



# Department of Veterans Affairs

## Financial Policy

### Volume VI

### Liabilities

### Chapter 21

### Contingent Liabilities

Approved:

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## 2101 Overview

This chapter establishes the Department of Veterans Affairs (VA) financial policies regarding recognition, accounting, and reporting of contingent liabilities. Contingencies are existing uncertainties that may have a financial impact, depending on future events. This chapter focuses on the contingencies that are conditional obligations whose existence depends on uncertain future events that are not wholly within VA’s control.

Key points covered in this chapter:

- VA will recognize the contingency as a liability when a past event or transaction has occurred and a future outflow or other sacrifice of resources is probable and measurable;
- At the interim and fiscal year-end reporting periods, VA will disclose contingent liabilities based on guidance from Federal Accounting Standards Advisory Board (FASAB), the Office of Management and Budget (OMB), and the U.S. Department of the Treasury (Treasury); and
- VA will prepare and submit the interim and final Legal Representation Letters (LRLs) and accompanying Management Schedules as required by OMB, Treasury, the U.S. Department of Justice (DOJ), and the U.S. Government Accountability Office (GAO).

## 2102 Revisions

Section	Revision	Office	Reason for Change	Effective Date
Various	Reformatted to new policy format and completed five-year review	OFP (047G)	Reorganize chapter layout	July 2019
2105 Policies	Updated policy statements	OFP (047G)	Properly reflect current contingent liabilities accounting and reporting requirements	July 2019

## 2103 Definitions

**Contingency** – An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when future events occur or fail to occur.

**Contingent Liability** – A liability that is both probable and measurable, representing a possible future outflow or other sacrifice of resources that is recognized for financial

statement reporting purposes.

**Legal Representation Letter** – A representation in the form of a letter from the Office of General Counsel (OGC) to the financial statement auditor which is used to corroborate the accuracy and completeness of litigation, claims, and assessments reported in the financial statements.

**Liability** – A probable future outflow or other sacrifice of resources as a result of past transactions or events.

**Measurable** – Reasonably estimable.

**Medical Malpractice** – A legal cause of action that occurs when a medical or health care professional deviates from standards in his or her profession, thereby causing injury to a patient.

**Nonrecognized Events** – Subsequent events that do not require recording in the financial statements but may require disclosure.

**Probable** – That which can reasonably be expected or is believed based upon existing evidence to be more likely to occur than not to occur.

**Reasonably Possible** – The chance of the future events occurring is more than remote but less than probable.

**Recognize** – To formally record or incorporate an item into an entity's financial statements as an asset, liability, revenue, expense, etc.

**Recognized Events** – Subsequent events that require recording in the financial statements.

**Remote** – That which can reasonably be expected or is believed based upon existing evidence to be more likely to not occur than to occur. The chance of the future event(s) occurring is slight.

**Subsequent Events** – Events or transactions that affect the basic information or required supplementary information and occur after the end of the reporting period but before the financial report is issued.

**Tort** – A civil wrong or wrongful act, whether intentional or accidental, from which injury occurs to another for which courts impose a liability. Torts include negligence cases as well as intentional wrongs that result in harm.

**Unasserted Claims** – Claims that are known or expected but, for which the injured party or potential claimant has not yet provided official notification to VA.

## 2104 Roles and Responsibilities

**Administrations and Staff Offices Chief Financial Officers (CFOs) or Directors** are responsible for identifying and providing the Office of Financial Reporting (OFR) with all unasserted claims within their jurisdiction and for cooperating with OGC in determining the likelihood that VA will incur a loss related to the claims.

**Office of Financial Reporting** is responsible for recording, reporting, and disclosing VA's contingent liabilities; preparing the LRL request, the LRL Management Schedule; and the memorandum for unasserted claims. OFR is also responsible for furnishing collected information and information on subsequent events to the Office of Inspector General (OIG).

**Office of General Counsel** is responsible for determining VA's loss contingencies, documenting said contingencies via case forms, preparation of the LRL and providing information to OFR and the external financial auditors on contingencies.

