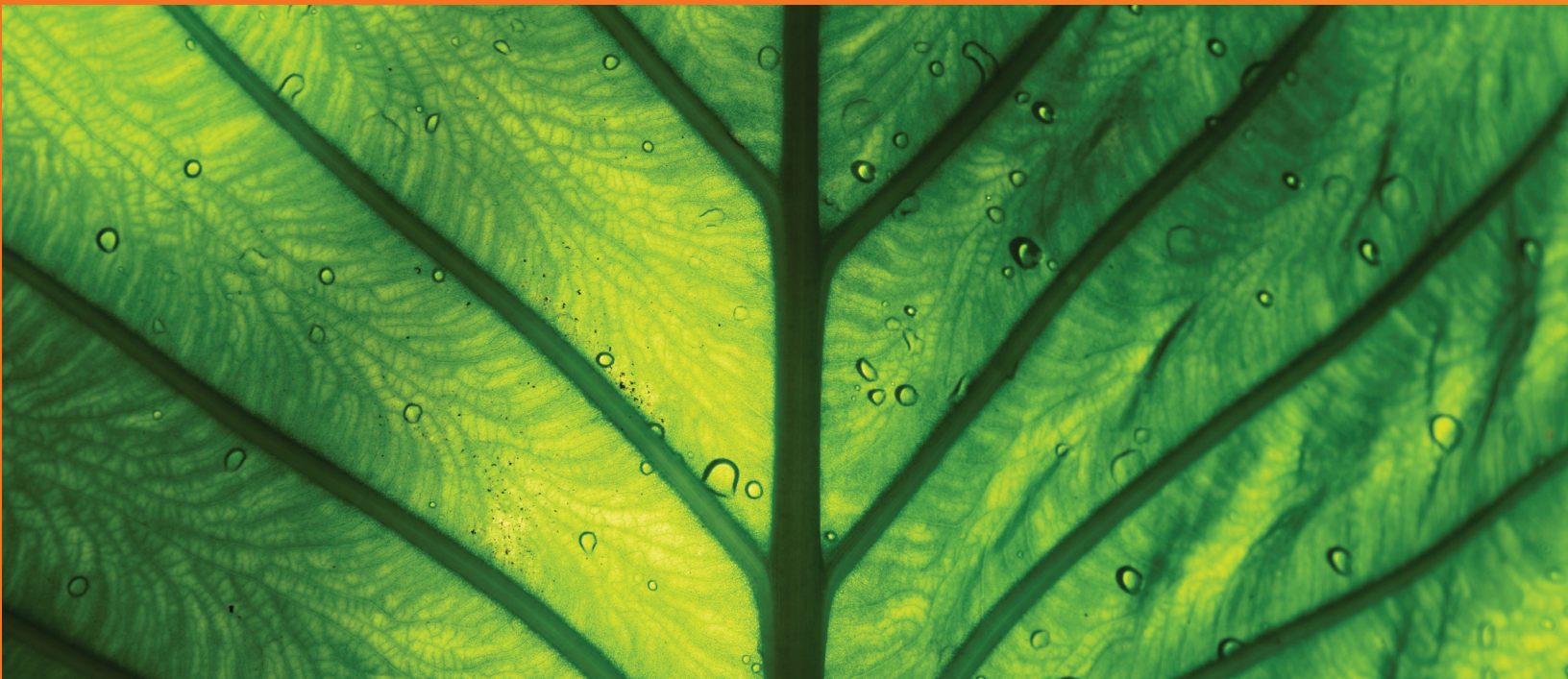




# Governmental Accounting and Auditing Update

Melisa F. Galasso, CPA







# **GOVERNMENTAL ACCOUNTING AND AUDITING UPDATE**

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**BY MELISA F. GALASSO, CPA**

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# Use of materials

This course manual accompanies all formats in which the course is offered, including self-study text, self-study online, group study, in-firm, and other formats, as applicable. Specific instructions for users of the various formats are included in this section.

CPAs are required to participate in continuing professional education (CPE) to maintain their professional competence and provide quality professional services. CPAs are responsible for complying with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies.

Professional standards for CPE programs are issued jointly by the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA) to provide a framework for the development, presentation, measurement, and reporting of CPE programs. The Statement on Standards for CPE Programs (CPE standards) is available as part of AICPA *Professional Standards*, either in paperback or as an online subscription through the AICPA's Online Professional Library.

## **Review questions and exercises for self-study participants**

The CPE standards require that self-study programs include review questions/exercises that provide feedback for both correct and incorrect responses. Note that these reviews are provided only as learning aids and do not constitute a final examination.

## **Requirements for claiming and receiving CPE credit**

CPE standards place responsibility on both the individual participant and the program sponsor to maintain a record of attendance at a CPE program. CPAs who participate in only part of a CPE program, should claim CPE credit only for the portion that they attended or completed.

You must document your claims of CPE credit. Examples of acceptable evidence of completion include:

- For group and independent study programs, a certificate or other verification supplied by the CPE program sponsor
- For self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination

When you participate in group study and other live presentations, you will receive a completion certificate from the program sponsor. CPE program sponsors are required to keep documentation on programs for five years, including records of participation.

When you participate in self-study, you must complete the exam within one year of the date of course purchase to receive a certificate indicating satisfactory completion of the CPE program.

- The exam for self-study in print format is located in the "Examination" section at the end of the course manual.

- You can find the course code number for both the self-study exam and the self-study evaluation in the examination's introductory material. You will complete the self-study exam and evaluation online at <https://cpegrading.aicpa.org>. You must provide the unique serial number printed on the inside front cover of this publication and you must achieve a minimum passing grade of at least 70 percent to qualify for CPE credit.
  - Upon achieving a passing grade, you will receive a certificate displaying the number of CPE credits earned based on a 50-minute learning segment, in compliance with CPE standards. The grading system provides a completion certificate online, which you may print or save as a PDF. The grading system maintains a transcript of your completed courses.
  - If you do not achieve a passing grade, the online grading system notifies you of this and also provides instructions for retaking the exam. You have three attempts to pass the exam. If you do not pass the exam in three attempts, please contact the Member Service Center at 1.888.777.7077 to obtain additional attempts.

### **Program evaluations**

The information accumulated from participant evaluation forms is important in our continual efforts to provide high quality continuing education for the profession. When you participate in group study and other live presentations, please return your evaluation forms prior to departing your program sessions. When you participate in self-study, please complete the course evaluation online. Your comments are very important to us.

### **Customer service**

For help and support, including information on refund claims and complaint resolutions, please call the Member Service Center at 1.888.777.7077, or visit the online help page at [www.aicpastore.com](http://www.aicpastore.com).

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## Chapter 1

# Federal Government Activities

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### **Learning objectives**

- Recognize how the effective dates of the Uniform Guidance affect various stakeholders.
- Identify requirements in the Uniform Guidance for auditors performing a compliance audit.
- Identify key revisions for determining major programs under the Uniform Guidance.

# Introduction

This chapter discusses ongoing developments relating to audits of entities expending federal awards.

# Update on revisions to Government Auditing Standards

In April 2017, the U.S. Government Accountability Office (GAO) issued an exposure draft containing proposed changes to *Government Auditing Standards, December 2011 Revision*. When issued in final form and effective, the revision will supersede the December 2011 revision of the standards. The revision to *Government Auditing Standards* is not expected to be final until later in 2018, but the effective date of the guidance will likely not be known until the revision is issued in final form.

The proposed changes update the Yellow Book to reflect major developments since the last revision and to emphasize specific considerations applicable to the government environment. Among the changes are the following:

- Format of the standards are revised to differentiate the requirements from the application guidance.
- Chapters are reorganized and realigned (for example, "Ethics, Independence, and Professional Judgement" is a separate chapter from "Competence and Continuing Professional Education").
- Supplemental guidance previously found in the appendix to the document is either incorporated into individual chapters or removed.

Internal control requirements and guidance have been revised to align with the *Standards for Internal Control in the Federal Government* (Green Book) and the *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) which were both updated after the issuance of the 2011 Yellow Book.

Changes in audit and attestation standards have also led to other proposed changes. Due to the issuance of SAS 130, integrated audits have been moved to the financial statement audit sections and out of the attestation standard sections to align with the generally accepted auditing standards (GAAS) changes. Due to the issuance of SSAE 18, there are changes to align the language and terminology with the attestation standards. SSARS 21, section 90 (Review of Financial Statements) is incorporated into generally accepted government auditing standards (GAGAS).

The proposal further confirms that GAGAS does not incorporate the AICPA's Code of Conduct by reference but recognizes that certain CPAs may use or may be required to use the code in conjunction with GAGAS.

The independence section is updated to state that any services performed by auditors related to preparing accounting records and financial statements, other than those already prohibited, create significant threats to auditors' independence and must be considered as such during the threats and safeguards analysis of the conceptual framework.

In the competence section, there were many edits including requiring management to assign competent auditors to conduct an engagement. It also addresses a new four-hour requirement in GAGAS topics to be required each time a new version of GAGAS is issued. Additionally, application guidance is provided concerning the topics required by the 80-hour GAGAS CPE requirement. The new standards also

incorporate some of the guidance from the current GAO CPE guidance document addressing common CPE questions, which will then be superseded.

The quality control sections are expanded to address client acceptance policies as well as written confirmation of independence policies and procedures.

Current GAGAS requires the disclosure of abuse if identified during the audit as a finding. The proposal also makes waste a required finding.

For more information on specific revisions or for an update on the status, go to the GAO website at [www.gao.gov/yellowbook/overview](http://www.gao.gov/yellowbook/overview).

# OMB reforms relating to federal awards

Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) establishes uniform cost principles and audit requirements for federal awards to nonfederal entities and administrative requirements for all federal grants and cooperative agreements. The stated goal of this reform was to streamline guidance for federal awards while easing administrative burden and to strengthen oversight of more than \$500 billion in federal funds expended annually.

Overall, the Uniform Guidance includes revisions to modify existing guidance and requirements considered to be outdated, ineffective, insufficient, or excessively burdensome. The Uniform Guidance consolidates the cost principles (other than those related to hospitals) into a single document with limited variations by type of entity. Combining the circulars containing the cost principles and administrative requirements necessitated revising terms and definitions where applicable. This guidance consolidates the requirements from the Office of Management and Budget (OMB) Circulars A-21, A-87, A-89, A-102, A-110, A-122, and the guidance in Circular A-50 on Single Audit Act follow-up. In addition, Subpart F of the Uniform Guidance contains revised audit requirements that were formerly found in Circular A-133.

Appendix IX, "Hospital Cost Principles," of the Uniform Guidance notes that the cost principles applicable to hospitals are not superseded with the issuance of the Uniform Guidance. The OMB plans to establish a review process to consider existing hospital cost determination and how best to update and align them with the cost principle guidance in the Uniform Guidance. Until the revised guidance is implemented for hospitals, the existing principles at 45 CFR Part 74 Appendix E, "Principles for Determining Cost Applicable to Research and Development Under Grants and Contracts with Hospitals," remain in effect.

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## Frequently asked questions

Frequently Asked Questions (FAQ) have been issued that provide clarifying information regarding specific sections of the Uniform Guidance. The FAQ are available at <https://cfo.gov/grants/uniform-guidance/>. The FAQ document accumulates all FAQ and therefore includes all FAQ issued to date. Also refer to the Resources section for links to the Uniform Guidance and related documents.

### Key point



It is important to note that it is the hospital cost principles (only) that are not superseded by the Uniform Guidance. However, hospitals are required to comply with the requirements of the Uniform Guidance other than the cost principles.

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## Summary of Uniform Guidance subparts

All guidance for federal agencies and nonfederal entities and their auditors is in the Uniform Guidance in the following sections of Part 200.

### Subpart A, acronyms and definitions (200.0-200.99)

Subpart A contains the various acronyms used in the document as well as the definitions.

### Subpart B, general provisions (200.100-200.113)

Subpart B explains the purpose, applicability, and effective date of the Uniform Guidance. A table in this subpart indicates which subparts are applicable to different types of awards. This table specifies the subparts that are applicable (or not applicable) to a particular type of federal award. Among the types of federal awards noted in the table are grant agreements, cooperative agreements, cost-reimbursement contracts, fixed amount awards, agreements for loans and loan guarantees, interest subsidies, and insurance. It is noted that the requirements established apply to all federal agencies that make federal awards to nonfederal entities, and that the requirements are applicable to all costs related to federal awards.

### Subpart C, pre-federal award requirements and contents of federal awards (200.200-200.211)

Subpart C provides information to federal agencies on information that is required to be provided to nonfederal entities related to applying for and receiving federal awards. This includes determining the type of instrument to be used (for example, grant agreement, cooperative agreement, or contract), and a listing of information that must be included in a federal award document. In addition, this subpart provides guidance to federal agencies regarding reviewing proposals, including evaluating risks posed by applicants.

