Federal Accounting Standards Advisory Board

Inter-Entity Cost Implementation
Amending SFFAS 4, *Managerial Cost Accounting Standards and Concepts*

Proposed Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by July 31, 2004

April 26, 2004

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- *“Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board”*
- *“Mission Statement: Federal Accounting Standards Advisory Board”*

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB’s website, at www.fasab.gov.

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Federal Accounting Standards Advisory Board

April 26, 2004

TO: HEADS OF FEDERAL AGENCIES AND ALL OTHERS WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled *Inter-Entity Cost Implementation*. Specific questions for your consideration appear on page v but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by July 31, 2004.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to comesw@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
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The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB newsletter.

David Mosso
Chairman

Executive Summary

What is the Board Proposing?

In this exposure draft, the Federal Accounting Standards Advisory Board (FASAB or "the Board") proposes to require full implementation of the inter-entity cost provision in Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*. When fully implemented, SFFAS 4 -- issued in July 1995 – would 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 provision is not fully implemented because SFFAS 4 provided for gradual implementation and implementation has not progressed. The Board is proposing full implementation for reporting periods beginning after September 30, 2007.

Why is the Board making this proposal?

In 1995, the Board believed gradual implementation was needed 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. Thus, an orderly means for consistently implementing the standard was viewed as necessary. The Board's implementation guidance states:

> 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)

OMB requested that the Accounting and Auditing Policy Committee (AAPC) provide assistance in developing the guidance anticipated by SFFAS 4, par. 110. The AAPC inter-entity cost task force (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 noted that the current limitation on recognizing inter-entity costs is 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 recommended no changes to the current limitations on application of SFFAS 4 inter-entity costs provisions. Instead, the task force expressed the belief that under-reimbursed or non-reimbursed inter-entity costs could be minimized through the use of interagency reimbursable agreements based on full costing standards. In essence, the task force recommendation is that federal entities identify non-reimbursed or under-reimbursed inter-entity costs and obtain reimbursement. This is an alternative means of ensuring full cost is recognized by receiving entities. If the task force approach is effective a transaction would occur and the related costs would be recognized. However, the task force's proposal (1) would 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 fully implemented over time.

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 proposed is sufficiently distant to alleviate the concerns expressed by the task force. The Board anticipates that there will be a need for further guidance and is prepared to provide guidance in response to specific and timely requests.

In addition, because there is no guarantee that reimbursable agreements would be universally obtainable and consistently pursued over 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.

The Board believes this proposal balances the concerns raised by the task force regarding current priorities and resource constraints, and the goals of SFFAS 4.

How would this proposal improve federal financial reporting?

This proposal would establish 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 few 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.

How would this proposal contribute to meeting the federal financial reporting objectives?

The Board believes that full cost information is essential to meeting the operating performance reporting objective. Statement of Federal Financial Accounting Concept 1, Federal Financial Reporting Objectives, states that:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

Inter-Entity Cost Implementation
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Questions for Respondents

1) This exposure draft proposes that the inter-entity cost provisions of SFFAS 4 (par. 105 – 115) be fully implemented for reporting periods beginning after September 30, 2007. Do you agree with this proposal? If not, please explain your reasons and any alternative that you would prefer.

2) Appendix B presents the alternative views of one member, Mr. Robert Reid. Do you agree with his proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis as envisioned in SFFAS 4? Please explain your reasons for agreeing or disagreeing.

3) Do you believe there are now non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria established in SFFAS 4, par. 111-113 (see page19)? Please provide examples and/or explain your answer.

4) Do you believe that federal entities will seek additional reimbursable agreements or modify existing reimbursable agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized? Please explain your answer.

5) Because this proposal includes a time period during which additional guidance may be sought (consistent with the task force recommendation found on page 16), the Board wishes to gather additional information that would be useful in planning for that guidance. Thus, the following questions are intended to assist the Board in planning and do not relate directly to the provisions of this proposal.

a. SFFAS 4 provides three factors to consider in determining whether an inter-entity cost is material to the receiving entity. (See SFFAS 4, par.112 at page 19.) The factors are:

   i. Significance to the entity -- The cost of the good or service is large enough that management should be aware of the cost when making decisions.

   ii. Directness of relationship to the entity's operations -- The good or service provided is an integral part of and necessary to the output produced by the entity.

   iii. Identifiability -- The cost of the good or service provided to the entity can be matched to the entity with reasonable precision.