**Office of Inspector General** is responsible for submitting the interim and final LRLs and subsequent event updates to Treasury's Fiscal Service, DOJ, and GAO.

## 2105 Policies

### 210501 General Policies

VA will comply with following authorities to estimate, record, and report contingent liabilities:

- OMB Circular A-136 and related bulletins;
- FASAB Statement of Federal Financial Accounting Standards (SFFAS) 5, 12, and 39;
- Treasury Financial Manual (TFM) 4700; and
- GAO Financial Audit Manual

### 210502 Estimate of Contingent Liabilities

- A. When a loss contingency exists, VA will, in accordance with SFFAS 5 and 12, estimate the possibility of the loss and recognize the contingency (if it meets the recognition criteria) as a contingent liability in its financial statements.
- B. VA will estimate contingent losses for Medical Malpractice and Other Torts claims,

and cases reported in the LRL.

1. The liability arising from Medical Malpractice and Other Torts claims is based on an actuarial estimate.
2. The liability arising from cases in the LRL is based on the estimated losses reported by the Office of General Counsel (OGC).

### **210503 Accounting for Contingent Liabilities**

- A. VA will record the recognized contingent liabilities in the interim and fiscal year-end accounting periods. The amount recorded represents the estimated value of probable loss and will be adjusted periodically based on changes in estimates.
- B. For the third quarter interim accounting period:
  1. To record the contingent liability arising from Medical Malpractice and Other Tort claims:
    - a. OFR will review the actuarial estimated range of the contingent loss from VBA's actuarial team and select the amount representing the best estimate within the range or the minimum amount of the range if there is no best estimate.
    - b. OFR will record its selected amount in a journal voucher in VA's financial reporting system at the interim reporting period.
  2. To record and calculate the amount of the estimated liability from the LRL in the financial statements, OFR will input the likelihood and estimated amount of the contingent loss into the interim LRL Management Schedule and calculate the amount that will be recorded via journal voucher in VA's financial reporting system.
- C. For the fiscal year-end accounting period:
  1. If the fiscal year-end actuarial estimate shows a significant difference from interim reporting for the Medical Malpractice and Other Tort claims, OFR will record a journal voucher to account for the difference.
  2. If the final LRL Management Schedule's calculation yields a significant difference from interim reporting for the cases in the LRL, OFR will record a journal voucher to account for the difference.
- D. OFR will retain sufficient evidence for the time period required according to National

Archives and Records Administration (NARA) statutes to support that the contingent loss is probable, and the dollar amount of the loss is reasonably estimated.

#### **210504 Reporting of Contingent Liabilities**

- A. A contingency will be recognized as a liability when a past event or exchange transaction has occurred, and a future outflow or other sacrifice of resources is probable and measurable. Only recognized contingencies will be recorded by OFR.
- B. The reporting and disclosure of contingent liabilities is dictated by the materiality of the event(s) and the degree of probability that the event(s) may occur.
  1. OFR will report a contingent liability at the estimated amounts on the consolidated balance sheet when the liability is probable and measurable.
  2. OFR will disclose a contingent liability in the notes to the financial statements if the likelihood of the contingent loss is at least reasonably possible. The disclosure will include:
    - The nature of the contingency;
    - An estimate or an estimated range of the possible liability, or a statement that such an estimate cannot be made; and
    - Information about the potential effect of litigation on VA's financial position.
- C. Subsequent events may bring additional evidence that changes the probability of contingencies. If the subsequent events have a material effect on the potential liability, VA will record the effects of the change in accordance with the guidance in SFFAS 5, 12, and 39.
  1. For recognized events, OFR will adjust the consolidated balance sheet and/or accompanying notes as needed. For example, OFR will make adjustments for a litigation settled in October with a different amount from the liability recorded at fiscal year-end.
  2. For nonrecognized events, OFR will disclose the information to the extent that prevents the consolidated balance sheet and accompanying notes from being misleading.