### Subpart D, post federal award requirements standards for financial and program management (200.300-200.345)

Subpart D contains information for both federal agencies and nonfederal entities regarding their responsibilities after a federal award is granted. It covers a wide range of topics. Auditors should identify and understand the content that relates to nonfederal entities because it will be one basis for compliance testing of awards, or increments of awards, subject to the Uniform Guidance.

Topic areas covered in Subpart D are as follows:

- Standards for financial and program management
- Property standards
- Procurement standards
- Performance and program monitoring
- Subrecipient monitoring
- Record retention and access
- Remedies for noncompliance
- Closeout
- Post-closeout adjustments and continuing responsibilities
- Collection of amounts due

### **Subpart E, cost principles (200.400-200.475)**

Subpart E contains information regarding cost principles for federal awards previously found in the cost circulars. These principles must be used in determining the allowable costs of work performed by the nonfederal entity under federal awards. These principles also must be used by the nonfederal entity as a guide in the pricing of fixed-price contracts and subcontracts where costs are used in determining the appropriate price.

### **Subpart F, audit requirements (200.500-200.521)**

Subpart F sets forth the requirements for auditors performing Uniform Guidance compliance audits of nonfederal entities expending federal awards.

### **Uniform Guidance appendixes**

There are a number of appendixes to the Uniform Guidance on a wide variety of subjects. Some of the appendixes contain detailed information on the subject, and others are references to material located elsewhere. Of special note are the following appendixes, some of which reference other guidance and requirements related to a single audit:

- Appendix I, *Full Text of Notice of Funding Opportunity*
- Appendix IX, *Hospital Cost Principles* – The Hospital Cost Principles appendix has not been updated. The existing principles located at 45 CFR Part 74 Appendix E, entitled "Principles for Determining Cost Applicable to Research and Development Under Grants and Contracts with Hospitals," remain in effect.
- Appendix X, *Data Collection Form (Form SF-SAC)* – The Data Collection (Form SF-SAC) is available on the Federal Audit Clearinghouse (FAC) website.
- Appendix XI, *Compliance Supplement* – The Compliance Supplement is available on the OMB website.

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## **Effective date of the Uniform Guidance**

### **Auditors**

The audit requirements found in the Uniform Guidance were effective for fiscal years beginning on or after December 26, 2014. In a single audit, all compliance audits are now being performed under the Uniform Guidance.

### **Federal agencies**

Under the Uniform Guidance, federal agencies were required to adopt, in unison, revised agency regulations that implement the Uniform Guidance. To accomplish this, all federal agencies were required to revise their existing regulations, policies, and procedures to be in line with the Uniform Guidance. A joint interim final rule was issued in December 2014 whereby all federal agencies adopted the revisions in unison to be effective on December 26, 2014.

## Agency implementation

Some agencies received OMB approval for exceptions to the Uniform Guidance. OMB states that it has approved exceptions only when they are consistent with existing policies of the agency. Therefore, all regulatory language included in the joint interim final rule should be consistent with either the Uniform Guidance or the agencies' existing policies and procedures. See the Resources section later in this chapter for information available regarding agency implementation.

### Key point



Most federal agency regulations for grants and agreements are located in the CFR at Title 2, Subtitle B, *Federal Agency Regulations for Grants and Agreements*. The Department of Health and Human Services codified the entire Uniform Guidance, as revised for their agency exceptions, in Title 45, CFR Part 75. Nonfederal entities and auditors who have questions about the nature of agency exceptions, and the effect of such exceptions on the audit, may consult with agency single audit coordinators or programs officials using the contact information in appendix 3, "Federal Agency Single Audit, Key Management Liaison, and Program Contacts," of the Compliance Supplement. Appendix 7, "Other Audit Advisories," of the Compliance Supplement includes some information regarding agency exceptions.

## Nonfederal entities

The Uniform Guidance defines a nonfederal entity as a "state, local government, Indian tribe, institution of higher education, or not-for-profit (NFP) organization that carries out a federal award as a recipient or subrecipient." (The Uniform Guidance does not apply to for-profit organizations.) Nonfederal entities are required to implement the Uniform Guidance administrative requirements and cost principles for all new federal awards and to certain funding increments made on or after December 26, 2014. As it relates to funding increments, note the following:

- For awards made before December 26, 2014, funding increments issued on or after December 26, 2014, where the agency *modified the terms and conditions of the award* are subject to the Uniform Guidance administrative requirements and cost principles.
- For awards made before December 26, 2014, funding increments issued on or after December 26, 2014, *with no changes to the award terms and conditions*, continue to be subject to the applicable pre-Uniform Guidance requirements.

The effective date of the Uniform Guidance as it relates to a subaward is the same as the effective date of the federal award from which the subaward is made.

## What does this mean to the auditee?

The effective date of the Uniform Guidance administrative requirements and cost principles has had an immediate effect on nonfederal entities. Many nonfederal entities have some awards subject to the pre-Uniform Guidance circulars and other federal awards subject to the Uniform Guidance administrative requirements and cost principles.



### Special note—election regarding procurement standards

The Uniform Guidance provided nonfederal entities a three-year grace period for adopting the Uniform Guidance procurement standards. A nonfederal entity could elect to delay implementation of the Uniform Guidance procurement standards for three full fiscal years beginning with the first fiscal year that begins on or after December 26, 2014. For example, the first fiscal year for an entity with a June 30 year-end would be the fiscal year July 1, 2015 to June 30, 2016. If delayed implementation is elected, the entity is required to implement the Uniform Guidance procurement standards beginning July 1, 2018. Although no official notification was required for the election, the Uniform Guidance states that a nonfederal entity must document whether it is in compliance with the old or new standard and must meet the documented standard.

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## Impact of the effective date of the administrative requirements and cost principles

### What does this mean to the auditor?

In light of the Uniform Guidance effective date provisions, as part of the audit planning process, auditors should determine the applicable criteria that are required to be used in performing the compliance audit for an award (that is, whether an award is subject to pre-Uniform Guidance administrative requirements and cost principles circulars versus the Uniform Guidance requirements). Federal awarding documents will be important tools for making this determination. Nonfederal entities and auditors with questions regarding the applicable criteria for federal awards may consult with agency single audit coordinators or program officials. Contact information for these agency representatives can be found in appendix 3, “Federal Agency Single Audit and Program Contacts” of the Compliance Supplement.

#### Key point



This situation may occur within a major program when the major program is funded through multiple funding sources.

When a nonfederal entity has both federal awards subject to the pre-Uniform Guidance requirements and the Uniform Guidance administrative requirements and cost principles, compliance testing will test against either the pre-Uniform Guidance criteria or the Uniform Guidance criteria depending on federal award dates. A separate sample for transactions subject to the pre-Uniform Guidance requirements and those subject to the Uniform Guidance requirements within a major program would not typically be needed when performing tests of compliance. However, it is recommended that the documentation include an identification of which set of guidance a transaction is subject to.

#### Key point



The audit requirements used to perform the audit have no impact on the effective date provisions of the Uniform Guidance administrative requirements and cost principles.

In summary, in a Uniform Guidance compliance audit, auditors should be aware that auditees may have some federal awards that are subject to the administrative requirements and cost principles circulars and other awards that are subject to the Uniform Guidance administrative requirements and cost principles. This situation will continue until all federal awards have been expended that are subject to the guidance found in the circulars. At that time, the circulars will be superseded.

Note: There are separate sections of the Compliance Supplement for auditing grants that are subject to the circulars that existed prior to the Uniform Guidance (Part 3.1) and a separate section for those that are subject to the Uniform Guidance (Part 3.2). The audit steps can be different between Part 3.1 and Part 3.2. For example, for the Allowability Compliance requirements, the underlying cost principles and administrative requirements that are referred to in Parts 3.1 and 3.2 are different. For Cash Management, in Part 3.2, the disbursements to subrecipients from all pass-through entities needs to be tested. In Part 3.1, this was only a requirement for states. Even if the client has only grants that are subject to Part 3.1, the audit should still be performed under Subpart F.



**Exercise 1-1**

Which cost principles apply to this award?		
Federal award funding period	Cost principles applicable to award	
	Circulars	Uniform Guidance
12-01-16 to 11-30-17		
Incremental funding action dated 03-01-17, based on an original award date of 03-01-13. The award terms and conditions were modified upon the incremental funding action.		
Incremental funding action dated 11-01-16, based on an original award date of 11-01-14. The award terms and conditions were not modified upon the incremental funding action.		
Incremental funding action dated 09-01-17, based on an original award date of 09-01-15. The award terms and conditions were not modified upon the incremental funding action.		

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## Knowledge check

1. Which is not a subpart within the Uniform Guidance?
  - a. Subpart B – “General Provisions.”
  - b. Subpart D – “Post Federal Award Requirements.”
  - c. Subpart G – “Hospital Cost Principles.”
  - d. Subpart E – “Cost Principles.”

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## Resources

### GAQC

The Government Audit Quality Center (GAQC) is a voluntary membership center for CPA firms and state audit organizations designed to improve the quality and value of governmental audits. For the purposes of the GAQC, governmental audits are performed under Government Auditing Standards and are audits and attestation engagements of federal, state, or local governments; not-for-profit entities; and certain for-profit organizations, such as housing projects and colleges and universities that participate in governmental programs or receive governmental financial assistance. The GAQC keeps members informed about the latest developments and provides them with tools and information to help them better manage their audit practice. Certain content on the GAQC's website referenced in this guide may be restricted to GAQC members only.

An Auditee Resource Center, open to the public, is also available on the GAQC website and provides information, practice aids, tools, and other resources that is of interest and benefit to auditees undergoing an audit performed under Government Auditing Standards.

For more information about the GAQC, visit the GAQC website at [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC).

### Other resources

In 2017, the Council on Financial Assistance Reform (COFAR) was disbanded. Information and documents previously found on the COFAR website were moved elsewhere. The Chief Financial Officers Council website, <https://cfo.gov//grants>, contains a number of documents to help nonfederal entities implement the Uniform Guidance, including a link to a Frequently Asked Questions document. The most up-to-date version of the FAQ is available at <https://cfo.gov/grants/uniform-guidance/>.

- The following documents were previously available on the COFAR website but, as of this publication, have been moved to [https://obamawhitehouse.archives.gov/omb/grants\\_docs](https://obamawhitehouse.archives.gov/omb/grants_docs):
- Uniform Guidance Crosswalk from Predominant Source in Existing Guidance (29 pages, 442 kb)
- Uniform Guidance Crosswalk to Predominant Source in Existing Guidance (10 pages, 282 kb)
- Uniform Guidance Cost Principles Text Comparison (174 pages, 1.62 mb)
- Uniform Guidance Audit Requirements Text Comparison (46 pages, 731 kb)
- Uniform Guidance Definitions Text Comparison (76 pages, 476 kb)
- Uniform Guidance Administrative Requirements Text Comparison (123 pages, 1 mb)

Note that some of these documents are out of date. This is mainly due to the final regulations issued and implemented by individual agencies being different from the draft versions (the crosswalks were based on drafts). However, they can provide information regarding the types of changes that were made under the Uniform Guidance as compared to prior requirements and guidance.

### **AICPA resources**

The AICPA has a number of different types of resources to assist recipients of federal awards and their auditors in understanding and implementing the reforms. Some of these resources are as follows:

- GAQC website ([www.aicpa.org/gaqc](http://www.aicpa.org/gaqc))
- Self-study and group study courses
- Intermediate and Advanced Single Audit Certificates
- Periodic webcasts
- Audit Guide, Government Auditing Standards *and Single Audits*
- Audit Risk Alert, Government Auditing Standards *and Single Audit Developments*

# Summary of significant changes to the single audit

There are a number of areas of change in the Uniform guidance. In some areas, it is updated language, whereas others have revised guidance and other details regarding the topic. The information presented in this section does not include all that may be important or relevant to the auditor or auditee. Instead, this section highlights some of the key areas of change to audit requirements found in the Uniform Guidance. The following areas will be discussed in the chapter:

- Terminology
- Uniform Guidance compliance audits
- Schedule of expenditure of federal awards
- Major program determination
- Reporting

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## Terminology

**Must and should.** The Uniform Guidance definitions of the terms *must* and *should* are different from those terms found in GAAS and GAGAS.

The Uniform Guidance uses the terms as follows:

- *Must* indicates a requirement in the document.
- *Should* indicates best practice or recommended approach. (*Should* does not indicate a requirement.)

