



## Commitments and Contingencies

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### Policy Statement

This policy establishes how and when the University must account for contingencies and commitments. The University must record an accrual and related expense for an estimated loss resulting from a contingency if certain criteria are met. The University must also disclose certain information about material commitments and contingencies in its financial statements. To ensure commitments and contingencies are recorded and reported properly, tubs must:

- Record accruals for probable and estimable material loss contingencies.
- Not record gains from contingencies until the contingency occurs and the revenue is earned.
- Notify Financial Accounting and Reporting of material contingencies and commitments.

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### Reason for Policy

To ensure adherence with Generally Accepted Accounting Principles (GAAP); to promote consistent accounting treatment across the University; to ensure the operating results of University units are properly recorded; and to ensure that all required disclosures are included in the University's financial statements.

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### Who Must Comply

All Harvard University schools, tubs, local units, Affiliate Institutions, Allied Institutions and University-wide Initiatives must comply.

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### Procedures

#### [I. Contingencies](#)

#### [II. Commitments](#)



## I. Procedures for Contingencies

1. **Identify loss contingencies.** A loss contingency is an existing condition, situation or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when future events occur or fail to occur.
2. **If the amount of the loss is reasonably estimable, assess materiality.** A loss contingency is material if it is greater than \$100,000 for large tubs or \$50,000 for small tubs.
3. **Assess the likelihood of the contingency loss occurring.**
  - A. Probable: The future event or events are likely to occur.
  - B. Reasonably possible: The chance of the future event or events occurring is more than remote, but less than likely.
  - C. Remote: The chance of the future event or events occurring is slight.
4. **Determine accounting treatment of the loss contingency based on its likelihood and materiality:**

	Material	Not Material
Probable and Estimable	Tubs must: Accrue expense Notify FAR for disclosure in financial statements	Tubs may accrue an expense at their discretion.
Reasonably Possible	Tubs must: Not accrue expense Notify FAR for disclosure in financial statements	Tubs must not accrue an expense.
Remote	Tubs must not accrue an expense	Tubs must not accrue an expense

- A. Tubs must accrue for non-legal loss contingencies that are probable and reasonably estimable using the University's Accounts Payable and Accrued Expense Procedures, associated with the Expense Recognition Policy.
  - B. Record accruals only for transactions with external entities. Process internal transactions using the guidance in the University's Internal Transfers and Internal Billing Transactions Policies.
5. **Record accruals associated with probable and estimable material loss contingencies.**
  - A. Timing
    - a. The University generally records loss contingency accruals at the end of each fiscal year; however, tubs should record specific contingencies quarterly as information becomes available.
    - b. Tubs should review and record any tub specific loss contingency accruals on a quarterly basis. Any new information that results in an adjustment to a University recorded loss contingency should be communicated to FAR as soon as it is known.
  - B. Coding
  - C. Debit the expense object code that most closely relates to the cost
    - a. Credit object code 2670, "Rsrvs for Contingent Liabilities"
    - b. The 33-digit coding for income and expenses must include a fund number between 000001 and 726999; however, balance sheet items such as accruals should generally not be recorded in a specific fund. The 33-digit coding for the balance sheet side of an entry to record an accrual should contain 000000 as the fund number, unless a fund is being used for specific tracking and recording purposes (e.g., if funds are used for separate programs and the tub would like to track balance sheet amounts for each program).



- c. Commitments or contingencies cannot be charged to sponsored accounts (funds in the range 100000-299999).
- D. Description: Include in the journal entry description that the accrual relates to a loss contingency, in addition to its general purpose.
- E. Examples of loss contingencies that require accrual if probable and reasonably estimable:
  - a. Losses associated with contracts that contain conditional terms when those conditions are met
  - b. An obligation to return contributed funds due to noncompliance with donor terms
  - c. An obligation to return sponsored funds due to noncompliance with sponsor restrictions (Tubs are responsible for working with the Office for Sponsored Programs to determine whether sponsored funds must be returned to the sponsor due to noncompliance with sponsor restrictions.)
  - d. Taxes, fines or penalties associated with the University's tax-exempt status or an IRS audit
  - e. Settlements or fines associated with legal cases, determined on a case by case basis in conjunction with the Office of the General Counsel and the Office of the Controller
  - f. Obligations relating to service or product warranties and defects
  - g. Other contingencies arising from contractual or other disputes
- F. At their own discretion, tubs may record accruals for probable loss contingencies that are under the University's materiality threshold.