   Is additional guidance needed to apply these factors? If so, please indicate what specific questions you have regarding the application of these factors.

b. SFFAS 4 provides that inter-entity cost recognition is not required if the under-reimbursed or non-reimbursed costs are related to broad and general support. Broad and general support is provided by a providing entity to all or most entities of the federal government and is not an integral part of the receiving entities' output. Is additional guidance needed to apply this exception? If so, please identify any activities that may be broad and general support but for which the above description does not resolve the classification.

Proposed Statement of Federal Financial Accounting Standards
Inter-Entity Cost Implementation

Introduction

1. This Board proposal follows extensive research and recommendations by an Accounting and Auditing Policy Committee (AAPC) task force addressing inter-entity cost guidance. The task force report acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing. However, the task force recommended continued deferral of SFFAS 4's inter-entity cost requirements while encouraging reimbursable agreements for inter-entity provision of goods and services. (Appendix C presents selected material from the task force research. The task force report is available on the AAPC website at http://www.fasab.gov/aapc/iecs.html.)

2. The Board's proposal 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. 84)

3. 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)

4. Given the extensive time devoted to researching this issue and the potential need for further research if the task force recommendation is adopted, the Board is proposing an option that would establish a date certain for full implementation while allowing entities the time envisioned in the task force recommendation. Entities may use the time period between issuance of the final standard and the actual effective date of the standard to establish reimbursable agreements as recommended by the task force, seek implementation guidance as envisioned by SFFAS 4, or develop internal guidance on recognizing inter-entity costs. Therefore, the Board believes this proposal balances the concerns raised by the task force and the goals of SFFAS 4.

Proposed Standards of Federal Financial Accounting

Amendments to SFFAS 4

Amendments to Existing Standards

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

6. 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

7. These proposed standards are effective for reporting periods beginning after September 30, 2007. Earlier implementation is encouraged.

The provisions 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.

8. 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.

9. While federal entities may continue to pursue reimbursable agreements, the Board does not wish to rely solely on that mechanism. Nor does the Board believe the existence of reimbursable agreements for all material[1] inter-entity costs at a point in time would be sufficient.

10. 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 proposal affords time to provide needed guidance as needs are identified.

11. In addition, this step would be consistent with the initial steps taken by the Board in Interpretation 6 and resolve 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.)

[1] SFFAS 4 addresses materiality at length in par. 112 and 113. Nothing in this exposure draft 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.

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

Appendix B: Alternative View

13. Mr. Reid opposes rescinding paragraph 110 and a portion of paragraph 111 of SFFAS 4.

14. The basis for conclusions of SFFAS 4 states that the Board has expressed the need to take a measured, step-by-step, practical approach to implementing the inter-departmental costing standard. The Board recommended that OMB, with assistance from the FASAB staff, should identify the specific inter-departmental un-reimbursed or under-reimbursed costs for entities to begin recognizing and OMB should then issue guidance identifying those costs. OMB should consider the requirements of the standard including the recognition criteria in developing the guidance and it should also consider suggestions and information provided by Treasury, GAO, and other agencies. The Board anticipated the largest and most important inter-departmental costs would be identified first, followed by others as entities gained experience in the application of the standard. This approach was seen as a practical way to ensure uniformity in the application and implementation of the standard and to provide time and experience in overcoming any other practical problems which may arise. Also, the Board could recommend specific inter-departmental costs for recognition in future standards.

15. Mr. Reid believes that the procedure for identifying costs to be recognized as set forth in SFFAS 4 is still the way to proceed. SFFAS 4 never contemplated the discontinuance of the procedure but did contemplate that specific costs would continue to be identified. It is a far different approach to open the door to all costs – this is what would happen with the elimination of paragraph 110 and such action would defeat the idea set forth in SFFAS 4 that the standard should be consistently applied and implemented. OMB in its April 6, 1998 technical guidance memorandum for the Implementation of Managerial Cost Accounting Standards for the Federal Government identified 4 costs [(1) employees' pension benefits; (2) the health, life insurance, and other benefits for retired employees; (3) other post-employment benefits for retired, terminated, and inactive employees, which include severance payments, training and counseling, continued health care, and unemployment and workers compensation under the Federal Employees' Compensation Act; and (4) losses in litigation proceedings to be recognized. At the conclusion of its April 6, 1998 technical guidance memorandum, OMB indicated that to ensure consistency, agencies should not recognize costs other than those listed until OMB provides further guidance.