Under GAAS and GAGAS, the term *must* indicates an unconditional requirement. GAAS and GAGAS define the term *should* as a presumptively mandatory requirement. An auditor must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare cases as noted in that guidance.

**Federal statutes versus laws.** In the Uniform Guidance, the phrase “federal statutes, regulations, and the terms and conditions of federal awards” has replaced the phrase used in OMB Circular A-133: “laws, regulations, and the provisions of contracts or grant agreements.” Note that variations of these terms are used in some cases.

**Contractor versus vendor.** The Uniform Guidance uses the term *contractor* instead of *vendor*. (However, the guidance relating to contractor versus subrecipient determination and characteristics of a payment to a contractor is substantially the same as that found in Circular A-133 relating to vendors.)

**Equipment versus supplies.** *Equipment* is defined as tangible personal property with a useful life of more than one year whose per-unit acquisition cost equals or exceeds \$5,000 (or the capitalization threshold of the nonfederal entity if lower). *Supplies* are tangible personal property other than those described in equipment. Therefore, a computer or any computer-related device is a supply if it doesn't meet capitalization thresholds.

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## Uniform Guidance compliance audits

The basic approach to a compliance audit under the Uniform Guidance has not changed. However, certain requirements have changed. Some of the more significant ones are noted here.

### Threshold

Under the Uniform Guidance, a nonfederal entity that expends \$750,000 or more in federal awards during the nonfederal entity's fiscal year must have a single audit or program-specific audit conducted in accordance with the Uniform Guidance. This change will result in fewer single audits being performed because those organizations with federal expenditures of \$500,000 to \$749,999 will no longer be required to have a single audit. The Federal Register Notice issuance of the Uniform Guidance notes that this increase in the single audit threshold reduces the audit burden for more than 5,000 nonfederal entities while maintaining audit coverage of more than 99 percent of the federal dollars expended.

### Internal control

Subpart D of the Uniform Guidance now explicitly states that internal controls over federal awards should be in compliance with *Standards for Internal Control in the Federal Government* (Green Book) or *Internal Control—Integrated Framework* issued by COSO. Note that the use of *should* indicates a best practice or recommended approach, not a requirement.

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## Schedule of expenditures of federal awards (SEFA)

The SEFA is a required part of the financial statements under the Uniform Guidance. The auditee is responsible for preparing the SEFA for the period covered by the auditee's financial statements. The Uniform Guidance specifies the content required to be included in the SEFA. Because the SEFA serves as the primary basis for the auditor's major program determination, appropriate major program determination by the auditor is dependent on the accuracy and completeness of the information in the SEFA.

Under the Uniform Guidance certain expenditures of federal awards must be presented on the face of the SEFA, with no option to present these items in the notes to the schedule. Items that are now required to be placed on the face of the SEFA include the following:

- Total amounts provided to subrecipients from each federal program  
Note: If there are no subrecipients, a separate column for subrecipient amounts is not required. However, there is nothing to preclude an auditee from including such a column to indicate there were no amounts provided to subrecipients; or, alternatively, an auditee could explain this in the notes to the SEFA (but this is not required).
- The total of federal awards expended for loan or loan guarantee programs
- For federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity
- Other noncash awards (for example, free rent, food commodities, and donated property and the value of insurance in effect)

In determining the value of total federal awards expended for loans and loan guarantees, in addition to the value of new loans made or received during the audit period, auditees must include the balances of loans from previous years in the SEFA if the federal government imposes continuing compliance requirements. The Uniform Guidance does NOT define *continuing compliance requirement*. For loan or loan guarantee programs, identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total federal awards expended for loan or loan guarantee programs in the schedule.

Other specific provisions in the Uniform Guidance as it relates to the SEFA are as follows:

- The schedule of expenditure of federal awards must include a total for each cluster of programs.
- The notes to the schedule must include *whether or not* the auditee elected to use the 10 percent *de minimis* indirect cost rate.

The total amount of federal expenditures on the face of the SEFA will be the same as the total amount of federal expenditures for the data collection form. This same total typically will be the total used to calculate the type A threshold for determining major programs. (A final type A threshold calculation may be affected by the requirements in CFR 200.518(b)(3) for large loans and loan guarantees.)

When no CFDA number is assigned, or a CFDA number is not available, it is recommended that the auditee use the reporting format prescribed by the FAC in the SEFA. As noted in the instructions to Form SF-SAC, the required first two digits of the CFDA number identify the federal awarding agency. If the three-digit CFDA extension is unknown, the auditee will enter a "U" followed by a two-digit number. Therefore, the first federal program with an unknown three-digit extension would be "U01" for all award lines associated with that program, and the second would be "U02." For example, the number for the first Department of Health and Human Service (HHS) program with an unknown CFDA number would be 93.U01. The two-digit extension number can start over for each federal agency or continue through the remainder of the data collection form. If the program is part of the Research and Development (R&D) cluster, then the instructions to form SF-SAC state that "RD" is required as the CFDA extension (for example, 93.RD for a HHS program in the R&D cluster with an unknown CFDA extension). The FAC also requires that additional award identification be provided when the CFDA extension is unknown. This additional information used to identify the award may be the program year, contract number, or another such identifying number. The auditor is required to provide an opinion (or disclaimer of opinion) on whether the SEFA is fairly stated, in all material respects, in relation to the financial statement as a whole. This typically requires using the financial statement materiality and not the materiality of the SEFA.

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## Determination of major programs

The process of identifying the major programs to audit remains a four-step process. However, there are a number of changes within the process.

The Uniform Guidance states that the auditor must use a risk-based approach to determine which federal programs are major programs. This risk-based approach must include consideration of current and prior audit experience, the oversight by federal agencies and pass-through entities, and the inherent risk of the federal program.

## Step one—determination of type A and type B programs

The auditor must identify the larger federal programs, which must be labeled type A programs. Type A programs are defined as federal programs with federal awards expended during the audit period exceeding the levels outlined in the following table.

Total federal awards expended <sup>1</sup>	Type A threshold
Equal to or exceed \$750,000 but ≤ \$25 million	\$750,000
Exceed \$25 million but ≤ \$100 million	Total federal awards expended times 0.03
Exceed \$100 million but ≤ \$1 billion	\$3 million
Exceed \$1 billion but ≤ \$10 billion	Total federal awards expended times 0.003
Exceed \$10 billion but ≤ \$20 billion	\$30 million
Exceed \$20 billion	Total federal awards expended times 0.0015

<sup>1</sup> Includes both cash and noncash awards.

Federal programs not labeled type A must be labeled type B programs.

For biennial audits the determination of type A and type B programs must be based upon the federal awards expended during the two-year period.

## Large loan and loan guarantee programs in type A program determination

Under the Uniform Guidance, the inclusion of large loan and loan guarantee programs must not result in the exclusion of other programs as type A programs. The guidance regarding large loan and loan guarantees as it relates to the identification of the type A threshold is summarized as follows:

- For the purpose of this calculation, a program is considered to be a “federal program providing loans” if the value of federal awards expended for loans within the program comprises 50 percent or more of the total federal awards for the program. (Note: A cluster of programs is treated as one program.)
- When a *federal program providing loans* exceeds four times the largest nonloan program, it is considered a “large loan program,” and the auditor must consider this federal program as a type A program and exclude its value in determining the type A threshold.
- The type A threshold is calculated after removing the total of all *large loan programs*.

## Step two—identification of low-risk type A programs

The auditor must identify type A programs that are low risk. In making the determination about whether a type A program is low risk, the auditor must consider whether there is an indication of significantly increased risk that would preclude the program from being low risk based on the following criteria:

- Oversight exercised by federal agencies and pass-through entities (for example, results of recent monitoring or other reviews or indication in the OMB Compliance Supplement that a federal agency has identified a federal program as higher risk)
- The results of audit follow-up
- Any changes in personnel or systems affecting the program that would indicate significantly increased risk that would preclude the program from being low risk



Note that these are the only criteria that the Uniform Guidance permits the auditor to consider in evaluating whether there is significantly increased risk for a type A program (that is, the auditor is not permitted to use judgment based on the inherent risk of a type A program).

In addition, to be considered low risk, a type A program must

- have been audited as a major program in at least one of the two most recent audit periods, and
- not have had any of the following in the most recent audit period:
  - Internal control deficiencies, which were identified as material weaknesses in the auditor's report on internal control for major programs
  - A modified opinion on the program in the auditor's report on major programs
  - Known or likely questioned costs that exceed 5 percent of the total federal awards expended for the program

The Uniform Guidance permits a federal awarding agency to request that a type A program for certain recipients not be considered low risk so that it would be audited as a major program.

### Key point



If no low-risk type A programs are identified in step 2, the auditor skips step 3 and moves directly to step 4.

### Step three—identification of high-risk type B programs

The auditor must identify type B programs that are high risk using professional judgment and the following criteria from section 200.519, *Criteria for Federal Program Risk*.

- Current and prior audit experience
- Oversight exercised by federal agencies and pass-through entities
- Inherent risk of noncompliance of the federal programs

However, the auditor is not required to identify more high-risk type B programs than at least one-fourth the number of type A programs identified as low risk under step 2. Once this number of high-risk type B programs have been identified (that is, at least one-fourth the number of low-risk type A programs), the auditor can discontinue further risk assessments of type B programs.

The Uniform Guidance does not require a specific number of high-risk type B programs to be identified. It is possible to risk assess all of an auditee's type B programs and determine that fewer than one quarter the number of low-risk type A programs are high-risk type B programs or that none are high-risk type B programs. Any programs determined to be high-risk type B programs are required to be audited as a major program.

### Key point



Under the Uniform Guidance, all type B programs *identified* as high risk are required to be audited as major programs. To the extent that an auditor performs risk assessments on type B programs beyond what is required under the Uniform Guidance and identifies more high-risk type B programs than required (that is, at least one-fourth the number of low-risk type A programs), those additional high-risk type B programs *must* be audited as major programs.

Except for known material weakness in internal control or compliance problems, a single criterion in risk would seldom cause a type B program to be considered high risk. When determining which type B programs to risk assess, the auditor is encouraged to use an approach that provides an opportunity for different high-risk type B programs to be audited as major over a period of time.

### Key point



The auditor is not expected to perform risk assessments on relatively small federal programs. The auditor is required only to perform risk assessments on type B programs that exceed 25 percent (0.25) of the type A threshold as determined in step 1.

### Step four—selection of programs to be audited as major

At a minimum, the auditor must audit all the following as major programs:

- a. All type A programs not identified as low risk under step 2
- b. All type B programs identified as high risk under step 3
- c. Programs to be audited as major based on a federal agency or pass-through entity request
- d. Additional programs as necessary to meet the percentage of coverage requirements

### Key point



If preliminary numbers were initially used or any adjustments are made to total federal expenditures during the audit, the major program determination should be reperformed to be sure that the correct major programs were selected for testing.

**Use final numbers!**

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## 2017 compliance supplement – smoothing

During the first three years of implementation, to avoid a spike in the demand for audit services every third year after implementation, auditors may audit some low-risk type A programs as additional major programs in the first and second years of implementation before they are determined not to be low risk because of the two-year look back rule, which would otherwise require them to be audited as major programs in the third year of implementation.

However, a low-risk, type A program would not be permitted to be audited more than once in the first three years of implementing the Uniform Guidance. The rationale for this exception is that step 4 of the major program determination process states that the programs required to be audited as major programs are “[a]t a minimum.” Smoothing the audit of low-risk, type A programs during the first three years of implementation would not result in additional costs overall; and, therefore, the costs associated with auditing these low-risk, type A programs in advance would be allowable. In addition, this method would allow for a more balanced workload in the initial years of implementation, which will help ensure audit quality because of a more consistent approach for budgeting and determining staffing resources.

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## Percentage of coverage

If the auditee meets the criteria for a low-risk auditee, the auditor need audit only major programs that, in aggregate, encompass at least 20 percent (0.20) of total federal awards expended. Otherwise, the auditor must audit the major programs that, in aggregate, encompass at least 40 percent (0.40) of total federal awards expended.