## 6. Comply with other restrictions when recording loss contingencies.

- A. Restricted fund spending: Expenses associated with accrued loss contingencies that are charged to restricted gift or endowment funds must be in accordance with the restrictions stipulated by the donors of those funds.
- B. Fund deficits due to accrued loss contingencies: accrued loss contingencies must be recorded regardless of whether a fund will be put into a deficit position. If this is a concern, units should consult their tub finance offices regarding how to accrue the loss. Generally, the monies may alternatively be spent out of a fund that has a similar purpose or, in the case of a restricted fund, similar donor terms.
- C. Accruals of loss contingencies may not be recorded to spend down remaining budgetary amounts.
- D. Accounting for reserves for general contingencies: accruals for general or unspecified business risks (i.e., reserves for general contingencies) are not permitted. Tubs may establish unrestricted designated (UD) funds to set aside monies for such future contingencies, but a liability may not be recorded. If a UD reserve fund is established, it may be funded via nonoperating transfers from other unrestricted monies using the University's Internal Transfers Policy.
- E. Service center inventories and rate setting: service center managers need to be aware that accruing for contingencies may affect their rate calculations. See the OSP Treatment of Service and Recharge Center Operations Policy for further guidance.
- F. Reference the Disposals and Impairments Procedures, associated with the University's Facilities and Equipment Policy, if the loss contingency results in loss or impairment of an asset.



**7. Inform Financial Accounting and Reporting (FAR) of any material and reasonably possible loss contingencies.**

- A. Tubs must notify FAR of material contingencies as they arise throughout the year/as the tubs become aware of the potential contingencies.
- B. Tubs must also communicate any material and reasonably possible contingencies annually at year end (via the Commitments and Contingencies annual request for information), so that they may be considered for disclosure in the University's annual financial report. Financial statement disclosures include the following information:
  - a. The nature and term of the obligation.
  - b. The amount of the fixed and determinable portion of the obligation as of the date of the balance sheet and, if determinable, for each of the five succeeding fiscal years.
  - c. The nature of any variable components of the obligation.
  - d. The amounts purchased under the obligation for each period in which an income statement is presented (i.e., current and prior year amounts expensed in the University's Statement of Changes in Net Assets) and the amount accrued in the University's Balance Sheet.
- C. If a material contingency is probable but has not been accrued because it is not estimable, (meaning the outflow of resources that will be required cannot be reliably quantified in monetary terms) the University may disclose a range of possible losses or a statement that the loss is not reasonably estimable.
- D. Use the central template to report contingencies to FAR at year end – this template is distributed annually near year end to all school/tub finance offices.
- E. Tubs must ALSO disclose other contingencies as part of the annual representation letter.

**8. Reverse the loss contingency accrual timely** when the University makes a payment relating to the loss contingency, or if the loss contingency does not materialize and no payments are required.

**9. Treat gain contingencies appropriately.**

- A. Gain contingencies may not be accrued.
- B. Recognize associated income only if and when the gain contingency materializes and income is earned.
- C. Gain contingencies are generally not disclosed in the University's annual financial report.
- D. See the University's Revenue Recognition Policy for further information on when income is considered earned.