#### **210505 Unasserted claims and the Legal Representation Letter**

- A. VA will collect information to identify and estimate the potential loss for each unasserted claim and existing case through the LRL process which starts at the end of June and runs through the middle of January the following fiscal year.

- B. To begin the process OFR will prepare and distribute an unasserted claims memorandum to the CFOs/Directors of the Administrations and Staff Offices. The memorandum will serve as guidance in identifying unasserted claims against VA that could result in an unfavorable outcome exceeding the thresholds of 1 million dollars individually or 50 million dollars in aggregate. [Appendix A](#) contains a sample memorandum.
- C. OFR will gather all unasserted claims obtained from Administrations and Staff Offices and submit those claims, with the request for the LRL, to OGC. [Appendix B](#) contains a sample LRL request memorandum.
- D. OGC will review the unasserted claims and the pending or threatened litigations.
  - 1. OGC will use case forms to document its review results for the pending or threatened litigation, unasserted claims, and litigation that is no longer pending.
  - 2. The information contained in the case forms includes the nature of the case, the progress of the case, the likelihood of unfavorable outcome, and the estimated amount or range of potential loss to VA.
- E. OGC will provide OFR its estimate of the likelihood of an unfavorable outcome; and an estimate or a range of the amount of potential loss for each case in the LRL.
  - 1. The likelihood of the cases in the LRL is evaluated as: probable, reasonably possible, and remote.
  - 2. VA will either recognize, disclose, or may not report the cases at all based on the likelihood of occurrence identified.
- F. OFR will review the case forms received from OGC for accuracy and completeness and resolve any discrepancies with OGC.
- G. OGC will draft the LRLs and send the drafts to OFR. OFR will review the information and provide comments to OGC if corrections and clarifications are needed. OFR will also prepare the interim and final LRL Management Schedules. The LRL Management Schedules summarize the content of the LRLs. Section 210503 B and C document policies regarding using the schedules in accounting for contingent liabilities.
- H. OGC will also send the year-end LRL to the financial statement auditors as requested to facilitate the audit process.
- I. OIG will submit the interim and final LRLs and Management Schedules to Treasury's Fiscal Service, DOJ, and GAO adhering to the submission dates in the Treasury Financial Manual (TFM) Chapter 4700.

- J. OGC will provide OFR any updates or changes to the cases/claims that occurs between the final LRL date to the publication date of the Agency Financial Report (AFR).
- K. OFR will review the updates and determine if any of the updates qualify as a subsequent event, defined as having a material influence on VA's AFR. Section 210504 B provides policies regarding how to determine a subsequent event's impact on VA's financial reporting.
- L. OGC will provide an updated LRL after the completion of OFR's review, sending the updated LRL to the financial statement auditors as requested.
- M. After the AFR's publication, OGC will continue providing OFR any update and changes to the cases/claims reported previously.
- N. OFR will review the updates and changes. OIG will notify Treasury's Fiscal Service, DOJ, and GAO via email of any subsequent changes in the likelihood or amount of loss for cases that arise after the final LRL but prior to the audit completion date as the end of the process.

## **2106 Authorities and References**

[OMB Circular A-136, Financial Reporting Requirements – Revised](#)

[OMB Bulletin, Audit Requirements for Federal Financial Statements](#)

[GAO Financial Audit Manual](#)

[SFFAS 5: Accounting for Liabilities of the Federal Government](#)

[SFFAS 12: Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government](#)

[SFFAS 39: Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards](#)

[Interpretations of Federal Financial Accounting Standards 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5](#)

[TFM Volume I Part 2 Chapter 4700 Agency Reporting Requirements for the Financial Report of the United States Government](#)

## 2107 Rescissions

VA Financial Policy, Volume VI, Liabilities, Chapter 21 - Contingent Liabilities dated July 2010.