16. Mr. Reid believes that the notion of consistent application is still a valid concern. The Accounting and Auditing Policy Committee Task Force was not able to identify additional costs to be recognized that were government-wide in nature and met the criteria of SFFAS 4. 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. Control over the implementation of the standard will be lost and uncertainty will result.

17. Mr. Reid believes that FASAB itself should identify specific costs to be recognized if FASAB is unhappy with progress being made to identify more costs. 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.

18. Mr. Reid believes that losing control over the recognition of inter-departmental costs can result in a lot of activity that yields little or no value as agencies seek to be in compliance with a standard that can be interpreted differently by the preparer and the auditor. This change will expose agencies to challenges by auditors over unknown or what may be immaterial costs but which cannot be determined without judgment or outside assistance. Also, uncontrolled imputation of inter-departmental costs may instigate an iterative process of charges and charge-backs. As agencies impute costs from others their costs change thereby changing the costs others would need to impute. This can create multiple rounds of cost imputation which would provide little benefit and would render the rapid closing of agency books very challenging. These are potential problems with eliminating paragraph 110.

19. Mr. Reid believes this exposure draft is presented as a furtherance of SFFAS 4 when it really is a departure from the ideas of SFFAS 4 as those ideas relate to the standard on inter-departmental cost recognition. Mr. Reid is not opposed to recognizing additional specific costs but is opposed to recognizing all costs that meet the recognition criteria for reasons already stated.

APPENDIX C: EXCERPTS FROM THE REPORT OF THE AAPC INTER-ENTITY COSTS TASK FORCE

This appendix provides selected items from the Report of the AAPC Inter-Entity Costs Task Force. A complete report is available at the AAPC website for those wishing to review the entire report.

INTER-ENTITY COSTS TASK FORCE RECOMMENDATIONS

- The Task Force's primary mission is to provide recommendations to AAPC (Accounting and Auditing Policy Committee) regarding:

  - Which, if any, additional inter-entity costs (for goods and services provided without reimbursement or with partial reimbursement) should be required for transactions between Federal agencies (inter-Departmental transactions)

  - If any additional required inter-entity costs are identified, at what reporting level(s) (e.g. agency, bureau, line office, program, treasury appropriation/fund symbol) should the inter-entity costs be recorded

  - Implementation issues for any new or revised requirements, including a) what government-wide guidance should be issued for any new requirements; and b) what entity(s) (e.g. OMB, FASAB, AAPC) would be responsible for issuing the guidance

- The Task Force reviewed the agency responses to the July 2000 AAPC survey on inter-entity costs, and reviewed in detail agencies' recommendations, collected by the Task Force, for possible additional required areas of inter-entity costs. See **Tab E** [of the full report] for a summary of the agencies' recommendations for task force consideration and the task force consensus for each possible area.

  The Task Force concluded that none of the possible areas considered should be an additional required inter-entity cost. Some of the possible areas, however, could serve as examples of inter-entity costs that could be material to a particular agency's financial statements.

- Following up on a suggestion received, the Task Force developed and distributed to Federal agency CFOs a Real Property Inter-Entity Costs Questionnaire **(Tab F [of the full report])**.

  The Task Force reviewed in detail the agencies' responses to the questionnaire and concluded that there did not appear to be enough of a material/significant, widespread applicability of inter-entity real property usage costs to warrant requiring Federal agencies to record inter-entity real property usage costs.

- The Task Force believes that the current OMB limitation on recording inter-entity costs is an impediment to the Federal government's (and agencies') continued progress towards full costing, as outlined in SFFAS No. 4. The Task Force also believes, however, that the revision or removal of the OMB limitation should not be implemented at this time due to the following:

  - The Task Force believes that the issue of inter-entity costs can be minimized by Federal agencies' expanded compliance with full costing standards. The expanded use of interagency agreements and billings between providing agencies and receiving agencies would help to reduce unrecorded inter-entity costs in agencies' financial statements. The Task Force believes this approach would be an effective way to minimize the unrecorded inter-entity costs, and should be pursued before consideration of the revision or removal of the OMB limitation.

  - The Task Force believes that various, significant government-wide requirements, including compliance with the intragovernmental business rules and improving intragovernmental transactions reconciliations, are more significant/material issues regarding Federal agencies' financial statements (based on the Task Force's work performed), and that the revision or removal of the OMB implementation would divert limited resources from these and other high priority matters

BACKGROUND, MISSION AND PROCESS

Background

- On April 6, 1998, the Office of Management and Budget (OMB) issued a memorandum on inter-entity costs – "Technical Guidance for the Implementation of Managerial Cost Accounting Standards in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*" **(Tab J [of the full report])**. Reporting entities were required to recognize several major categories of costs that are incurred by a reporting entity but are paid by other entities (this recognition is also required in SFFAS No. 4 and OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*).

