

VA Financial Policies and Procedures  
Contingent Liabilities

CHAPTER 21

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## 2101 OVERVIEW

This chapter establishes the Department of Veterans Affairs (VA) financial policies and procedures for the accounting of contingent liabilities. A contingent liability represents an amount that is recognized as a result of a past event where a future outflow or other sacrifice of resource is probable and measurable. The probability of the future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These facts and circumstances include the law that provides general authority for Federal entity operations and specific budget authority to fund programs.

Contingent liabilities are generally not subsequent events (210612 Definition), but they may meet the definition of a subsequent event in a given situation. When a contingent liability also meets the definition of a subsequent event, VA will account for the event as a contingent liability as provided for in this chapter. For example, during the period October 1–November 15, 2009, a VA announcement was made advising of new evidence that may have linked certain Veterans to special service-connected illnesses emanating from association with Agent Orange. The contingent liability is the evidence linking Agent Orange to additional illnesses which could lead to a higher contingent liability amount. Because of the date the announcement was made, the contingent liability could also be defined as a subsequent event. VA disclosed the possible contingent liability in the Fiscal Year 2009 Performance and Accountability Report (2009 PAR).

This chapter does not cover gain contingencies or measurement of contingencies involving impairment of nonfinancial assets.

210101 ACCOUNTING AND RECORDING CONTINGENT LIABILITIES. VA will include information on the potential impact of contingent liabilities to the financial position per Financial Accounting Standards Advisory Board's (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 5 and No. 12.

Contingencies should be recognized as a liability when all three of the following conditions are met:

- A. A past event or exchange transaction has occurred;
- B. A future outflow or other sacrifice of resources is probable; and
- C. The future outflow or sacrifice of resources is measurable.

210102 FINANCIAL REPORTING AND DISCLOSURE OF CONTINGENT LIABILITIES. VA will report recognized contingent liabilities in the financial statements as an estimated amount on the face of the Consolidated Balance Sheets. When a

contingent liability does not meet any of the conditions for liability recognition<sup>1</sup> and there is a reasonable possibility that a loss or an additional loss may have been incurred, VA will disclose the contingent liability in a footnote. Proper reporting is dictated by the materiality of the event(s) and the degree of probability that the event(s) may become certain.

## 2102 POLICIES

### 210201 ACCOUNTING AND RECORDING CONTINGENT LIABILITIES.

A. VA's Chief Financial Officer (CFO), in consultation with the General Counsel, will determine whether it is probable that a legal or other claim or condition will result in a loss to VA and that the loss is estimable. Probability varies within different ranges and is outlined as follow:

- Probable. The chance that the future confirming event or events can reasonably be expected or believed to be more likely than not to occur given available evidence or logic, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, the chance of the future confirming event or events is likely to occur.
- Reasonably Possible. The chance of the future confirming event or events occurring is more than remote, but less than probable.
- Remote. The chance of the future event or events occurring is slight.

B. The CFO will recognize a contingency as a liability when (1) a past event or exchange transaction has occurred, (2) a future outflow or other sacrifice of resources is probable and (3) the future outflow or other sacrifice of resources is measurable.

C. The CFO will ensure that contingent liability cost estimates are recorded in VA's financial system, as well as report and disclose them, when the specific events meet the materiality criteria described in the Procedures Materiality section below and SFFAS No. 1.

D. The CFO will include information in the consolidated financial statements on the General Counsel's opinion about the potential effect of litigation on VA's financial position.

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<sup>1</sup> Refer to Volume VI Chapter 1, *Definition and General Principles for Recognition of a Liability*, for additional information.

210202 FINANCIAL REPORTING AND DISCLOSURE OF CONTINGENT LIABILITIES. VA will disclose contingent liabilities in footnotes to the financial statements, if there is at least a reasonable possibility that a loss event, or an additional loss event, may have occurred and the amount of such events cannot be reasonably estimated. Disclosure should include a description of the nature of the contingent liability and cite a reason why the contingent liability cannot be reasonably determined.