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## Low-risk auditee requirements

The requirements a nonfederal entity must meet to qualify as a low-risk auditee have been revised under the Uniform Guidance. An auditee that meets all the following conditions for each of the preceding two audit periods must qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with the section dealing with major program determination:

- The entity must have had single audits performed on an annual basis. A nonfederal entity that has biennial audits does not qualify as a low-risk auditee.
- The entity must have submitted the data collection form and reporting package to the FAC on time.
- The auditor’s opinion on whether the entity’s financial statements were prepared in accordance with generally accepted accounting principles (GAAP) or a basis of accounting required by state law and the auditor’s in-relation-to opinion on the SEFA were unmodified. Therefore, unless *required* by state law, an auditee that prepares its financial statements on a non-GAAP basis of accounting, such as the cash or modified cash basis, cannot be considered a low-risk auditee.
- The entity had no deficiencies in internal control that were identified as material weaknesses under the Yellow Book.
- The auditor did not report a substantial doubt about the entity’s ability to continue as a going concern.
- None of the entity’s federal programs had audit findings from any of the following in either of the preceding two audit periods in which they were classified as type A programs:
  - Internal control deficiencies that were identified as material weaknesses in the auditor’s report on internal control for major programs
  - A modified opinion on a major program in the auditor’s report on major programs
  - Known or likely questioned costs that exceeded 5 percent of the total federal awards expended for a type A program during the audit period

In addition, there is no provision in the Uniform Guidance that allows a cognizant or oversight agency to provide a waiver of the low-risk auditee criteria.

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## Knowledge check

2. What is the dollar threshold at which the Uniform Guidance requires a nonfederal entity to have a single audit?
  - a. \$300,000.
  - b. \$500,000.
  - c. \$750,000.
  - d. \$1,000,000.
3. What is a large loan program?
  - a. A federal program providing loans that exceeds two times the largest nonloan program.
  - b. A federal program providing loans that exceeds three times the largest nonloan program.
  - c. A federal program providing loans that exceeds four times the largest nonloan program.
  - d. A federal program providing loans that exceeds five times the largest nonloan program.
4. As it relates to using professional judgment in the determination of major programs, which statement is correct?
  - a. Type A programs allow for more professional judgment than type B programs.
  - b. Type A programs allow for less professional judgment than type B programs.
  - c. Type A programs allow for the same amount of professional judgment than type B programs.
  - d. Professional judgment is not permitted in major program determination.

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## Audit findings

### Audit findings reported

Under the Uniform Guidance, the auditor must report the following as audit findings in a schedule of findings and questioned costs:

- Significant deficiencies and material weaknesses in internal control over major programs and significant instances of abuse relating to major programs
- Material noncompliance with the provisions of federal statutes, regulations, or the terms and conditions of federal awards related to a major program
- Known questioned costs that are greater than \$25,000 for a type of compliance requirement for a major program – The auditor must also report known questioned costs when likely questioned costs are greater than \$25,000 for a type of compliance requirement for a major program.
- Known questioned costs that are greater than \$25,000 for a federal program that is not audited as a major program
- The circumstances concerning why the auditor's report on compliance for each major program is other than an unmodified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs
- Known or likely fraud affecting a federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs
- Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings, prepared by the auditee, materially misrepresents the status of any prior audit finding

## Audit findings detail

The required audit findings must include the following specific information, as applicable:

- Federal program and specific federal award identification including the Catalog of Federal Domestic Assistance (CFDA) title and number, federal award identification number and year, name of federal agency, and name of the applicable pass-through entity
- The criteria or specific requirement upon which the audit finding is based, including the federal statutes, regulations, or the terms and conditions of the federal awards
- The condition found, including facts that support the deficiency identified in the audit finding
- A statement of cause that identifies the reason or explanation for the condition or the factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective action
- The possible asserted effect to provide sufficient information to the auditee and federal agency or pass-through entity (in the case of a subrecipient) to permit them to determine the cause and effect to facilitate prompt and proper corrective action
- Identification of questioned costs and how they were computed – Known questioned costs must be identified by applicable CFDA number(s) and applicable federal award identification number(s).
- Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem – Where appropriate, instances identified must be related to the universe and the number of cases examined and must be quantified in terms of dollar value. The auditor should report whether the sampling was a statistically valid sample.
- Identification of whether the audit finding was a repeat of a finding in the immediately prior audit and, if so, any applicable prior year audit finding numbers  
Note: If you had a finding in the prior year (say 2017-002) and this year it is a repeat finding, when you number your finding for the current year, it should be finding 2018-00X; and then, in the details, it should indicate the prior year finding number of 2017-002.
- Recommendations to prevent future occurrences of the deficiency identified in the audit finding
- Views of responsible officials of the auditee (not only when there is disagreement with the audit finding)
- A reference number in the format meeting the requirements of the data collection form submission to allow for easy referencing of the audit findings during follow-up

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## Other reporting considerations

### Summary schedule of prior audit findings

The Uniform Guidance requires the auditee to prepare a summary schedule of prior audit findings when audit findings were not corrected or were only partially corrected. The summary schedule must describe the reasons for the finding's recurrence and planned corrective action, and any partial corrective action taken. Note that this document is prepared by the auditee. The summary schedule of prior audit findings must include findings relating to the financial statements, which are required to be reported in accordance with *Government Auditing Standards*.

## Corrective action plan

At the end of the audit, the auditee must prepare a corrective action plan to address each audit finding included in the current year auditor's report. This includes findings relating to the financial statements required to be reported in accordance with GAGAS. The corrective action plan must provide

- the name(s) of the contact person(s) responsible for corrective action,
- the corrective action planned for each audit finding (referred to by the auditor-assigned reference number), and
- the anticipated completion date.

If the auditee does not agree with the audit findings, or believes corrective action is not required, the corrective action plan must contain an explanation and specific reasons why the auditee disagrees.

The Uniform Guidance clearly states that the auditee's corrective action plan must be a separate document from the schedule of findings and questioned costs. Therefore, it is clear that the schedule of findings and questioned costs is an auditor's responsibility and the corrective action plan is an auditee's responsibility. In July 2017, another set of FAQ was released. This included a requirement that the auditee must prepare the corrective action plan on auditee letterhead. Note the use of the term *must*. The 2017 FAQ document can be found at <https://cfo.gov/wp-content/uploads/2017/08/July2017-UniformGuidanceFrequentlyAskedQuestions.pdf>.

## Extensions of due dates

Federal agencies no longer have the authority to grant extensions of the due date of reports.

## Data collection form

All federal agencies, pass-through entities, and others interested in a reporting package and data collection form must obtain it by accessing the FAC.

### Key point



Subrecipients are no longer required to submit a reporting package to a pass-through entity due to the public availability of FAC reporting packages.

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## FAC

The FAC must make the reporting packages received available to the public (except for Indian tribes exercising the option described in the following section), maintain a database of completed audits, provide appropriate information to federal agencies, and follow up with known auditees that have not submitted the required data collection forms and reporting packages.

## Exception for Indian tribes

An auditee that is an Indian tribe may opt not to authorize the FAC to make the reporting package publicly available on a website, by excluding the authorization for the FAC publication in the statement described previously. If this option is exercised, the auditee becomes responsible for submitting the reporting package directly to any pass-through entities through which it has received a federal award and to pass-through entities for which the summary schedule of prior audit findings reported the status of any findings related to federal awards that the pass-through entity provided. Unless restricted by federal statute or regulation, if the auditee opts not to authorize publication, it must make copies of the reporting package available for public inspection.

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## Protected personally identifiable information

The Uniform Guidance has guidance regarding the use of personally identifiable information (PII). Auditees and auditors must ensure that their respective parts of the reporting package do not include protected PII.

PII is information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual. Some information that is considered to be PII is available in public sources such as telephone books, public websites, and university listings. This type of information is considered to be *public PII* and includes, for example, first and last name, address, work telephone number, email address, home telephone number, and general educational credentials. The definition of PII is not anchored to any single category of information or technology. Rather, it requires a case-by-case assessment of the specific risk that an individual can be identified. Non-PII can become PII whenever additional information is made publicly available, in any medium and from any source, that, when combined with other available information, could be used to identify an individual.

*Protected PII* is defined in the Uniform Guidance as "an individual's first name or first initial and last name in combination with any one or more of types of information, including, but not limited to, Social Security number, passport number, credit card numbers, clearances, bank numbers, biometrics, date and place of birth, mother's maiden name, criminal, medical, and financial records, and educational transcripts. This does not include PII that is required by law to be disclosed."

# General provisions and pre-award and post-award requirements

Administrative requirements are found in the following subparts of the Uniform Guidance:

- Subpart B—General Provisions
- Subpart C—Pre-Federal Award Requirements and Contents of Federal Awards
- Subpart D—Post-Federal Award Requirements

The guidance in these parts is effective upon agency implementation, that is, December 26, 2014.

The Uniform Guidance requires federal agencies to take a number of actions and to put in place various policies and procedures. Requirements for federal agencies to review the merit of an applicant's proposal and the risk posed by the applicant may significantly affect state and local governments and not-for-profit organizations. The merit review process must be described or incorporated by reference in the funding opportunity. For competitive grants or cooperative agreements, the Federal awarding agency must have in place a framework for evaluating the risks posed by applicants before they receive Federal awards. Agencies may consider financial stability, quality of management systems, history of performance, as well as reports and findings from audits. Subpart C suggests that federal awarding agencies may use a risk-based approach when making awards. Auditors will need to determine if any such actions have been taken by a federal agency or pass-through entity and the effect, if any, on the compliance audit performed under the Uniform Guidance requirements.

Federal awarding agencies are required to review information available through any OMB designated repositories of government-wide eligibility qualification or financial integrity information *prior to making a federal award*. A federal awarding agency or a pass-through entity may impose additional specific award conditions, as needed:

- Based on federal awarding agency review of risk posed by applicants using data from OMB designation repositories
- When an applicant or recipient
  - has a history of failure to comply with general or specific terms and conditions of a federal award,
  - fails to meet expected performance goals, or
  - is not otherwise responsible

Examples of specific conditions include using reimbursements rather than advance payments, requiring approvals to move to next phase of a project, additional prior approvals, and additional reporting and or monitoring.



A sampling of the provisions affecting nonfederal recipients of federal awards relating to general provisions and to the pre- and post-federal award requirements are as follows:

- A number of requirements relate to responsibilities of pass-through entities, which somewhat follow those required of federal awarding agencies. A few of the more noteworthy responsibilities include the requirement to
  - evaluate each subrecipient’s risk of noncompliance for purposes of determining appropriate, monitoring including consideration of whether the subrecipient has new personnel or systems,
  - review financial and programmatic reports required by the pass-through entity,
  - verify each subrecipient is audited as required by Subpart F, or
  - consider taking enforcement action against noncompliant subrecipients.
- Nonfederal entities must disclose in writing any potential conflict of interest to the federal awarding or pass-through entity. In addition, nonfederal entities must maintain written standards of conduct covering conflicts of interest and governing performance of its employees engaged in the selection, award, and administration of contracts.
- Nonfederal entities or applicants for a federal award must disclose, in a timely manner, in writing to the federal awarding agency or pass-through entity all violations of federal criminal law that could affect the federal award that involve fraud, bribery, or gratuity violations.
- At the end of a federal award, nonfederal entities are required to certify in writing that the project or activity was completed or that the level of effort was expended. If the required level of activity or effort was not carried out, the amount of the federal award is required to be adjusted.
- Changes in the principal investigator, project leader, project partner, or scope of effort must receive the prior written approval of the federal awarding agency or pass-through entity. In addition, recipients must request prior approval from federal awarding agencies to change key persons specified in the application.
- Federal award recipients are required to relate financial data to performance accomplishments of the federal award; when applicable, recipients must also provide cost information to demonstrate cost effective practices.
- Internal control provisions include the following:
  - Nonfederal entities *must* (are required to) establish and maintain effective internal control that provides reasonable assurance the entity is managing federal awards in compliance with federal statutes, regulations, and terms and conditions of the federal award.
  - Internal controls over federal awards *should* (best practice/recommended) be in compliance with *Standards for Internal Control in the Federal Government* or the *Internal Control Integrated Framework* issued by COSO.
  - Additionally, internal controls should include reasonable measures to safeguard protected personally identifiable information and other information designated by the federal awarding agency or pass-through entity as sensitive, or that the recipient considers sensitive.

The Uniform Guidance provides rules regarding methods for collection, transmission, and storage of information. Nonfederal entities must use open and machine-readable formats. In addition, entities must always provide or accept paper versions of federal award-related information to and from the nonfederal entity upon request. When original records are electronic and cannot be altered, there is no need to create and retain paper copies. Entities can convert paper originals to electronic versions but must perform periodic quality control reviews. Entities must have reasonable safeguards against alteration and ensure that the documents remain readable.

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## Procurement standards

When states make property and services purchases, they must follow the same policies and procedures used for procurements from nonfederal funds. All other nonfederal entities (including subrecipients of a state) must have written procurement procedures that reflect the procurement standards. The requirements include additional documentation regarding conflicts of interest including organizational conflict of interest policies. Nonfederal entities must oversee contractors, avoid acquisition of unnecessary or duplicative items, use only responsible contractors, and maintain sufficient records.