- AAPC was asked to add to its agenda a project to study inter-entity costs and gather information from agencies. The first phase of the AAPC project began with a survey on inter-entity costs. The survey was sent to each Federal CFO in July 2000. The AAPC summarized the survey findings, and also prepared a staff issue paper discussing the survey findings and inter-entity cost issues. Please see Tab **K [of the full report]** for written materials issued by the AAPC regarding the first phase of the inter-entity costs project.

- The second phase of the project was to form a government-wide task force that will further assist the AAPC and OMB in developing effective guidance on inter-entity costs. James Taylor, Deputy CFO, Department of Commerce serves as the Task Force Chair, and the first meeting was held in February 2002. The task force consists of representatives from Federal Agencies and Federal Inspector General offices, and two FASAB staff accountants. Please see Tab **I** [of the full report] for the task force roster. The Task Force Chair would like to thank all task force members for their efforts, and further recognize Monica Valentine, Assistant Director, FASAB, (Federal Accounting Standards Advisory Board) for her invaluable assistance throughout the project.

Mission

- With broad participation from Federal agencies, the Federal audit community, and AAPC determine:

    1) Which, if any, additional inter-entity costs (for goods and services provided without reimbursement or with partial reimbursement) should be required for transactions between Federal agencies (inter-departmental transactions)

    2) If any additional required inter-entity costs are identified, at what reporting level(s) (e.g. agency, bureau, line office, program, treasury appropriation/fund symbol, etc.) should the inter-entity costs should be recorded

    3) If any additional inter-entity cost areas are not identified, determine if the OMB limitation on recording inter-entity costs in only four areas should be revised or removed

    4) Identify implementation issues, including a) what government-wide guidance should be issued for any new requirements; and b) what entity(s) (e.g. OMB, FASAB, AAPC) would be responsible for issuing the guidance. For any new requirements, the task force believes that:

        (i) There should be Federal audit community understanding and buy-in

        (ii) There should be a process in place for evaluating materiality of the inter-entity costs

        (iii) There should be guidance available for agencies to arrive at a common implementation path

- Provide conclusions and recommendations to the AAPC regarding the Task Force's work

<u>Process</u>

- Review applicable Federal standards, guidance studies, and surveys, including:

  - SFFAS No. 4, paragraphs 105 through 115 – Inter-Entity Costs **(Tab D [of the full report])**

  - Implementing The Inter-Entity Cost Standard: Summary of Survey Findings and Discussion of Issues, A Staff Issue Paper Prepared for AAPC; July 2001 (includes agency responses to survey regarding inter-entity costs for both providing entities and receiving entities) **(Tab K [of the full report])**

  - OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, Section 4.3, Program Costs, page 31 (limits agencies' recording of inter-entity costs to three areas), which states:

    > "Reporting entities are required to recognize the following costs, including the portions that are funded through the Office of Personnel Management (OPM), the Department of Defense, the Department of the Treasury, the Department of Labor, or other agencies: (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 (see FASAB interpretation No.2, *Accounting for Treasury Judgement Fund Transactions*). To ensure consistency, agencies should not recognize costs other than those listed until OMB provides further guidance."

  - April 6, 1998 OMB memorandum, *Technical Guidance for the Implementation of Managerial Cost Accounting Standards for the Federal Government* **(Tab J)** (limits agencies' recording of inter-entity costs to four areas – similar to the areas listed in OMB 01-09 per above)

- Obtain any comments/feedback about the task force's mission from members' respective agencies

- Review agencies' responses to the previous AAPC survey on inter-entity costs **(Tab K [of the full report])**, and identify, any possible additional required areas of inter-entity costs for task force consideration

- Obtain members' respective agencies' recommendations of possible additional required areas of inter-entity costs for task force consideration.

Members will also include their own recommendations for task force consideration.