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## II. Procedures for Commitments

### 1) Determine if a commitment exists.

- A. Commitments are obligations of the University to external entities, often arising in connection with contracts.
- B. Examples of commitments include but are not limited to:
  - a. Plant acquisitions
  - b. Promises to contribute monies or other assets
  - c. Guarantees of debt for another entity
  - d. Contractual obligations associated with the construction or purchase of real property or equipment, or from the purchase of patent or other rights
  - e. Significant new or ongoing leasing arrangements
  - f. Unconditional noncancelable purchase obligations
  - g. Commitments from research and other sponsored activities, to the extent that award and grants monies have not been expended
  - h. Commitments for matching grant requirements
  - i. Other commitments under gifts, grants or contracts
  - j. Tax law obligations

### 2) Don't record an accrual.

Commitments other than pledges payable are generally not accrued, but if material may require disclosure in the University's annual financial report.

### 3) Determine if the commitment is material for financial reporting purposes.

A commitment is material if it is greater than \$100,000 for large tubs or \$50,000 for small tubs.

### 4) Report material commitments to Financial Accounting and Reporting (FAR).

- A. Use the central template to report commitments to FAR at year end – this template is distributed annually near year end to all school/tub finance offices.
- B. FAR evaluates commitments for potential disclosure in the annual financial report.
- C. Financial statement disclosures about commitments include the following information
  - a. The nature and term of the obligation
  - b. The amount of the fixed and determinable portion of the obligation as of the date of the balance sheet and, if determinable, for each of the five succeeding fiscal years
  - c. The nature of any variable components of the obligation
  - d. The amounts purchased under the obligation for each period in which an income statement is presented (i.e., current and prior year amounts expensed in the University's Statement of Changes in Net Assets) and the amount accrued in the University's Balance Sheet
- D. Tubs must ALSO disclose other contingencies as part of the annual representation letter.



# HARVARD UNIVERSITY FINANCIAL POLICY

Responsible Office: Financial Accounting and Reporting

Date First Effective: 2/1/2010

Revision Date: 6/30/2013

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## Responsibilities and Contacts

**School/tub finance offices** are responsible for ensuring that local units abide by this policy and the accompanying procedures. Tubs must notify FAR regarding material commitments and contingencies as they arise throughout the year and no later than year end and must disclose commitments and contingencies as part of the annual representation letter.

**Office of the General Counsel (OGC)** is responsible for providing information to FAR regarding significant legal commitments and contingencies at each fiscal year end, in connection with the annual financial statement audit. As part of the year end close, OGC helps FAR evaluate loss contingencies related to legal matters. **Contact: (617) 495-1280 or <http://www.ogc.harvard.edu/>**

**Financial Accounting and Reporting (FAR)** is responsible for maintaining this policy and for providing guidance regarding the policy. FAR is also responsible for collecting information from tubs regarding material commitments and contingencies, and for supplying this information to external auditors. **Contact: (617) 495-8032**

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## Definitions

**Contingencies:** events that may or may not occur and which may result in a loss or gain to the University.

**Commitments:** obligations of the University to external entities, often arising in connection with contracts.

**Estimable:** the outflow of resources that will be required can be reliably quantified in monetary terms.

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## Related Resources

Facilities and Equipment Policy Disposals and Impairments Procedures:

[http://hwpi.harvard.edu/files/fad\\_policies/files/facil equip dispo impai.pdf](http://hwpi.harvard.edu/files/fad_policies/files/facil equip dispo impai.pdf)

OSP Treatment of Service and Recharge Center Operations Policy: <http://osp.fad.harvard.edu/content/service-center-policy>

Internal Transfers Policy: [http://hwpi.harvard.edu/fad\\_policies/pages/internal-transfers](http://hwpi.harvard.edu/fad_policies/pages/internal-transfers)

Revenue Recognition Policy: [http://hwpi.harvard.edu/fad\\_policies/pages/revenue-recognition](http://hwpi.harvard.edu/fad_policies/pages/revenue-recognition)

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## Revision History

6/30/2013: Updated format, required contingency accruals be recorded on a quarterly basis (instead of annually).

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## Appendix

N/A