Nonfederal entities must maintain records sufficient to detail the history of procurement. The Uniform Guidance has specific documentation requirements regarding procurement. Entities must document

- rationale for the method of procurement,
- selection of contract type,
- contractor selection or rejection, and
- basis for the contract price.

### Permitted methods of procurement

Nonfederal entities must use one of the following methods of procurement:

- Procurement by micro-purchases (less than \$3,500<sup>1</sup> and no quotations required as long as the nonfederal entity considers the price to be reasonable). Micro-purchases must be distributed equitably among qualified suppliers.
- Procurement by small purchase procedures (less than the simplified acquisition threshold—currently \$150,000—and quotations must be obtained from an adequate number of qualified sources). Adequate number is not defined in the guidance.
- Procurement by sealed bids (preferred method for construction contracts) submitted in response to formal advertising<sup>2</sup> and providing sufficient response time prior to the bid opening date. Fixed price contracts are awarded to lowest bidder.
- Competitive proposal: Request for proposal must be publicized with proposals solicited from adequate number of qualified sources. The entity must have a written method for conducting evaluations of proposals received. The contract must be awarded to the firm with a proposal most advantageous to the program—price and other factors considered.
- Noncompetitive proposals are appropriate ONLY when
  - goods or services are available only from a single source,
  - there is a public emergency,
  - after soliciting number of sources competition is deemed inadequate, and
  - the awarding agency expressly authorized noncompetitive proposals in response to written request from organization.
- A nonfederal entity must perform a cost or price analysis for every procurement action in excess of the simplified acquisition threshold, including contract modifications. In addition, an independent estimate of the cost must be made before receiving bids or proposals.

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<sup>1</sup> If the requirements of the Davis-Bacon Act of 1931 are applicable, this threshold is \$2,000.

<sup>2</sup> Only state, local, and tribal governments are required to publicly advertise the invitation to bid and to open bids publicly.

Note: Auditors and nonfederal entities will need to pay particular attention to the growing number of exceptions. There have been exceptions made to thresholds (like the micro-purchase threshold) for several agencies. Confirming with the agency is the easiest way to ensure proper compliance.

### Special note—election regarding procurement standards

The Uniform Guidance provided nonfederal entities a three-year grace period for adopting the Uniform Guidance procurement standards. A nonfederal entity could elect to delay implementation of the Uniform Guidance procurement standards for three full fiscal years beginning with the first fiscal year that begins on or after December 26, 2014. For example, the first fiscal year for an entity with a June 30 year-end would be the fiscal year July 1, 2015, to June 30, 2016. If delayed implementation is elected, the entity is required to implement the Uniform Guidance procurement standards beginning July 1, 2018. Although no official notification was required for the election, the Uniform Guidance states that a nonfederal entity must document whether it is in compliance with the old or new standard and must meet the documented standard.

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## Knowledge check

5. Which is NOT defined in the Uniform Guidance as a type of information considered *protected PPI*?
  - a. Social Security number.
  - b. Passport number.
  - c. Email address.
  - d. Place of birth.
6. Which statement is correct regarding the corrective action plan?
  - a. The corrective action plan is the same document as the schedule of finding and questioned cost.
  - b. The corrective action plan is a standalone document.
  - c. The corrective action plan is the responsibility of the auditor.
  - d. The corrective action plan is optional.
7. Which is NOT an approved method of procurement?
  - a. Procurement by macro-purchases.
  - b. Procurement by small purchase procedures.
  - c. Procurement by sealed bid.
  - d. Noncompetitive proposal.

# Federal cost principles


Subpart E supersedes all existing OMB cost circulars other than previous guidance relating to hospitals. In addition, Subpart E makes limited exceptions to the cost principles based on entity type. Auditors will need to determine if their clients have received federal funds (directly or from a pass-through entity) from any agency with OMB approved implementation changes to the Uniform Guidance.

Requirements in Subpart E related to direct costs may prove problematic for some nonfederal entities that do not have effective cost accounting systems. Direct costs are defined as those that can be specifically identified with a particular cost objective such as a federal award or that can be *directly assigned to such activities relatively easily with a high degree of accuracy* (emphasis added). The Uniform Guidance also states that the identification of a cost with a federal award (rather than the nature of the goods or services received) is the determining factor in distinguishing between direct and indirect costs.

Some of the more significant requirements relating to the federal cost principles follow.

- Indirect cost rates
  - Most nonfederal entities that have never received a negotiated indirect cost rate may elect to charge a *de minimis* rate of 10 percent of modified total direct costs, which may be used indefinitely.
  - Any nonfederal entity that has a federally negotiated indirect cost rate may apply for a one-time extension of a current negotiated indirect cost rate for a period of up to four years.
- Required certifications
  - Annual and final fiscal reports (or vouchers) requesting payment signed by an official who is authorized to legally bind the nonfederal entity. The required language for this certification is located in section 200.415, *Required Certifications*.
  - Cost allocation plan or indirect cost rate proposal.
  - For not-for-profit entities only, certifications as appropriate that they did not meet the definition of a major corporation as defined in section 200.414, *Indirect (F&A) Costs*.
- Collection costs incurred to recover improper payments are allowable as direct or indirect costs.
- Conference costs incurred by a sponsor or host may include the costs of identifying (not providing) locally available dependent care resources. Additionally, temporary dependent care costs, above and beyond regular dependent care resulting directly from travel to conferences, are allowable under certain circumstances.
- Standards for documentation of personnel expenses include the following:
  - Charges to federal awards must be based on records that accurately reflect the work performed. Such records must
    - be supported by a system of internal control that provides reasonable assurance the charges are accurate, allowable, and properly allocated;
    - be incorporated into the official records of the nonfederal entity;
    - reasonably reflect the total activity for which the employee is compensated;
    - encompass both federally assisted and all other activities compensated by the nonfederal entity on an integrated basis;
    - comply with established accounting policies and practices of the nonfederal entity; and
    - support the distribution of the employee's salary or wages among specific activities or federal award or other cost objective (for employees working on more than one federal award, a federal award and a nonfederal award, an indirect cost activity and a direct cost activity, and other similar circumstances).

- Nonfederal entities meeting the previously-noted standards will not be required to provide additional support or documentation for the work performed other than that required under U.S. Department of Labor regulations implementing the Fair Labor Standards Act of 1938.
  - Charges for salaries and wages of nonexempt employees must be supported by records indicating the total number of hours worked each day in addition to the previously noted documentation requirements.
- In certain circumstances, states, local governments, and Indian tribes, may use substitute processes or systems for allocating salaries and wages to federal awards in place of or in addition to the requirements noted previously.
- When records of a nonfederal entity do not meet the standards prescribed, the federal government may require personnel activity reports including prescribed certifications or equivalent documentation to support the records required in the cost principles.

<b>Key point</b>	
	<p>The requirements found in the Uniform Guidance relating to personal services emphasize internal controls and provide less prescriptive guidance on documentation primarily in the area of time and effort reporting of employees.</p>

In addition to the requirements in Subpart E, specific guidance relating to indirect costs, indirect cost proposals, and central service cost allocation plans is provided in the following appendixes to the Uniform Guidance.

Appendix III to Part 200	<i>Indirect (F&amp;A) Costs Identification and Assignment, and Rate Determination for Institutions of Higher Education (IHEs)</i>
Appendix IV to Part 200	<i>Indirect (F&amp;A) Costs Identification and Assignment, and Rate Determination for Nonprofit Organizations</i>
Appendix V to Part 200	<i>State/Local Government-wide Central Service Cost Allocation Plans</i>
Appendix VI to Part 200	<i>Public Assistance Cost Allocation Plans</i>
Appendix VII to Part 200	<i>States and Local Government and Indian Tribe Indirect Cost Proposals</i>

## Key point



The Uniform Guidance provides for a government-wide audit quality project to be performed every six years beginning in 2018. The result of this study must be made public. The stated purpose of this project is to determine the quality of single audits by providing a statistically reliable estimate of the extent that single audits conform to applicable requirements, standards, and procedures and to make recommendations to address noted audit quality issues, which may include changes to the requirements. It is anticipated the quality study will occur in 2019 or 2020.

**Now is the time to prepare!**

# OMB Compliance Supplement for single audits

The Compliance Supplement, updated yearly, is one of the most important sources of guidance for the auditor performing single audits. The supplement identifies the types of compliance requirements that OMB and the federal agencies expect to be considered as part of a single audit. It provides information for auditors to understand federal program objectives, procedures, and compliance requirements as well as audit objectives and suggested audit procedures for the compliance requirements included in the supplement. It includes the following:

- Part 1—Background, Purpose, and Applicability
- Part 2—Matrix of Compliance Requirements
- Part 3—Compliance Requirements
- Part 4—Agency Program Requirements
- Part 5—Clusters of Programs
- Part 6—Internal Control
- Part 7—Guidance for Auditing Programs Not Included in this Compliance Supplement
- Appendixes

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## Types of compliance requirements

The 12 types of compliance requirements are as follows:

A—Activities Allowed or Unallowed

B—Allowable Costs/Cost Principles

C—Cash Management

D—Reserved

E—Eligibility

F—Equipment and Real Property Management

G—Matching, Level of Effort, Earmarking

H—Period of Performance

I—Procurement and Suspension and Debarment

J—Program Income

K—Reserved

L—Reporting

M—Subrecipient Monitoring

N—Special Tests and Provisions

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## 2018 Compliance Supplement

As of January 2018, when this chapter was updated, the 2018 Compliance Supplement was not available in final form. The general information provided here is based on the 2017 Compliance Supplement. The following sections of the Compliance Supplement are updated each year for new or revised information:

- Part 2, Matrix of Compliance Requirements, updates which of the 12 types of compliance requirements are applicable to programs included in the Compliance Supplement based on added and deleted compliance requirements in Part 4 program supplements, or to make corrections.
- Part 4 adds and deletes programs and makes changes to a number of existing programs necessary due to regulatory or other changes.
- Part 5 makes updates to the Student Financial Assistance and Research and Development clusters and also updates a program name and adds new clusters.
- Appendix III, *Federal Agency Single Audit and Program Contacts*, update information on responsible single audit offices/officials and program contacts.
- Appendix VII, *Other Audit Advisories*, removes outdated information from
  - Part II, *Effect of Changes to Compliance Requirements*,
  - Part IV, *Due Date for Audit Reports and Low-Risk Auditee Criteria*,
  - Part VII, *OMB-Approved Exceptions to the Guidance in 2 CFR Part 200*, and
  - Part VIII, *Report on the National Single Audit Sampling Project*.
- Appendix IX, *Compliance Supplement Core Team*, updated team members.

As was the case for 2016, Part 3, *Compliance Requirements*, of the 2017 Compliance Supplement includes two sections. Part 3.1 is used for awards subject to the circulars. Part 3.2 is used for auditing federal awards subject to the Uniform Guidance administrative requirements and cost principles.

### Key point



It is important that auditors use the applicable section of part 3 of the Compliance Supplement (3.1 or 3.2) based on which set of requirements apply to the federal award being tested.

### Key point



Be sure to use the version of the supplement that corresponds with the entity's year-end. For example, the 2018 Compliance Supplement must be used for June 30, 2018 year-ends and forward. Year-ends prior to that date (for example, a May 31, 2018, year-end) are required to use the 2017 Compliance Supplement.

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## AICPA GAQC Compliance Supplement practice tips

The AICPA GAQC ([www.aicpa.org/gaqc](http://www.aicpa.org/gaqc)) has assembled a list of tips for using the Compliance Supplement. The following information is derived from that list.



## Practice tips for using the Compliance Supplement

1	Be sure you are using the version of the supplement that is effective for the year under audit.
2	As part of your single audit engagement team preparation, hold a planning meeting to review the applicable Compliance Supplement with your audit team. Focus the review on the programs to be audited and any significant changes made to the supplement from the prior year. Appendix V of the supplement is particularly useful in identifying the changes made each year. Appendix VII should be a key part of the discussion this year as well.
3	<p>The matrix of compliance requirements in part 2 identifies the compliance requirements that are applicable to the programs included in the supplement. Many issues with using this part of the supplement have been noted in single audit quality reviews. It is important that you use it correctly.</p> <p>Remember that even though a "Y" within the matrix indicates that a compliance requirement applies to a federal program, it may not apply at a particular entity, because either that entity does not have activity subject to that type of compliance requirement or the activity could not have a material effect on a major program. Therefore, you need to exercise professional judgment when determining which compliance requirements marked "Y" need to be tested at a particular nonfederal entity. Use part 2 appropriately by</p> <ul style="list-style-type: none"><li>▪ using professional judgment;</li><li>▪ assessing each compliance requirement individually;</li><li>▪ considering both quantitative and qualitative materiality when deciding whether an "applicable" compliance requirement is material to a major program; and</li><li>▪ documenting the determination of why an applicable requirement is not deemed direct and material. Just using an "n/a" or "not direct and material" tick mark is not enough. You need to document your logic for making the decision.</li></ul>
4	Because parts 4 and 5 of the supplement do not include guidance for all types of compliance requirements that pertain to a program (see introduction to part 4 for additional information), you should use those parts in conjunction with parts 2 and 3.
5	Refrain from using the supplement as a de facto audit program. Remember that the supplement includes "suggested" audit procedures. Auditor judgment is necessary to determine whether the suggested audit procedures are sufficient to achieve the stated audit objectives or whether additional or alternative audit procedures are needed. Therefore, you should <i>not</i> consider the supplement to be a "safe harbor" for identifying the audit procedures to apply in a particular engagement. A good understanding of your client is necessary to be sure you are performing the correct procedures for your client's facts and circumstances. Also, you should understand the various federal programs that your client receives to determine whether modifications to the audit approach are necessary.