- Consider the possible additional inter-entity cost areas collected, and determine if any additional areas of inter-entity cost should be required

- Determine if the OMB limitation on inter-entity costs should be revised or removed

- Identify implementation issues

SUMMARY OF WORK PERFORMED

- Task Force meetings were held: February 21, 2002, March 17, 2002, July 26, 2002, and
  March 20, 2003

Preliminary Procedures:

- Discussed in detail the inter-entity costs standards, guidance, and OMB requirements

- Discussed in detail the a) July 2001 AAPC staff issue paper; and b) agencies' survey responses to the AAPC survey on inter-entity costs

- Discussed examples or possible examples of areas where agencies are not being reimbursed or are partially being reimbursed for costs incurred that benefit other agencies. For example, the task force discussed:

    - Social Security Administration's (SSA) maintenance of social security numbers

    - Disbursements processing by Treasury's Financial Management Service (FMS)

    - Overhead costs of OMB, FMS, and the Office of Personnel Management

    - Services of the General Services Administration that are not fully reimbursed

    - Legal services or contracted legal services of the Department of Justice

- Discussed possible inter-entity cost areas that may fall under the “broad, general support” discussed in SFFAS No. 4, paragraph 112, which states:

  > “Most often this type of support involves the establishment of policies and/or the provision of general guidance. The costs of such broad services should not be recognized as an expense (or asset) by the receiving entities when there is no reimbursement of costs. Thus the standard does not apply when support is of a general nature provided to all or most entities of the federal government.”

  - Discussed, for example, that FMS’ disbursements processing, on behalf of Federal agencies, likely falls under the broad, general support exception for many agencies

Review of Possible Additional Required Areas of Inter-Entity Costs:

- Discussed a publication article that reported on the plan being developed by the OMB and the State Department for a new requirement that Federal agencies share overseas embassy construction costs. The Task Force noted that this plan is indicative of the increased need of Federal agencies, due to budget constraints, to identify and recover costs incurred on behalf of or benefiting other agencies.

- Reviewed the agency responses to the July 2000 AAPC survey on inter-entity costs. Members took these items into consideration when providing their recommendations for possible additional required areas of inter-entity costs.

- Reviewed in detail each of the agency recommendations for possible additional required areas of inter-entity costs. See **Tab E [of the full report]** for the summary of agencies' recommendations for task force consideration and the task force consensus for each possible area.

  NOTE: The Task Force concluded that none of the possible areas considered should be an additional required inter-entity cost. Some of the possible areas, however, could serve as examples of inter-entity costs that could be material to a particular agency's financial statements.

Review of the "Use of Real Property" as a Possible Additional Required Area of Inter-Entity Costs:

- It was suggested to the Task Force to pursue possibly requiring the recording of one additional area of inter-entity costs, and use this inter-entity cost area as a model for any future expansion of recording inter-entity costs across the government. It was further suggested that the "Use of Real Property" be specifically considered for this purpose. Examples of real property inter-entity costs include non-reimbursed or under-reimbursed usage of land or office space (e.g. if an agency allows another agency the free use of their land for storage of materials or if the Department of State provides free use of office space overseas). In the FASAB survey of a few years ago, for example, there were one or more instances of non-reimbursed or under-reimbursed usage of land. It was noted that:

  - Improved accounting of and accountability for real property is one current focus of OMB

  - Benchmark or third party information on market value rates, for example, a rent rate per square foot) and possibly other information could be available to agencies

  - The recording of inter-entity costs in this area could help with real property peripheral issues, such as maintenance and utilities.

- The Task Force further discussed the real property inter-entity costs area and members brought up a few examples (from their individual knowledge or from the original AAPC survey) of inter-entity real property costs. The Task Force determined that a survey to Federal agencies would be beneficial.

- The Task Force developed and distributed to Federal agency CFOs a Real Property Inter-Entity Costs Questionnaire **(Tab F [of the full report])**. The Task Force summarized **(Tab G [of the full report])**, the agency responses received. Please see **Tab H [of the full report]** for agencies' complete responses.

- The Task Force reviewed in detail the agencies' responses to the questionnaire. The Task Force noted that responses included some examples of inter-entity costs for real property usage. It appears, however, that for many survey respondees, the non-reimbursed or under reimbursed usage of real property is not a significant/material part of their operations, and that the most accurate accounting for real property inter-entity costs generally would not materially impact the results of the agency financial statements at the agency level. Please note that the issue of materiality at the program level is a more complicated issue, and that it is hard to draw government-wide conclusions of inter-entity real property usage materiality at the program level.

  The Task Force concluded, however, that there did not appear to be enough of a material/significant, widespread applicability of inter-entity real property usage costs to warrant requiring Federal agencies to record inter-entity real property usage costs.

- The Task Force noted that DOD indicated that Federal agencies use DOD real property, and that DOD currently has system limitations that prevent it from producing data regarding usage of DOD real property. The Task Force's conclusions are subject to this current limitation of information from DOD.