## 2108 Questions

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

VHA	<a href="#">VHA 10A3A Accounting Policy</a> (Outlook)
VHA	<a href="#">VAFSC Nationwide Accounting</a> (Outlook)
VBA	<a href="#">VAVBAWAS/CO/FINREP</a> (Outlook)
NCA	<a href="#">NCA Financial Policy Group</a> (Outlook)
All Others	<a href="#">OFP Accounting Policy</a> (Outlook)

**Appendix A: Sample Memorandum to Administrations and Staff Offices**

Enclosed is an example from FY 2018. The memorandum is revised annually according to updated requirements and deadlines.

**Department of Veterans Affairs                      Memorandum**

Date: June 8, 2018

From: (Acting) Associate Deputy Assistant Secretary for Financial Reporting

Subject: Independent Inquiry of Unasserted Claims for the FY 2018 VA Legal Representation Letter to (*auditor*)

To: Chief Financial Officer, Veterans Benefits Administration (24)  
Chief Financial Officer, Veterans Health Administration (10A3)  
Chief Financial Officer, National Cemetery Administration (42)  
Director, Franchise Office (047F)  
Director, Financial Services Center (104)  
Executive Director, Office of Acquisition, Logistics, and Construction (003)  
Director, OI&T Financial Management and Oversight Service (005F1B)

1. In connection with the audit of the consolidated financial statements of the Department of Veterans Affairs (VA) as of September 30, 2018, our independent auditor (*auditor*), has asked us to provide information on "unasserted claims", which VA believes could result in an unfavorable outcome in an amount over \$1,000,000 individually or \$50,000,000 in the aggregate.
2. Unasserted claims relate to matters which in Management's opinion should be sent to the General Counsel in order to receive a legal assessment concerning the likelihood of an unfavorable outcome. Excluded from this reporting requirement are tort claims and matters for which a claim has already been either threatened or asserted. Regional Counsel can provide guidance as to whether a matter has resulted in a threatened or asserted claim.
3. **Multiple responses are required for Audit purposes.** The initial response should be sent to OFR (*designated point of contacts*) before July 3, 2018, and should include matters that existed as of June 30, 2018. The second response is due to OFR before October 2, 2018, and should include matters that existed as of September 30, 2018. The final response should be sent to OFR on January 23, 2019 and should include matters that existed up to and including January 22, 2019. The last response date is tentative and will be adjusted based upon GAO established deadlines related to their audit of the consolidated U.S. financial statements.

Due Date	Period Covered
7/3/2018	As of 6/30/2018
10/2/2018	7/1 – 9/30, 2018
1/22/2019 <sup>1</sup>	10/1/2018 – 1/22/2019

4. Responses should include the following information for all matters:
  - a) The Station number, City, and State where the unasserted claim arises;
  - b) The approximate amount, if known, of the unasserted claim, and when it came to your attention as a potential unasserted claim;
  - c) The issue generating the unasserted claim (e.g., contract dispute);
  - d) The person(s) or entity likely to assert the claim;
  - e) POC (VA official) who can provide information about each unasserted claim; and
  - f) The VA four-digit fund account that the claim would be paid from in the event of an unfavorable outcome.
5. Negative responses are required.
6. Please do not hesitate to contact OFR (*designated point of contacts*) directly at (*email, phone*), if you have any questions about this request.

(*name*), **(Acting) Assistant Secretary for Management**

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<sup>1</sup> This is an estimated date based on last year's time frame.

**Appendix B: Sample Request of the Legal Representation Letter**

Enclosed is an example from FY 2018. The memorandum is revised annually according to updated requirements and deadlines.

**Department of Veterans Affairs                      Memorandum**

Date: June 8, 2018

From: (Acting) Associate Deputy Assistant Secretary for Financial Reporting

Subject: Independent Audit of the FY 2018 Financial Statements -- Litigation, Claims, and Assessments

To: Executive Director, OGC Management, Planning and Analysis (026)

Thru: Deputy Director, OGC Homeland Security and Operations Division

1. Pursuant to 31 U.S.C. 3521, (*auditor*) is auditing the financial statements of the Department of Veterans Affairs (VA) for the year ended September 30, 2018. 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 the AICPA's AU-C Section 501 Audit Evidence – Specific Considerations for Selected Items (including Litigation, Claims and Assessments), (*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, VA 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 a copy to me) information on matters 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.