### **2103 AUTHORITY AND REFERENCES**

210301 [Federal Accounting Standards Advisory Board \(FASAB\), Statement of Federal Financial Accounting Standards \(SFFAS\) No. 1, Accounting for Selected Assets and Liabilities](#)

210302 [FASAB, SFFAS No. 5, Accounting for Liabilities](#)

210303 [FASAB, SFFAS No. 12, Recognition of Contingent Liabilities Arising From Litigation: An Amendment of SFFAS No. 5, Accounting for Liabilities of the Federal Government](#)

210304 [SFFAS Interpretation No. 2, Accounting for Treasury Judgment Fund Transactions](#)

210305 [Office of Management and Budget \(OMB\) Circular No. A-136, Revised, Financial Reporting Requirements](#)

### **2104 ROLES AND RESPONSIBILITIES**

210401 The Assistant Secretary for Management/Chief Financial Officer (CFO) oversees all financial management activities relating to the Department's programs and operations, as required by the Chief Financial Officers Act of 1990 and 38 U.S.C. 309. Responsibilities include the direction, management and provision of policy guidance and oversight of VA's financial management personnel, activities and operations. The CFO establishes financial policy, systems and operating procedures for all VA financial entities and provides guidance on all aspects of financial management.

210402 Under Secretaries, Assistant Secretaries, Chief Financial Officers, Fiscal Officers, Chiefs of Finance Activities, Chief Accountants and other key officials are responsible for ensuring compliance with the policies and procedures set forth in this chapter.

210403 The Office of Financial Policy (OFP) provides VA-wide financial policy and procedures guidance. Among its responsibilities, OFP develops, coordinates, issues, evaluates and reviews Departmental financial policies, systems and procedures for compliance with all financial laws and regulations.

210404 VA's Office of General Counsel is responsible for providing information to the Chief Financial Officer (CFO) for submission to VA's financial statement auditors, relating to all matters where VA is a party to litigation, including various administrative proceedings, legal actions, claims brought against it and cases to be paid from the Judgment Fund against VA. This information is communicated in the form of a representation letter on all such matters.

## **2105 PROCEDURES**

### **210501 ACCOUNTING AND RECORDING CONTINGENT LIABILITIES.**

A. VA's CFO, in consultation with the General Counsel, will determine whether it is probable that a contingent loss to VA exists. With the exception of pending or threatened litigation and unasserted claims, the CFO will consider the chance that the future confirming event or events can reasonably be expected or believed to be more likely than not to occur given available evidence or logic. For pending or threatened litigation and unasserted claims, the CFO will consider whether the chance of the future confirming event or events is likely to occur.

B. The CFO will recognize an expense and a contingent liability for the full amount of the expected loss, when the loss is probable and estimable. The expense and contingent liability would be adjusted periodically, as necessary, based on any changes in the estimated loss.

1. The unit of analysis for estimating liabilities may vary according to reporting entity and the nature of the transaction or event (e.g., the contingent liability recognized may be the estimation of an individual transaction or event or a group of transactions or events).

2. The estimated contingent liability may be a specific amount or a range of amounts, as determined below:

a. If an amount within a range is a better estimate than any other amount within the range, that amount is recognized.

b. If no amount within a range is a better estimate than any other amount, the minimum amount in the range is recognized. The range and a description of the nature of the contingency will be disclosed.

3. The CFO will record, report and disclose any subsequent event that meets the criteria to be treated as a contingent liability. The exact accounting, reporting and disclosure will be determined as to whether the subsequent event is to be recognized or disclosed as follows:

a. A recognized subsequent event is an event or transaction that provides additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Such an event is to be recognized in the financial statements as if they occurred before the balance sheet date.

b. A non-recognized subsequent event is an event or transaction that provides evidence about conditions that did not exist at the date of the balance sheet, but arose after the balance sheet date, but before the financial statements are issued or are available to be issued. VA will disclose non-recognized subsequent events that are of such a nature that omitting them would cause VA's financial statements to be misleading. The nature of the event and an estimate of its financial effect will be disclosed. VA should also consider providing pro forma financial statements if the non-recognized subsequent event is significant.

4. Per SFFAS No. 12, for certain loss contingencies identified, such as matters of pending or threatened litigation and unasserted claims, VA will recognize a contingent liability when (1) a future outflow or other sacrifice of resources is likely to occur (rather than more likely than not), (2) a past event or exchange transaction has occurred and (3) the future outflow or sacrifice of resources is measurable.

5. The CFO will record the amount of any recognized contingent liability in the Standard General Ledger (SGL) Account 2920. This contingent liability account shows the estimated value of a probable loss. VA must have sufficient evidence to support its position that it is probable that an asset has been impaired or a contingent liability incurred and the dollar amount of the loss may be reasonably estimated.

C. Materiality. Recognition and disclosure of contingent liability cost estimates is subject to materiality criteria (SFFAS No. 1). The CFO will ensure that contingent liability cost estimates are recorded in the financial system, as well as report and disclose them, when the specific events meet the materiality criterion outlined below:

1. Materiality depends on the degree to which omitting or misstating information about an item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

2. Materiality has both quantitative and qualitative aspects. Even though quantitatively immaterial, certain types of misstatements could have a material impact and warrant disclosure in the financial statements for qualitative reasons.