- The Task Force noted that it would be helpful to further pursue the GSA's "foregone rent" instances, in order to provide further clarification/guidance as to whether those costs should be considered inter-entity costs to the receiving agency.

Review of the Possible Revision or Removal of the OMB Restriction on Recording Inter-Entity Costs:

- The Task Force believes that the current OMB limitation on recording inter-entity costs is an impediment to the Federal government's (and agencies') continued progress towards full costing, as outlined in SFFAS No. 4. The Task Force also believes, however, that the revision or removal of the OMB limitation should not be implemented at this time due to the following:

- The Task Force believes that the issue of inter-entity costs can be minimized by Federal agencies' expanded compliance with full costing standards. The expanded use of interagency agreements and billings between providing agencies and receiving agencies would help to reduce unrecorded inter-entity costs in agencies' financial statements. The Task Force believes this approach would be an effective way to minimize the unrecorded inter-entity costs, and should be pursued before consideration of the revision or removal of the OMB limitation.

- The Task Force believes that various, significant government-wide requirements, including compliance with the intragovernmental business rules and improving intragovernmental transactions reconciliations, are more significant/material issues regarding Federal agencies' financial statements (based on the Task Force's work performed), and that the revision or removal of the OMB implementation would divert limited resources from these and other high priority matters

- Before implementation of any revision or removal of the OMB restriction, the Task Force believes that:

  b) There should be detailed, practical guidance (beyond SFFAS No. 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.

  c) 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.

  d) 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

APPENDIX D: EXCERPTS FROM SFFAS No. 4

INTER-ENTITY COSTS

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.

105. As stated in the preceding standard, to fully account for the costs of the goods and services they produce, reporting entities should include the cost of goods and services received from other entities. Knowledge of these costs is helpful to top-level management in controlling and assessing the operating environment. It is also helpful to other users in evaluating overall program costs and performance and in making decisions about resource allocations and changes in programs.

Inter-Entity Activities

106. Within the federal government, some reporting entities rely on other federal entities to help them achieve their missions. Often this involves support services, but may include the provision of goods. Sometimes these arrangements may be stipulated by law, but others are established by mutual agreement of the entities involved. Such relationships can be classified into two types depending upon funding methods.

Provision of goods or services with reimbursement -- In this situation, one entity agrees to provide goods or services to another with reimbursement at an agreed-upon price. The reimbursement price may or may not be enough to recover full costs. Usually the agreement is voluntarily established through an inter-agency agreement. Revolving funds can also be included in this group, because they are usually established to recover costs through sale of their outputs to other government entities. They are usually meant to be self-sustaining through their sales, without receiving additional appropriations. However, they do not always charge enough to cover full costs.

Provision of goods or services without reimbursement -- One entity provides goods or services to another entity free of charge. The agreement may be voluntary, legally mandated, or inherently established in the mission of the providing entity.

107. Recently, consideration has been given to expanding the concept of inter-entity support within the federal government. Under this concept, entities could sell their outputs on a competitive basis. Entities would have the authority to purchase goods or services from any federal or private provider. This is seen as a way to improve government efficiency through competition since inefficient government providers would be forced to improve or stop providing these goods or services. This could result in consolidating support services in fewer governmental entities. Underlying this concept is the requirement that all costs be recognized in developing the price at which goods and services would be sold to other entities.

Accounting and Implementation Guidance

108. If an entity provides goods or services to another entity, regardless of whether full reimbursement is received, the providing entity should continue to recognize in its accounting records the full cost of those goods or services. The full costs of the goods or services provided should also be reported to the receiving entity by the providing entity.

109. The receiving entity should recognize in its accounting records the full cost of the goods or services it receives as an expense or, if appropriate, as an asset (such as work-in-process inventory). The information on costs of non-reimbursed or under-reimbursed goods or services should be available from the providing entity. However, if such cost information is not provided, or is partially provided, a reasonable estimate may be used by the receiving entity. The estimate should be of the cost of the goods or services received (the estimate may be based on the market value of the goods or services received if an estimate of the cost cannot be made). To the extent that reimbursement is less than full cost, the receiving entity should recognize the difference

in its accounting records as a financing source.[2] Inter-entity expenses/assets and financing sources would be eliminated for any consolidated financial statements covering both entities.

110. 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, 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.