3. Your initial response should include matters that existed at June 30, 2018 and should be sent along with finalized case summary information to OFR and (*auditor*) by July 20,

2018. By July 3, 2018, OFR expects to receive Unasserted Claims information as of June 30, 2018, this information will be provided to OGC by COB on July 5, 2018. Multiple updates to the litigation, claims, and assessments information are required throughout the Audit process.

4. For fiscal year-end, a response is required for the September 30, 2018, audit of VA's consolidated financial statements being issued by November 15, 2018, and the GAO audit of the consolidated U.S. financial statements being issued by a date to be determined. Your response for September 30, 2018 data should be sent so that updated case summary information is received by OFR by October 4, 2018 and the representation letter to (*auditor*) by October 10, 2018. We expect to receive updated Unasserted Claims information as of September 30, 2018 on October 2, 2018 and will submit that data to OGC on October 3, 2018.

5. Subsequent responses should be sent to (*auditor*) (copy OFR) before November 7, 2018, covering the period from October 1, 2018 to November 3, 2018, and before November 15, 2018, covering the period from November 4, 2018, to November 15, 2018. And, the final response should be sent to OFR before January 23, 2019 for the period of November 16, 2018 through January 22, 2019. You may submit this response via e-mail, versus a formal letter. We will inform you, as soon as possible, of any change to the requested effective date.

6. To monitor the timeline more efficiently, the key due dates are summarized in the table below:

Due Date	Due		Period Covered
	From	To	
7/3/2018 (unasserted claims)	Admins' CFOs; Franchise; FSC; OALC; OIT	OFR	As of 6/30/2018
7/5/2018 (unasserted claims)	OFR	OGC	
7/5/2018 (case forms)	OGC	OFR	
7/20/2018 (signed LRL)	OGC	OFR & Auditor	
10/2/2018 (unasserted claims)	Admins' CFOs; Franchise; FSC; OALC; OIT	OFR	7/1 – 9/30, 2018
10/3/2018 (unasserted claims)	OFR	OGC	
10/4/2018 (case forms)	OGC	OFR	

Due Date	Due		Period Covered
	From	To	
10/10/2018 (signed LRL)	OGC	OFR	
11/7/2018	OGC	OFR & Auditor	10/1 - 11/3, 2018
11/15/2018	OGC	OFR & Auditor	11/4 – 11/15, 2018
1/22/2019 <sup>2</sup> (Subsequent Event)	OGC	OFR	11/15/2018 through GAO Audit Report

7. Please include any cases<sup>3</sup> 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, 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 \$1,000,000 individually or \$50,000,000 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 \$1,000,000 individually or \$50,000,000 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.

<sup>2</sup> The calendar year 2019 dates are estimated based on last year's time frame.

<sup>3</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 names of any outside legal counsel/other lawyers representing or advising the government in the matter (Department of Justice or outside law firms).
- g) The VA four digit fund account that the claim would be paid from in the event of an unfavorable outcome.

We also request that you identify litigation reported in your prior year legal representation letter as pending or threatened but 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 \$1,000,000 individually or \$50,000,000 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.
- e) The VA four digit fund account that the claim would be paid from in the event of an unfavorable outcome.

8. 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.

9. Please describe the cases using the Department of Justice forms (one for pending or threatened litigation, another for unasserted claims). The current forms are located at their Web site at <https://www.justice.gov/forms>.

10. 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.

11. Please address your reply to the auditor's designated point of contact at (*fax, phone, and email*). You may also contact him at (*alternative phone*) when your reply is available for pick up, and send a copy of your reply to me. Do not hesitate to contact OFR designated point of contacts at (*phone, email*), if you have any questions about this request.

**(name), (Acting) Assistant Secretary for Management**