3. The determination of materiality requires the application of professional judgment. The determination of materiality for any contingent liability estimate will be made based on the specific facts of the case. Detailed records will be maintained to support all materiality decisions.

4. Contingent liability estimates that are material will be recorded in the accounting system and reported in financial statements as of the report date. The CFO will make the determination at year end in preparing the financial statements in consultation with the General Counsel and VA's financial statement independent auditor.

D. VA will recognize a contingent liability for Veterans' benefits as of the date of financial statements and will accrue liabilities for future program benefits at the end of the reporting period.

1. The liability for the VA's future compensation amounts will be recorded based on statistical calculations and actuarial assumptions. Amounts pertaining to future pensions will also be based on statistical calculations and actuarial assumptions and the amounts disclosed in the notes to VA's financial statements. VA will recognize its share of the cost of providing pension benefit expense to eligible employees using cost factors prescribed by the Office of Personnel Management.

2. VA will recognize a liability for the Federal Employees Compensation Act (FECA) amount that is computed for VA by the Department of Labor. The amount of the liability is to be reported in the Department's financial statements.

E. Representation Letters.

1. During the fourth quarter of the fiscal year as part of end-of-year procedures, VA's General Counsel will provide the Department's CFO with information about all litigation matters to which VA is a party, including various administrative proceedings, legal actions, claims brought against it and cases to be paid from the Judgment Fund against VA.

2. The financial statement auditors prepare a memorandum for VA to request a legal representation letter from the General Counsel. The specifics on the due dates and number of updates to the legal representation letter from the General Counsel will be specified in the requesting memorandum. The specific details in the request may change each year because the financial statement auditors prepare the request based upon when they require the information for the audit. (See Appendix A for an example of the requesting memorandum).

a. The data collected will be summarized into three categories: probable, reasonably possible and remote.

(1) Amounts classified as probable are recognized in the accounting systems and reported on the consolidated balance sheet.

(2) Amounts reported as reasonably possible are disclosed in the footnotes to the financial statements.

(3) Amounts reported as remote are not included in the reports.

3. The General Counsel will provide an opinion (addressed to the auditors) in the form of a written representation letter about whether the ultimate resolutions of these administrative proceedings, legal actions and claims will have any material impact on the financial position or results of VA operations.

4. Relevant information in the representation letter to VA's auditor will be properly disclosed in the notes to VA's consolidated financial statements (e.g., VA's 2009 PAR, Note 17, Contingencies, on <http://www.va.gov>).

F. On any matter involving litigation claims, once a claim has been settled or a court judgment has been assessed against VA and the Judgment Fund<sup>2</sup> is determined to be the appropriate source for the payment of the claim, the contingent liability will be removed from VA's financial statements and an "other financing source",<sup>3</sup> representing the amount to be paid by the Judgment Fund, will be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount will reflect only the amount paid by the Judgment Fund on behalf of VA.

#### 210502 FINANCIAL REPORTING AND DISCLOSURE OF CONTINGENT LIABILITIES.

A. VA will report contingent liabilities that meet the criteria for recognition in a manner that best describes the underlying event(s) that gave rise to the contingent liability.

B. VA will disclose contingent liabilities,<sup>4</sup> when the amount cannot be reasonably estimated and there is at least a reasonable possibility that a loss, or an additional loss, may have occurred.

C. In the disclosure, VA will include the nature of the contingency and an estimate of the possible contingent liability, an estimate of the range of the possible contingent liability or a statement that such an estimate cannot be made. In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose Federal financial reports.

D. Contingencies classified as remote need not be reported in general purpose Federal financial reports, although law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included

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<sup>2</sup> For additional information on the Judgment Fund, refer to Vol. VI, Chapter 20, *Judgment Fund*.

<sup>3</sup> See SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, for a discussion on "Financing Imputed for Cost Subsidies."

<sup>4</sup> Disclosure in this context refers to reporting information in notes regarded as an integral part of the basic financial statements.



in general purpose Federal financial reports (e.g., total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.

E. For those loss contingencies identified in SFFAS No. 12 (see 210501B3 examples) disclosure would be required if it is at least reasonably possible that a loss or an additional loss may have been incurred.

F. FASAB indicated that VA medical benefits, whether for mandatory or discretionary programs, are best measured by the annual cost incurred rather than by actuarially-determined charges during the Veteran's military service. A Veteran's medical care does not satisfy the probability or reasonably measurable criteria in SFFAS No. 5 at earlier dates; therefore, future medical benefits do not constitute a long term liability to be recognized in the Balance Sheet. FASAB believes VA medical benefit liability and related expenses should be recognized in the period medical care service is rendered. VA should consider, however, what disclosures would be appropriate for these costs under the contingency standard.