## Appendix A

# MAJOR PROGRAM DETERMINATION CASE STUDY

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**This appendix is required reading for CPE credit.**



## Case study

NFP Entity's programs and expenditures are listed in the *2018 Summary of Programs by CDFA Number*, which consists of summarized data collected by the auditor.

2018 Summary of programs by CDFA number				
CFDA	Program title	Funds expenditure	Last year audited	Inherent risk assessment
<b>Department of Agriculture</b>				
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	\$ 1,200,000	2017	High
10.559	Summer Food Service Program for Children	\$ 300,000	2016	Low
10.572	WIC Farmers' Market Nutrition Program	\$ 125,000	2014	Low
<b>Department of Justice</b>				
16.527	Supervised Visitation, Safe Havens for Children	\$ 400,000	2017 SD	High
16.606	State Criminal Alien Assistance Program	\$ 771,000	2016	Low
<b>Environmental Protection Agency</b>				
66.001	Air Pollution Control Program Support	\$ 200,000	2017	Low
66.034	Surveys, Studies, Research, Investigations, Demonstrations, and Special Purpose Activities Relating to the Clean Air Act	\$ 50,000	2017	High
66.039	National Clean Diesel Emissions Reduction Program	\$ 800,000	2017 SD	Moderate
<b>Department of Health and Human Services</b>				
93.052	National Family Caregiver Support, Title III, Part E	\$ 1,500,000	2015	Low
93.069	Public Health Emergency Preparedness	\$ 600,000	2017 MW	Moderate
93.217	Family Planning Services	\$ 250,000	2017 MW	Low
93.243	Substance Abuse and Mental Health Services Projects of Regional and National Significance	\$ 150,000	2017	High
93.283	Centers for Disease Control and Prevention Investigations and Technical Assistance	\$ 100,000	2017	Low
93.556	Promoting Safe and Stable Families	\$ 500,000	2014	High
93.563	Child Support Enforcement	\$ 25,000	2017 SD	Moderate

**2018 Summary of programs by CDFA number (continued)**

CFDA	Program title	Funds expenditure	Last year audited	Inherent risk assessment
93.566	Refugee and Entrant Assistance State Administered Programs	\$ 500,000	2017	Low
93.568	Low-Income Home Energy Assistance	\$ 250,000	2016	Low
93.667	Social Services Block Grant	\$ 1,750,000	2017	Low
93.767	Children's Health Insurance Program	\$ 650,000	2017 MW	High
93.914	HIV Emergency Relief Project Grants	\$ 1,250,000	2016	Low
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	\$ 1,000,000	2015	Moderate
93.943	Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	\$ 450,000	2016	Low
93.959	Block Grants for Prevention and Treatment of Substance Abuse	\$ 50,000	2013	Low
93.991	Preventive Health and Health Services Block Grant	\$ 10,000	2015	High
93.994	Maternal and Child Health Services Block Grant to the States	\$ 500,000	2016 SD	Moderate
		<u>\$ 13,381,000</u>		

**Notes:**

All had unmodified opinions on programs.

Material weaknesses were found in programs 93.069, 93.217, and 93.767.

Significant deficiencies were found in programs 16.527, 66.039, 93.563, and 93.994.

Immaterial instances of questioned costs were found in programs 10.572, 93.914, and 93.919.

No findings were found in the remainder of the programs.

No agency had indicated a program high risk.

No agency oversight occurred.

The inherent risk assessment is the assessment you would determine today IF you did an assessment. Not all items may require an assessment.

NFP Entity does not meet the criteria as a low-risk auditee. In preparing for the audit, answer the following questions:



6. Assuming the risk assessment is performed beginning at the top of the Catalog of Federal Domestic Assistance listing of programs, which type B programs would you considered high risk (and why)?

7. How many type B programs did you risk assess?

8. Which programs would you audit as major programs?

CFDA #	Dollars expended	Type A or B?	Why selected?
		<b>Total must be equal to or greater than \$5,352,400 (40% of total expenditures)</b>	





## Chapter 2

# GASB Activities

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### **Learning objectives**

- Identify recently issued and newly effective accounting standards affecting state and local governments.
- Recognize potential issues and challenges in implementing recently issued and newly effective accounting standards applicable to state and local governments.

# Recent GASB standards

The following GASB statements issued before January 2018 are summarized in this chapter:

- Effective for periods beginning after December 15, 2016
  - GASB Statement No. 81, *Irrevocable Split-Interest Agreements*
- Effective for fiscal years beginning after June 15, 2017
  - GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*
  - GASB Statement No. 85, *Omnibus 2017*
  - GASB Statement No. 86, *Certain Debt Extinguishment Issues*
- Effective for reporting periods beginning after June 15, 2018
  - GASB Statement No. 83, *Certain Asset Retirement Obligations*
- Effective for reporting periods beginning after December 15, 2018
  - GASB Statement No. 84, *Fiduciary Activities*
- Effective for reporting periods beginning after December 15, 2019
  - GASB Statement No. 87, *Leases*

In addition to the specific standards indicated here, an appendix to this chapter discusses other GASB projects and their status.

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## Knowledge check

1. GASB Statement No. 84, *Fiduciary Activities*, is effective for which reporting periods?
  - a. Beginning after June 15, 2017.
  - b. Beginning after December 15, 2016.
  - c. Beginning after June 15, 2018.
  - d. Beginning after December 15, 2018.

# GASB Statement No. 74

Note: This standard was effective for fiscal years beginning after June 15, 2016. However, this serves as the basis for GASB Statement No. 75 and has, therefore, been retained.

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## Why was this statement issued?

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, was issued in June 2015. GASB Statement No. 74 addresses accounting and reporting for other postemployment benefits (OPEB) plans. Statement No. 74 is similar to GASB Statement No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*, in that it affects the plan and not the employer.

The objective of the statement is to provide transparency and to improve the usefulness of information available to stakeholders about postemployment benefits other than pensions included in the external financial reports of state and local governmental OPEB plans. A comprehensive review of the effectiveness of existing standards was the impetus for the statement.

GASB Statement No. 74 replaces statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement 43, and Statement No. 50, *Pension Disclosures*.

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## Who is affected by this statement?

The provisions of this statement are applicable to all state and local governmental OPEB plans.

OPEB comprises postemployment healthcare benefits including medical, dental, vision, hearing, and other health-related benefits, as well as other forms of postemployment benefits such as death benefits, life insurance, disability, and long-term care. OPEB does not include termination benefits or termination payments for sick leave.

Unlike GASB Statement No. 67 for pension plans, GASB Statement No. 74 addresses those plans administered through a trust as well as those not administered through a trust. Defined benefit and defined contribution plans that are administered through trusts must meet the following criteria:

- Contributions to the OPEB plan and earnings on those contributions are irrevocable.
- OPEB plan assets are dedicated to providing OPEB.

- OPEB plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the OPEB plan administrator. If the plan is a defined benefit OPEB plan, plan assets are also legally protected from creditors of the plan members.

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## What are the main provisions of this statement?

GASB Statement No. 74 provides that defined benefit OPEB plans that are administered through trusts must present two required financial statements—the statement of fiduciary net position and the statement of changes in fiduciary net position.

The financial statements must be prepared using the economic resources measurement focus and accrual basis of accounting. A statement of fiduciary net position includes information about assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, as applicable, as of the end of the OPEB plan's reporting period. A statement of changes in fiduciary net position includes information about the additions to, deductions from, and net increase (or decrease) in fiduciary net position for the OPEB plan's reporting period.

Assets accumulated for purposes of providing OPEB through defined benefit OPEB plans that are not administered through trusts must present any assets accumulated for OPEB purposes as assets of the employer or nonemployer contributing entity. Governments that hold assets accumulated for OPEB purposes in a fiduciary capacity should report the assets in an agency fund.

### Notes to financial statements

The statement requires that entities disclose a plan description including the name of the OPEB plan, identification of the entity that administers the OPEB plan, and identification of the OPEB plan as a single-employer, multiple-employer, or cost-sharing OPEB plan. Other requirements related to plan description include the number of participating employers and number of nonemployer contributing entities, as well as information about the OPEB plan's board and composition.

Entities should disclose the following:

- The number of plan members, separately identifying numbers of the following:
  - Inactive plan members currently receiving benefit payments
  - Inactive plan members entitled to but not yet receiving benefit payments
  - Active plan members
- If the OPEB plan is closed to new entrants, that fact should also be disclosed.
- The authority under which benefit terms are established or may be amended, the types of benefits provided through the OPEB plan, and the classes of plan members covered
- A brief description of contribution requirements

Related to OPEB plan investments, entities must disclose the following:

- Investment policies
- Identification of investments in any one organization that represent 5 percent or more of the OPEB plan's fiduciary net position
- The annual money-weighted rate of return on OPEB plan investments

Disclosures specific to single-employer and cost-sharing OPEB plans:

- The components of the liability of the employers and nonemployer contributing entities to plan members including total OPEB liability, the plan's fiduciary net position, the net OPEB liability, and the plan's fiduciary net position as a percentage of the total OPEB liability
- Significant assumptions and other inputs used to measure the total OPEB liability such as
  - Measures of the net OPEB liability calculated using
    - a healthcare cost trend rate that is 1 percentage point higher than the assumed healthcare cost trend rate and
    - a healthcare cost trend rate that is 1 percentage point lower than the assumed healthcare cost trend rate
  - The discount rate applied in the measurement of the total OPEB liability and the change in the discount rate since the OPEB plan's prior fiscal year-end, if any
  - Assumptions made about projected cash flows into and out of the OPEB plan
  - The long-term expected rate of return on OPEB plan investments and a description of how it was determined, including significant methods and assumptions used for that purpose
  - Measures of the net OPEB liability calculated using
    - a discount rate that is 1 percentage point higher than that required by paragraph 48 and
    - a discount rate that is 1 percentage point lower
- The date of the actuarial valuation or alternative measurement method calculation

Required supplementary information (RSI) for single-employer and cost-sharing OPEB plans  
(Information about cost-sharing OPEB plans should be presented for the OPEB plan as a whole):

- A 10-year schedule of changes in the net OPEB liability
  - Service cost
  - Interest on the total OPEB liability
  - Changes of benefit terms
  - Differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total OPEB liability
  - Changes of assumptions about future economic or demographic factors or of other inputs
  - Contributions from employers
  - Contributions from nonemployer contributing entities
  - The total of contributions from active plan members and inactive plan members not yet receiving benefit payments
  - OPEB plan net investment income
  - Benefit payments (including refunds of plan member contributions and amounts from employers or nonemployer contributing entities for OPEB as the benefits come due)
  - OPEB plan administrative expense
- Other individually significant and separately identified changes
- A 10-year schedule presenting the following for each year:
  - The total OPEB liability
  - The OPEB plan's fiduciary net position
  - The net OPEB liability
  - The OPEB plan's fiduciary net position as a percentage of the total OPEB liability
  - The covered-employee payroll
  - The net OPEB liability as a percentage of covered-employee payroll.

- A 10-year schedule presenting the following for each year (if an actuarially determined contribution (ADC) is calculated):
  - The ADCs of employers or nonemployer contributing entities
    - For cost-sharing OPEB plans, the statutorily or contractually required contribution of employers or nonemployer contributing entities, if different than the ADC
  - The amount of contributions recognized during the fiscal year by the OPEB plan in relation to the ADC
  - The difference between the ADC and the amount of contributions recognized
  - The covered-employee payroll
  - The amount of contributions recognized by the OPEB plan in relation to the ADC as a percentage of covered-employee payroll
- A 10-year schedule presenting for each fiscal year the annual money-weighted rate of return on OPEB plan investments

RSI for multiple-employer (agent) OPEB plans:

- A 10-year schedule presenting for each fiscal year the annual money weighted rate of return on OPEB plan investments should be presented in required supplementary information.

