mr. Reid believes that as agencies impute costs from others, their costs will increase thereby increasing the costs others would need to impute from them. He believes this will create multiple rounds of cost imputation which will provide little benefit and will not be useful for agency decision making as it relates to costing of programs.

50. Mr. Reid believes this standard is a departure from the ideas of SFFAS 4 as they relate to the standard on inter-departmental cost recognition. He is not opposed to recognizing additional specific costs, but is opposed to doing so in an uncontrolled fashion.