

## Guidance on Full Implementation of Inter-Entity Costing

### A. Guidance to be Developed by FASAB Staff Relating to Paragraph 112 – Materiality

Staff believes that a staff implementation guide could be developed to address questions relating to the materiality concept established in par. 112 of SFFAS 4. The guidance would be in the form of questions and answers and may include illustrations. Staff implementation guidance would be at level D of the GAAP hierarchy and require Board review. If a majority did not object the guidance would be issued. The staff draft would be developed through review of the cost accounting project records and we would seek pre-release review and comment by individuals currently involved in applying SFFAS 4.

Target completion date: by 9/30/06 based on an FY2009 implementation of inter-entity costing.

1. Additional guidance should be given on applying the materiality criteria. For example--should all criteria; two criteria in combination; or only one criterion be met before an item is recognized?
2. Is materiality to be assessed based on (a) the individual inter-entity good or service (for example, a single technical inquiry to FASAB staff), or (b) all inter-entity transactions in aggregate (for example, all technical inquiries to FSAB staff during the period)?
3. Is materiality assessed relative to (c) the program, or (d) the entity?
4. Is materiality assessed relative to the (a) net cost or (b) gross cost?
5. Is significance to the entity limited to quantitative assessments?
6. Further discussion of identifiability and examples of costs that are not identifiable to the entity with reasonable precision should

#### SFFAS 4 (from par. 112)

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.

be provided.

This guidance may clarify some of the following comments provided by respondents:

- At what level will costs be considered material? Will materiality occur at the appropriation/fund level or at the program level or at the transaction level? Another issue is whether materiality should be set at a particular threshold. This may more objectively contribute to making the determination as to whether a cost is material, but again, at which level should the threshold be applied?
- Is materiality also determined by the importance of the goods or services provided to the receiving entity in completing the mission associated with a particular program or output?
- The standard requires recognition of inter-entity costs when they are material to the receiver, but ignores inter-entity costs that are material to the provider. If a small Agency provides goods and services to a large Agency, the inter-entity costs may be immaterial to the receiver, but very material to the provider.

#### B. Guidance to be Developed by AAPC Task Force and Issued as a Technical Release

The AAPC would be asked to continue the work begun by its task force. In addition, the AAPC would resolve individual cases raised by agencies.

The task force would be provided with an initial plan from FASAB staff to facilitate meeting key milestones and to suggest various means of communicating with the community. Communication during the development of the draft Technical Release would encourage identification of cases at individual agencies as well as soliciting feedback on draft guidance.

Individual requests for guidance must be received by 6/30/07 for resolution by 6/30/08.

Target completion dates: 9/30/07 for the issues identified below and 6/30/08 for individual cases

1. Extensive evaluation of costs to determine which ones may be considered “Broad and General” for all entities and if possible, a list of the costs that should be considered Broad and General for all entities will be developed.
2. Additional guidance or discussion on the factor *Directness of relationship to the entity’s operations* as used in determining if a transaction should be considered material to the receiving entity. Guidance may clarify some of the following comments provided by respondents:
  - Clarity on the directness of the relationship to the entity’s operations?
  - If the costs associated with the goods or services being provided are allocated to more than one program or output, is it still considered integral?
3. Additional guidance or discussion on the factor *Identifiability* as used in determining if a transaction should be considered material to the receiving entity. Guidance may clarify some of the following comments provided by respondents:

- o If a cost cannot be assigned to a receiving entity by a provider, with reasonable precision, it appears that the receiving entity is exempted from imputing the cost. Is this correct? How is reasonable precision defined by FASAB? How will receiving entity auditors determine that the providing entity cannot identify the cost, with reasonable precision, for the receiving entity?
  - o Who is doing the matching in the third criterion, the provider or the receiver? Depending upon the circumstances, either the provider or the receiver may provide the most accurate data.
4. Technical Releases addressing – in logical groupings if feasible – individual inter-entity costs identified by preparers or auditors.

C. Guidance to be developed by OMB:

OMB would provide guidance on operational aspects of implementation.

Target Completion Date: 9/30/05 for item 1. 9/30/07 for remaining items.

1. Guidance detailing the responsibilities and deliverables of both the providing and receiving entity, establishing timelines for carrying out those responsibilities; and establishing a communication process between providing and receiving entities.
2. Guidance on elimination entries.
3. Guidance on documentation to support the audit process.