G. VA will disclose in a footnote to the financial statements information on the role played by the Judgment Fund in the payment of a possible loss relating to litigation matters.

## 2106 DEFINITIONS

210601 Contingency. A contingency is an existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (e.g., collectability of receivables, pending or threatened litigation, possible claims and assessments, etc).

210602 Contingent Liability. Refers to a liability representing an amount that is recognized as a result of a past event where a future outflow or other sacrifice of resource is probable and measurable. A contingent liability should be disclosed in the notes to the financial statements if any of the conditions for liability recognition (probable and measurable) are not met and there is a reasonable possibility that a loss or additional loss may have been incurred. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability or a statement that such an estimate cannot be made.

210603 Disclosure. Reporting information in notes or narrative regarded as an integral part of the basic financial statements.

210604 Federal Agencies' Centralized Trial-Balance System (FACTS I). A Treasury system that collects agency pre-closing adjusted trial balances at the fund group level,

using U.S. Standard General Ledger (SGL) accounts in numerical order with the required attributes.

210605 Liability. The probable future outflow or other sacrifice of resources as a result of past transactions or events.

210606 Measurable. Reasonably estimable.

210607 Probable. That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic, with the exception of pending or threatened litigation and unasserted claims (see 210501B3)<sup>5</sup>. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for Federal entity operations and specific budget authority to fund programs.

210608 Reasonably Possible. The chance of the future confirming event or events occurring is more than remote but less than probable.

210609 Recognize. The formal recording or incorporating of an item into VA's financial statements as an asset, liability, revenue, expense, etc.

210610 Remote. The chance of the future event(s) occurring is slight.

210611 Representation Letter. The primary form of communication between VA's General Counsel, at the request of management and VA's auditor covering all litigation, claims and assessments pertaining to VA, including matters handled by the Department of Justice (DOJ) or any other outside legal counsel on behalf of VA. This letter is the auditor's primary means of corroborating the information furnished by management concerning the accuracy and completeness of litigation, claims and assessments.

210612 Subsequent Events. Events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued. These events are categorized into two types as follows:

A. Type 1 subsequent events are recognized (require recording in the financial statements) subsequent events; and

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<sup>5</sup> Per SFFAS No. 12, the concept of probability is imprecise and difficult to apply with respect to most legal matters. The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation. Accordingly, in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims and recognizing an associated liability, "probable" refers to that which is likely, not to that which is more likely than not. Note that the remaining two criteria for recognizing a liability--that is, a past event or exchange transaction has occurred and the future outflow or sacrifice of resources is measurable--also must be met before recognizing a contingent liability in matters involving litigation.

B. Type 2 subsequent events are non-recognized (don't require recording in the financial statements, but may require footnote disclosure) subsequent events.

### **2107 RESCISSIONS**

210701 VA Directive 4668, Liabilities, Accounting Standards for Liabilities of the VA, Paragraph 2c (1)-(4).

### **2108 QUESTIONS**

Questions concerning these financial policies and procedures should be directed as follows:

VHA	VHA Accounting Policy (Outlook)
VBA	VAVBAWAS/CO/FINREP (Outlook)
All Others	OFP Accounting Policy (Outlook)

APPENDIX A: ILLUSTRATION OF SAMPLE REPRESENTATION LETTER

Department of  
Veterans Affairs

# Memorandum

Date:

From: Assistant Secretary for Management (004)

Subj: OIG Audit of the FY *(Year)* Financial Statements

To: *(Name)*, General Counsel (02)

1. Pursuant to 31 U.S.C. 3521, *(Auditor)* is auditing the financial statements of the Department of Veterans Affairs as of and for the year ended September 30, *(year)*. In performing audits of Government entities, auditors comply with *Government Auditing Standards*, issued by the Comptroller General of the United States (the yellow book). For financial statement audits, *Government Auditing Standards* incorporate the fieldwork and reporting standards of the American Institute of Certified Public Accountants (AICPA) and the Statements on Auditing Standards that interpret them. Consistent with AU 337 of the AICPA's *Codification of Statements on Auditing Standards*, *(Auditor)* has inquired about litigation, claims and assessments to obtain evidence as to the financial accounting and reporting of such matters in the financial statements. The purpose of this letter is to request your assistance in responding to that inquiry. The American Bar Association *Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information* (December 1975) provides guidance for the lawyer's response to the auditor's request.