### Defined contribution OPEB plans that are administered through a trust

Defined contribution plans must disclose the following information:

- Identification of the plan as a defined contribution OPEB plan
- The authority under which the OPEB plan is established or may be amended
- Classes of plan members covered
- The number of plan members, participating employers, and nonemployer contributing entities

## Knowledge check

2. Which is NOT required to be disclosed by defined contribution OPEB plans?
  - a. Identification of the OPEB plan as a defined benefit OPEB plan.
  - b. The authority under which the OPEB plan is established or may be amended.
  - c. Classes of plan members covered.
  - d. The number of plan members, participating employers, and nonemployer contributing entities.

## How does this standard affect recognition and measurement?

### Total OPEB liability

The total OPEB liability is defined as the portion of the actuarial present value of projected benefit payments that is attributed to past periods of plan member service. It is based on a three-step process.

- Project
- Discount
- Attribute

The total OPEB liability should be determined by an actuarial valuation as of the OPEB plan's most recent fiscal year-end. As entities are permitted to perform biennial valuations, if the last valuation is older than the most recent fiscal year end, the entity must use update procedures to roll forward to the OPEB plan's most recent fiscal year-end. An actuarial valuation can be performed no earlier than 24 months before the OPEB plan's most recent fiscal year-end.

If update procedures are used and significant changes occur between the actuarial valuation date and the OPEB plan's fiscal year-end, professional judgment should be used to determine the extent of procedures needed to roll forward the measurement from the actuarial valuation to the OPEB plan's fiscal year-end. Often a new actuarial valuation is needed.

### **Step 1—Projection of benefit payments**

Actuaries will project benefit payments to be provided to current active and inactive plan members in accordance with the benefit terms and any additional legal agreements to provide benefits that are in force at the OPEB plan's fiscal year-end. Projected benefit payments should include the effects of automatic benefit changes, including automatic cost of living adjustments (COLAs) and projected ad hoc benefit changes (including ad hoc COLAs), to the extent that they are considered to be substantively automatic. Projected benefit payments should be based on claims costs, or age adjusted premiums that approximate claims costs.

### **Step 2—Discount**

The discount rate should be the single rate that reflects the following:

- The long-term expected rate of return on OPEB plan investments that are expected to be used to finance the payment of benefits, to the extent that the plan's fiduciary net position is projected to be sufficient to make projected benefit payments and plan assets are expected to be invested using a strategy to achieve that return.
- A yield or index rate for 20-year, tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher to the extent that the conditions in the bullet above are not met.

### **Step 3—Attribution of the actuarial present value of projected benefit payments to periods**

The entry age actuarial cost method should be used to attribute the actuarial present value of projected benefit payments of each plan member to periods. Attribution should be made on an individual plan-member-by-plan-member basis. Each plan member's service costs should be level as a percentage of that member's projected pay. The attribution period begins in the first period in which the member provides service under the benefit terms (notwithstanding vesting or other similar terms). The service costs should be attributed through all assumed ages of exit from active service.

### **Alternative measurement method**

If an entity has fewer than 100 plan members (active and inactive), in place of an actuarial valuation, the total OPEB liability may be measured using an alternative measurement method. This method uses an approach that includes the same broad measurement steps as an actuarial valuation (project, discount, and attribute). However, it allows for simplified assumptions so that the method potentially could be applied by nonspecialists.

### **Measurement of the Net OPEB liability**

The net OPEB liability is measured as the total OPEB liability described already less the OPEB plan's fiduciary net position as presented in the statement of fiduciary net position. The net OPEB liability should be measured as of the OPEB plan's most recent fiscal year-end.

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## **When is this statement effective?**

Provisions of GASB Statement No. 74 are effective for fiscal years beginning after June 15, 2016.

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## **Knowledge check**

3. When projecting OPEB costs, which one should NOT be projected?
  - a. The effects of automatic postemployment benefit changes.
  - b. Automatic COLAs.
  - c. Ad hoc postemployment benefit changes that are not substantively automatic.
  - d. Projected benefit payments.



# GASB Statement No. 75

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## Why was this statement issued?

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, issued in June 2015, revised guidance for the financial reports of Other Post Employment Benefit (OPEB) plans. Although GASB Statement No. 74 replaced the requirements of GASB Statement No. 43 relating to reporting by OPEB plans, Statement No. 75 is necessary to reflect those changes in the financial statements of the sponsoring or participating employer.

In other words, Statement No. 75 is the companion statement to GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. Additionally, GASB Statement No. 75 enhances accountability and transparency through new and revised note disclosures and required supplementary information (RSI).

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## Who is affected by this statement?

OPEB includes postemployment healthcare benefits including medical, dental, vision, hearing, and other health-related benefits as well as other forms of postemployment benefits such as death benefits, life insurance, disability, and long-term care. OPEB does not include termination benefits or termination payments for sick leave.

GASB Statement No. 75 has a significant effect on state and local governments that sponsor post-employment plans that are administered through a trust as well as those that are not administered through a trust. For the first time, these governments will be required to recognize their long-term obligation for OPEB benefits as a liability. In addition, GASB Statement No. 75 will require state and local governments to more comprehensively and comparably measure the annual costs of OPEB benefits. As measured under this new statement, OPEB expense will likely exceed OPEB expense calculated under the old requirements of GASB Statement No. 45. For some governments, the increase in OPEB expense may be significant.

### Cost-sharing employers

This statement has a significant effect on state and local governments who participate in a multiple-employer cost-sharing plans sponsored by another government. Prior to the issuance of GASB Statement No. 75, governments participating in these types of OPEB plans provided very limited disclosures about such plans.

Also, measuring the OPEB expense and any related obligations was previously relatively straightforward and required little effort on the part of the participating government. Now, many of the requirements of

GASB Statement No. 75 will affect cost-sharing employers as well as governments sponsoring single-employer defined benefit plans.

### Special funding situations

Governments that participate in special funding situations<sup>1</sup> are also affected by the requirements of GASB Statement No. 75. Both the employer having the OPEB plan and the nonemployer entity legally required to contribute to it will recognize expenses, liabilities, and deferred inflow or outflow of resources under the requirements of Statement No. 75.

### Defined contribution OPEB Plans

GASB Statement No. 75 will also affect state and local governments providing defined contribution OPEB plans. Measurement of OPEB expense and OPEB expenditures is revised with this statement as well as any related OPEB liability. Changes to required footnote disclosures relating to these plans also may be required under GASB Statement No. 75.

#### Key point



The requirements of GASB Statement No. 75 relating to OPEB expense and the total and net OPEB liabilities will primarily affect financial statements prepared using the economic resources measurement focus and accrual basis of accounting.

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## What are the main provisions of this statement?


GASB Statement No. 75 addresses accounting and financial reporting for OPEB that are provided to employees of state and local governmental employers administered through a trust (providing the plan has certain characteristics as delineated in both GASB Statement Nos. 74 and 75). GASB Statement No. 75 also addresses accounting and financial reporting for OPEB that are NOT administered through a trust. This statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expenses and or expenditures.

In addition, GASB Statement No. 75 details the recognition and disclosure requirements for employers with liabilities (payables) to a defined benefit OPEB plan and for employers whose employees are provided with defined contribution OPEB. The statement also addresses circumstances for a

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<sup>1</sup> Special funding situations are defined as circumstances in which a nonemployer entity is legally responsible for making contributions directly to an OPEB plan that is used to provide OPEB to employees of another entity or entities if one of two specific circumstances exists. If the amount of contributions for which the nonemployer entity is legally responsible is not dependent upon one or more events unrelated to pensions, a special funding arrangement exists. A special funding arrangement also exists if the nonemployer entity is the only entity with a legal obligation to make contributions directly to a pension plan.

nonemployer entity that has a legal requirement to make contributions directly to an OPEB plan (defined as a special funding situation in the statement).

Key point	
	<p>When a plan stand-alone financial report is prepared in accordance with the requirements of GASB Statement No. 74, the sponsoring government is not required to include the required information identified in the detailed disclosure and required supplementary information requirements of GASB Statement No. 75 in the government's financial report.</p> <p>However, if the plan does not prepare a stand-alone financial report, GASB Statement No. 75 requires the government plan sponsor to include basically the same information required in stand-alone reports in its financial reports.</p>

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## How does this statement affect defined benefit plans?

Like GASB Statement No. 74, this statement identifies methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. In addition, GASB Statement No. 75 requires new or expanded note disclosures as well as additional required supplementary information.

Measurement of the total and net OPEB liabilities required to be recognized under GASB Statement No. 75 is the same as that defined in GASB Statement No. 74. Under GASB Statement No. 75, the actuarial valuation of the total OPEB liability is required to be performed at least every two years, with more frequent valuations encouraged. For the sponsoring employer, GASB Statement No. 75 requires the total OPEB liability to be determined using either of the following methods:

- An actuarial valuation as of the date of the employer's fiscal year end
- Roll-forward procedures from the date of the actuarial valuation to the date of the employer's fiscal year-end. This update should be made using an actuarial valuation as of a date that is no more than 30 months and one day earlier than the employer's most recent fiscal year-end.

## Key point



Some local governments that participate in a state sponsored cost-sharing plan may have a different fiscal year than that of the state. This will likely need to be considered when preparing the local government's external financial statements.

For example, a city with a year end of December 31, 2018, may use roll-forward procedures to update the state's actuarial valuation performed as of June 30, 2016. There are 30 months and one day between the date of the state's actuarial valuation and the city's fiscal year-end, which is the maximum amount of time that is permitted if roll-forward procedures are used by the sponsoring and participating government.

### Single and agent employers

If a defined benefit OPEB plan is used to provide OPEB to the employees of only one employer, the OPEB plan should be classified for financial reporting purposes as a single-employer defined benefit OPEB plan. In a multiple-employer defined benefit OPEB plan that is administered through a trust, if the assets of the OPEB plan are pooled for investment purposes but separate accounts are maintained for each individual employer so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees, the OPEB plan should be classified as an agent multiple-employer defined benefit OPEB plan.

When changes occur in the net OPEB liability, GASB Statement No. 75 requires that these changes in the *total OPEB liability* be included in OPEB expense as follows.

In the period the change occurs include the following:

- Current-period service cost
- Interest on the total OPEB liability
- Changes of benefit terms are required to be included in OPEB expense immediately
- Projected earnings on the OPEB plan's investments

Over a closed period equal to the average of the expected remaining service lives of all employees (active and inactive) that are provided with benefits through the OPEB plan beginning with the current period, include the following:

- Changes in economic and demographic assumptions or in other inputs
- Differences between expected and actual experience

Differences between the projected earnings on OPEB plan investments and actual experience will be included in OPEB expense over a closed period of five years, beginning with the current period.

Certain amounts relating to OPEB expense and the net or total OPEB liability are required to be reported as deferred outflows or deferred inflows of resources. These items include the following:

- Changes in the net OPEB liability not included in OPEB expense
- Employer contributions subsequent to the measurement date of the net OPEB liability

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## Knowledge check

4. What change in total OPEB liability is NOT included in OPEB expense in the current period?
- a. Current period service cost.
  - b. Interest on the total OPEB liability.
  - c. Projected earnings on plan investments.
  - d. Actual earnings on plan investments.

### Cost-sharing employers<sup>2</sup>—No special funding situations

The requirements discussed previously that relate to single and agent employers are also required for the plans of cost-sharing employers but in a somewhat different manner. A cost-sharing plan has OPEB obligations to employees of more than one government though the plan assets are pooled and can be used to pay benefits to employees of any participating employer.

A cost-sharing employer is required to recognize its proportionate share of the following in its financial statements prepared using the economic resources measurement focus and accrual basis of accounting:

- Collective net OPEB liability
- Collective OPEB expense
- Collective deferred outflows of resources and deferred inflows of resources related to OPEB

Determining a cost-sharing employer's proportionate share may be problematic for governments that participate in a cost-sharing plan. Statement No. 75 requires that the employer's proportion be determined on a basis that is consistent with the manner in which contributions are made to the OPEB plan. If there are separate rates related to separate portions of the collective net OPEB liability, these should be considered in determining the employer's proportionate share.

### Key point



Although not required, GASB encourages cost-sharing employers to use their projected long-term contribution effort compared to the total projected long-term contribution effort of all participating employers as the basis for determining their proportionate share. However, this data may not be readily available to many governments.

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<sup>2</sup> Accounting and reporting for OPEB by cost-sharing employers depends on whether a special funding situation exists. Special funding situations are discussed in the next section.