Recognition Criteria

111. Ideally, all inter-entity costs should be recognized. This is especially important when those costs constitute inputs to government goods or services provided to non-federal entities for a fee or user charge. The fees and user charges should recover the full costs of those goods and services.[3] Thus, the cost of inter-entity goods or services needs to be recognized by the receiving entity in order to determine fees or user charges for goods and services sold outside the federal government. Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above.

112. However, the situation is often different with goods or services transferred within the federal government that do not involve eventual sales to entities outside the federal government.

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[2] Footnote 32 in SFFAS 4 reads: See Statement of Recommended Federal Accounting Concepts No. 2, Entity and Display, par. 65, page 21. See also, FASAB Exposure Draft, Accounting for Liabilities of the Federal Government, pars. 62-99, pages 26-46, which addresses accounting for pensions and other retirement benefits (ORB). The payment of pension and ORB costs for an entity by another entity has often been likened to providing goods and services. In the case of pensions, employees of the reporting entity provide services to that entity and part of the salary-related cost is paid by a different entity. The pension administering entity does not provide goods or services to the reporting entity (other than normal pension administration services), but rather pays their costs directly. The difference is subtle but important. However, the accounting is similar. This document is consistent with the section of the liabilities exposure draft dealing with accounting for pensions and other retirement benefits.

[3] Footnote 33 in SFFAS 4 reads: OMB Circular A-25 addresses user charges by federal entities.

The federal government in its entirety is an economic entity. Therefore, it is reasonable to expect some flow of goods or services between reporting entities as those entities assist each other in fulfilling their missions and operating objectives. There are some cases in which the cost of non-reimbursed or under-reimbursed goods or services received from other entities need not be recognized as part of the cost of the receiving entity. The following general criteria are provided to help in determining the types of inter-entity costs that should or should not be recognized.

Materiality -- As with other accounting standards, the provisions of this standard need not be applied to immaterial items. However, in the context of deciding which inter-entity transactions are to be recognized, materiality, as used here, is directed to the individual inter-entity transaction rather than to all inter-entity transactions as a whole. **Under this concept, a much more limited recognition is intended than would be achieved by reference to the general materiality concept**.

In this context, then, materiality should be considered in terms of the importance of the inter-entity transaction to the receiving entity. The importance of the transactions, and thereby their recognition, should be judged in light of the following factors:

Significance to the entity -- The cost of the good or service is large enough that management should be aware of the cost when making decisions.

Directness of relationship to the entity's operations -- The good or service provided is an integral part of and necessary to the output produced by the entity.

Identifiability -- The cost of the good or service provided to the entity can be matched to the entity with reasonable precision.

The determination of whether the cost is material requires the exercise of considerable judgment, based on the specific facts and circumstances of each transaction.

Broad, general support -- Some entities provide broad, general support to many, if not all, reporting entities in the federal government. Most often this type of support involves the establishment of policies and/or the provision of general guidance. The costs of such broad services should not be recognized as an expense (or asset) by the receiving entities when there is no reimbursement of costs. Thus the standard does not apply when support is of a general nature provided to all or most entities of the federal government.

An example of this situation can be found in the Office of Management and Budget which establishes policy and provides general guidance to all parts of the executive branch of government. The costs of OMB should not be spread over all reporting entities because the services provided are (1) general and broad in scope, (2) provided to almost all reporting entities in the executive branch, and (3) not specifically or directly tied to the receiving entity's outputs.

On the other hand, some services provided, under certain circumstances, should still be recognized even though they may be considered broad and general in nature if such services are integral to the operations of the receiving entity. Such services include check writing by the Department of Treasury or legal activities performed by the Department of Justice. For example, when the issuance of checks is integral to the operations of an entity (e.g., the Internal Revenue Service and the Social Security Administration), the receiving entity should include the full cost of issuing checks in the full cost of its outputs. However, if the issuance of checks is insignificant and incidental to the operations of an entity, the entity should not normally recognize that cost.

113. The decision as to whether the cost of non-reimbursed or under-reimbursed goods and services should be recognized requires the use of judgement. None of the criteria listed above are, by themselves, fully or exclusively determinative. They should be considered in combination. Ultimately, inclusion or exclusion of the cost should be decided based on the specific facts and circumstances of each case, with consideration of the degree to which inclusion or exclusion would change or influence the actions and decisions of a reasonable person relying on the information provided.

Accounting Example

114. The following tables provide an example of the accounting entries to be made when the receiving entity (Agency R) recognizes an expense for services received from a providing entity (Agency P) on a non-reimbursable basis. In the example, the full costs of these services to Agency P are $100,000.