2. In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, as amended by SFFAS No. 12 and Interpretation No. 2 of SFFAS No. 4 and 5, the Department of Veterans Affairs may need to report certain information in its financial statements and notes concerning contingent liabilities for litigation, claims and assessments. We request that you provide *(Auditor)* with information (with a copy to me) on matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Department in the form of legal consultation or representation.

3. Your response should include matters that existed at September 30, *(year)* and should be sent so as to be received by *(Auditor)* by October 15, *(year)*. In addition, an updated response is required for the audit of VA's consolidated financial statements being issued by November 16, *(year)* and the GAO audit of the consolidated U.S.

financial statements being issued by December 15, (*year*). The updated response for the period of October 1, (*year*), to November 2, (*year*), should be submitted to (*Auditor*) by November 11, (*year*). You may submit this subsequent request via e-mail, versus a formal letter. We will inform you as soon as possible of any change to the requested effective date.

4. Please include any cases<sup>6</sup> with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Department of Veterans Affairs in the form of legal consultation or representation, even those cases for which you believe the Judgment Fund or some financing source other than VA budgetary resources will pay any potential loss. Under U.S. generally accepted accounting principles, these amounts will be included as liabilities or disclosure items in VA's financial statements. Please aggregate cases similar in nature where appropriate. Please list the matters in order of the amount of potential loss, starting with the largest.

**Pending or Threatened Litigation (excluding unasserted claims):**

(*Auditor*) has determined that any matters for which the amount of potential loss exceeds \$500,000 individually or \$20,000,000 in the aggregate could be material to the financial statements. Please provide to (*Auditor*) the information described below about pending or threatened litigation where the amount of potential loss exceeds \$500,000 individually or \$20,000,000 in the aggregate:

- a) The nature of the matter. Include a description of the case or cases and amount claimed, if specified.
- b) The progress of the case to date.
- c) The Government's response or planned response (for example, to contest the case vigorously or to seek an out-of-court settlement).
- d) An evaluation of the likelihood of unfavorable outcome. Please categorize likelihood as probable (an unfavorable outcome is likely to occur), reasonably possible (the chance of an unfavorable outcome is less than probable but more than remote) or remote (the chance of an unfavorable outcome is slight).
- e) An estimate of the amount or range of potential loss, if one can be made, for losses considered to be probable or reasonably possible.

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<sup>6</sup> This includes any cases that do not seek monetary damage awards, but would require the Government to use financial resources to implement remedies or actions sought by litigation or unasserted claims (for example, to increase the scope of or change to a more costly methodology of, environmental restoration and cleanup).

- f) The name of VA's legal counsel handling the case and the names of any outside legal counsel/other lawyers representing or advising the Government in the matter (DOJ or outside law firms).

We also request that you identify litigation reported in your prior year legal representation letter as pending or threatened, but that is no longer pending or threatened, and a short description of the disposition.

**Unasserted Claims and Assessments:**

Please provide the following information for all unasserted claims and assessments that you consider to be probable of assertion and which, if asserted, would have at least a reasonable possibility (more than remote) of an unfavorable outcome in an amount over \$500,000 individually or \$20,000,000 in the aggregate, involving matters to which you have devoted substantive attention:

- a) A description of the nature of the matter.
- b) The Government's planned response if the claim is asserted.
- c) An evaluation of the likelihood of an unfavorable outcome. (Categorize likelihood as probable (likely to occur) or reasonably possible (less than probable but more than remote.)
- d) An estimate of the amount or range of potential loss, if one can be made.

5. Please specifically confirm to (*Auditor*) that our understanding of the following is correct: Whenever, in the course of performing legal services for us, with respect to a matter recognized to involve an unasserted possible claim or assessment that may require financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will (1) advise us of your conclusion and (2) consult with us concerning the question of such disclosure and the applicable requirements of SFFAS No. 5, as amended.

6. Please describe the cases using DOJ forms (one for pending or threatened litigation, another for unasserted claims). The current forms are located at its Web site, <http://www.usdoj.gov/civil/forms/forms.htm>.

7. Please separately identify any cases with respect to which you have been engaged and to which you have devoted substantive attention on behalf of VA in the form of legal consultation or representation for which you believe another Government entity will be responsible for any potential liability. Please specifically identify the nature of and reasons for any limitations on your response to this request.

8. Please address your reply to *(name)*, *(Auditor)*, *(address)* and via fax at *(xxx) xxx-xxxx*. Please also send a copy of your reply to me. You may contact *(name)*, at *(xxx) xxx-xxxx* when your reply is available for pick up. Do not hesitate to contact *(him/her)* or me if you have any questions about this request.

Assistant Secretary for Management