115. Agency R recognizes an "Expense of services provided by Agency P" equal to the full cost of the services received. It also recognizes a financing source, "Services provided by Agency P," equal to the amount not reimbursed, which in this case is the full $100,000. Agency P recognizes an "Expense of services provided to Agency R" equal to the full cost of the services provided with a credit to "Appropriations used."

Table 1: Agency R's Accounting Entries *

	Debit	Credit
Expense of services provided by Agency P:	$100,000	
Services provided by Agency P:		$100,000

* This example shows the cost recognized as an expense. However, as discussed in the text, it may be an asset.

Table 2: Agency P's Accounting Entries

	Debit	Credit	
Expense of services provided to Agency R:	$100,000		
Appropriated capital	$100,000		
Fund balance with Treasury		$100,000	
Appropriated capital used			$100,000

FULL COST

Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

89. This standard states that reporting entities should measure and report the full costs of their outputs in general purpose financial reports. "Outputs" means products and services generated from the consumption of resources. 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. The standard does not require full cost reporting in federal entities' internal reports or special purpose cost studies. Entity management can decide on a case-by-case basis whether full cost is appropriate and should be used for internal reporting and special purpose cost studies.

Direct Costs

90. Direct costs are costs that can be specifically identified with an output. All direct costs should be included in the full cost of outputs. Typical direct costs in the production of an output include:

(a) Salaries and other benefits for employees who work directly on the output;

(b) Materials and supplies used in the work;

(c) Various costs associated with office space, equipment, facilities, and utilities that are used exclusively to produce the output; and

(d) Costs of goods or services received from other segments or entities that are used to produce the output (See discussions and explanations in the next section on "Inter-Entity Costs").

Indirect Costs

91. Indirect costs are costs of resources that are jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. Typical examples of indirect costs include costs of general administrative services, general research and technical support, security, rent, employee health and recreation facilities, and operating and maintenance costs for buildings, equipment, and utilities. There are two levels of indirect costs:

(a) Indirect costs incurred within a responsibility segment. These indirect costs should be assigned to outputs on a cause-and-effect basis, if such an assignment is economically feasible, or through reasonable allocations. (See discussions on cost assignments in the "Costing Methodology" section.)

(b) Costs of support services that a responsibility segment receives from other segments or entities. The support costs should be first directly traced or assigned to various segments that receive the support services. They should then be assigned to outputs.

92. A reporting entity and its responsibility segments may incur general management and administrative support costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization costs, and they should be reported on the entity's financial statements (such as the Statement of Net Costs) as costs not assigned to programs.[4]

94. Most of the employee benefit programs are covered by trust funds administered by the Office of Personnel Management (OPM) and the Department of Defense (DoD). Contributions to the trust funds come from three sources: current and retired employees, employing agencies, and direct appropriations. The management expenses of the trust funds are paid with the funds' receipts.

95. Federal financial accounting standards require that the employing entity accrue the costs to the federal government of providing pension and ORB benefits to employees and recognize

[4] Footnote 28 in SFFAS 4 reads: A similar explanation is provided in FASAB Statement of Recommended Accounting Concepts No. 2, Entity and Display, par. 95, page 33.

the costs as an expense when the benefits are earned.[5] The employing entity should recognize those expenses regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds. This principle should also be applied to health and life insurance benefits for current employees and comparable benefits for military personnel. The costs of employee benefits incurred by responsibility segments should be directly traced or assigned to outputs.

96. OPEB costs include severance payments, counseling and training, health care, and workers compensation benefits paid to former or inactive employees. OPEB costs are often incurred as a result of such events as reductions in force or on-the-job injuries of employees. Federal financial accounting standards require that OPEB costs be reported as an expense for the period during which a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the accounting date.[6]

97. Since the recognition of OPEB costs is linked to the occurrence of an OPEB event rather then the production of output, in many instances, assigning OPEB costs recognized for a period to output of that period would distort the cost of output. In special purpose cost studies or cost findings, management may distribute OPEB costs over a number of years in the past to determine the costs of the outputs that the OPEB recipients helped to produce.

[5] Footnote 29 in SFFAS 4 reads: FASAB Exposure Draft, Accounting for Liabilities of the Federal Government (November 7, 1994), pars. 62-99, pages 26-46.

[6] Footnote 30 in SFFAS 4 reas: Ibid., pars. 100-102, page 47.

APPENDIX E: AAPC TASK FORCE MEMBERS

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