GASB Statement No. 75 requires cost-sharing employers to recognize the following in OPEB expense over a closed period equal to the average of the expected remaining service lives of all employees (active and inactive) that are provided with benefits through the OPEB plan:

- Change in the employer's portion of the collective net OPEB liability
- Difference (during the measurement period) between the employer's contributions and its proportionate share of the total of contributions from all participating employers that are included in the collective net OPEB liability

The following amounts are required to be reported as deferred outflows of resources or deferred inflows of resources:

- Portions of the effects noted previously not included in OPEB expense
- Employer contributions subsequent to the measurement date of the net OPEB liability

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## How does this statement affect special funding situations?

### Governmental nonemployer contributing entities

Under the requirements of GASB Statement No. 75, a nonemployer contributing government accounts for and reports amounts related to the special funding arrangement similar to that required of cost-sharing employers. However, special funding situations may be present in single- and agent-defined benefit plans as well as in defined contribution plans.

Regardless of the type of plan, GASB Statement No. 75 requires the nonemployer contributing government to measure and recognize its proportionate share of the following:

- Collective OPEB expense
  - Classify expense in the same manner as it classifies similar grants to other entities
- Collective net OPEB liability
- Collective deferred outflows of resources and collective deferred inflows of resources related to OPEB

GASB 75 includes the following disclosures and RSI

- The level of detail of related footnote disclosures depends on the proportion of the collective net OPEB liability recognized by the nonemployer government
- The level of information of the 10-year schedules of RSI depends on the proportion of the collective net OPEB liability recognized by the nonemployer government

### Employers having special funding situations

Governmental employers that receive funds under a special funding situation for defined benefit OPEB may be significantly affected by the requirements of GASB Statement No. 75. Under this statement, the government receiving contributions under a special funding situation for a defined benefit OPEB is required to recognize, adjusted for the involvement of nonemployer contributing entities, the following:

- Proportionate share of the collective OPEB liability
- Additional expense and revenue for the OPEB support of the nonemployer contributing entity
- Deferred outflows of resources and deferred inflows of resources related to OPEB

- Related footnote disclosures
- 10-year schedules of RSI

### Key point



There are three different dates that employers must keep track of:

- Employer's fiscal year-end
- Actuarial valuation date (Total Liability)
  - As of date no more than 30 months (+one day) prior to employer's fiscal year-end
  - Actuarial valuations at least every two years (more frequent valuations encouraged)
- Measurement date (Net Liability)
  - No earlier than end of employer's prior fiscal year
  - Both components (Total Liability and Plan's Fiduciary Net Position) must be as of the same date
  - If not the actuarial valuation date, total pension liability "rolled forward" to measurement date

## How does this statement affect defined contribution plans?

An employer whose employees are provided with defined contribution OPEB is required to recognize OPEB expense and OPEB liabilities relating to defined contribution plans as follows:

- OPEB expense and OPEB liability (economic resources statements)
  - OPEB expense equal to the amount of contributions or credits to employee accounts that are defined by the benefit terms as attributable to employees' services in the period. Contributions and credits are to be net of forfeited amounts that are removed from employee accounts. Amounts reallocated to the accounts of other employees are not considered forfeited amounts for this purpose.
  - Change in OPEB liability equal to the difference between amounts recognized in OPEB expense and amounts paid by the employer to the plan.
- OPEB expenditures and OPEB liability (current financial resources statements)
  - OPEB expenditures are the total of amounts paid by the employer to the plan and the change between the beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources.
  - A liability for defined contribution plans is recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources.

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## How does this statement affect defined benefit OPEB that is provided through OPEB plans that are not administered through trusts?

### Insured benefits

In this scenario, defined benefit OPEB is provided through an arrangement where governments pay premiums to an insurance company while employees are in active service and the insurance company unconditionally undertakes an obligation to pay the OPEB of those employees. Employers would therefore recognize OPEB expense or expenditures equal to the amount of premiums or other payments required in accordance with their agreement with the insurance company. Governments should disclose a brief description of the benefits provided through the arrangement.

### Other than insured benefits

The approach to the measurement of OPEB liabilities, OPEB expense, and deferred outflows of resources and deferred inflows of resources related to OPEB are typically the same as for those administered through trusts. In addition, similar note disclosures and required supplementary information are required to be presented. The major difference is that employers would recognize the total OPEB liability as opposed to a net OPEB liability. That is because any amounts set aside are reflected as general assets of the employer or nonemployer contributing entity. In addition, when discounting the projected amounts, governments would be required to use the 20-year tax-exempt bond rate instead of a blended rate.

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## How does this statement affect financial reporting?

### Notes to the financial statements

GASB Statement No. 75 requires disclosure of the following in the notes to financial statements when

- the total amounts (aggregate for all OPEB) are not otherwise identifiable from the information in the financial statements for:
  - OPEB assets and liabilities,
  - deferred outflows of resources and deferred inflows of resources related to OPEB, and
  - OPEB expense and or expenditures for the period associated with net OPEB liabilities.
- the OPEB plan issues a stand-alone financial report (or the plan is included in the report of a public employee retirement system or another government) that is available to the public. If there is such a report, information on how to obtain the report should also be included.

Information in the notes should be disclosed for benefits provided through each single-employer or agent OPEB plan in which the employer participates. Disclosures common to more than one OPEB plan should be combined to avoid unnecessary duplication.

In some cases, OPEB plans administered through a trust prepare separate stand-alone financial reports for OPEB plans that are included in the financial report of a government employer. To the extent similar



information is required by this statement and GASB Statement No. 75, the government employer should present the disclosures in a manner that avoids unnecessary duplication.

This section discusses only the disclosures required by GASB Statement No. 75 that are incremental to those required in the stand-alone statements of an OPEB plan by GASB Statement No. 74. Please see GASB Statement No. 74 for more information relating to note disclosures.

Primarily, GASB Statement No. 75 requires additional disclosures for cost-sharing employers that are not found in GASB Statement No. 74. The following additional disclosures are required of all cost-sharing employers under GASB Statement No. 75:

- Information about the employer's proportionate share of the collective net OPEB liability. All of the components required to be disclosed are the same as those delineated in GASB Statement No. 74 and include the following:
  - Assumptions and other inputs used to measure total OPEB liability
  - Information about the discount rate
- The OPEB plan's fiduciary net position similar to that required in GASB Statement No. 74.
  - These disclosures need not be included if information about how to obtain a financial report that includes them is available on the internet (as a stand-alone financial report or included as a fiduciary fund in the financial report of another government). In such cases, the government employer
    - May reference the other report for these disclosures.
    - Should disclose that the OPEB plan's fiduciary net position has been determined on the same basis used by the OPEB plan, and include a brief description of the following:
      - OPEB plan's basis of accounting, including the policies with respect to benefit payments, refunds of employee contributions, and the valuation of OPEB plan investments.
      - Significant changes that occurred indicating the disclosures included in the OPEB plan's financial report generally do not reflect the facts and circumstances at the measurement date.
      - Information about the substance and magnitude of any significant changes.
- Other information that should be included is as follows:
  - Amount of the employer's proportionate share of the collective net OPEB liability
  - For special funding situations, include the following:
    - Portion of the nonemployer contributing entities' total proportionate amount of the collective net OPEB liability associated with the employer
    - Total amount of the employer's proportionate share of the collective net OPEB liability
    - Employer's percentage of the collective net OPEB liability, the basis on which it is determined, and the change in its proportion since the prior measurement date
    - Measurement date of the collective net OPEB liability, the date of the actuarial valuation on which the total OPEB liability is based, and, if applicable, the fact that update procedures were used to roll forward the total

## Required supplementary information

This section discusses only the supplementary information required by GASB Statement No. 75 that is incremental to that required in the stand-alone statements of an OPEB plan by GASB Statement No. 74. Please see GASB Statement No. 74, for more information related to required supplementary information in the stand-alone statements of an OPEB plan.

The required supplementary information should be presented in 10-year schedules separately for each cost-sharing OPEB plan through which OPEB are provided. The information should be determined as of the measurement date of the collective net OPEB liability or the employer's most recent fiscal year-end, as applicable.

Required supplementary information presented in a 10-year schedule for cost-sharing OPEB plans includes the following:

- If the employer does not have a special funding situation, include the following:
  - Employer's proportion (percentage) of the collective net OPEB liability
  - Employer's proportionate share (amount) of the collective net OPEB liability
  - Employer's covered-employee payroll
  - Employer's proportionate share (amount) of the collective net OPEB liability as a percentage of the employer's covered-employee payroll
  - OPEB plan's fiduciary net position as a percentage of the total OPEB liability
- If the employer has a special funding situation, include the following:
  - Employer's proportion (percentage) of the collective net OPEB liability
  - Employer's proportionate share (amount) of the collective net OPEB liability
  - Portion of the nonemployer contributing entities' total proportionate share (amount) of the collective net OPEB liability that is associated with the employer
  - Total of the employer's proportionate share (amount) of the collective net OPEB liability and the portion of the nonemployer contributing entities' total proportionate share (amount) of the collective net OPEB liability that is associated with the employer
  - Employer's covered-employee payroll
  - Employer's proportionate share (amount) of the collective net OPEB liability as a percentage of the employer's covered-employee payroll
  - OPEB plan's fiduciary net position as a percentage of the total OPEB liability

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## Knowledge check

5. Which is NOT a disclosure required of cost-sharing employers under GASB Statement No. 75?
- a. OPEB plan's fiduciary net position.
  - b. Employer's proportionate share of the collective net OPEB liability.
  - c. Measurement date of the collective net OPEB liability.
  - d. Measurement date of the collective OPEB expense.

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## When is this statement effective?

Provisions of GASB Statement No. 75 are effective for fiscal years beginning after June 15, 2017.

In the first period that this statement is applied, changes made to comply should be treated as an adjustment of prior periods and financial statements presented for the periods affected should be restated. It may not be practical for some governments to determine the amounts of all deferred inflows of resources and deferred outflows of resources related to OPEB at the beginning of the implementation period. In such circumstances, these deferred amounts should not be reported. However, deferred inflows of resources and deferred outflows of resources related to contributions made after the measurement date are to be reported.

If restatement is not practical, the cumulative effect of applying this statement, if any, should be reported as a restatement of beginning net position for the earliest period restated. The financial statements should disclose the nature of any restatement and its effect, along with the reasons for not restating prior periods.

The information for all periods for the 10-year schedules may not be available initially to be presented as RSI. In these cases, during the transition period, that information should be presented for as many years as are available. The schedules should not include information that is not measured in accordance with the requirements of this statement.

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## Implementation issues

State and local governments sponsoring defined benefit OPEB plans that are administered through trusts have a significant number of issues to address. Early identification of the issues and a plan to resolve them in a timely manner is the first step to a smooth implementation of GASB Statement No. 75.

Governments will need to determine early in the implementation process the human, capital, and financial resources needed to address the implementation issues. Because it is likely that additional staff, consultant, and actuarial costs will be incurred, inclusion of adequate amounts in the annual budgets of the governments and the plans will be critical to effectively addressing the implementation issues.

### General issues

A significant amount of coordination between plan administrators and the governments they serve will be necessary in the year GASB Statement No. 75 is implemented and every year thereafter.

Government employers that have the same year-end as the plan issuing stand-alone financial reports will need to determine if the plan will issue its report prior to when the government employer plans to issue their financial report. For example, if a government employer plans to issue its financial report for the year ended June 30, 2018, on December 1, 2018, it will need to ensure the plan's stand-alone

financial report is actually available at that time and in the manner referenced<sup>3</sup> in the notes of the government employer.

### **Comparison to pensions**

Although many governments have recently completed the process of adopting Statement Nos. 67, 68, and 73 for pensions, it is important to note that the implementation for OPEB may be different. For example, in many states, pensions are administered through a statewide cost-sharing plan. Many of those states, however, do not have a statewide OPEB plan. Therefore, the work performed by the state in preparation for pensions will instead be performed by the local governments.

### **Special funding situations**

Governments involved in OPEB plans encompassing special funding situations may need to coordinate with each other to obtain the information they need to implement the requirements of GASB Statement No. 75. Coordination may reduce duplication of effort for either the nonemployer providing contributions or the employer receiving the contributions.

Situations may also exist in which special funding situations have been previously identified as such by either the nonemployer contributing government or the cost-sharing employer. In such cases, a prior period adjustment may be necessary before the restatements that are required by GASB Statement No. 75 at transition can be determined.

### **Cost-sharing employers**

For cost-sharing employers there are significant implementation issues that governments sponsoring single or agent employer plans do not face. Cost-sharing employers do not typically have direct access to the plan sponsor or administrator. Consequently, they are not in a position to provide input into the assumption selection process nor will they be able to assist in determining the timing of the information required to implement this statement.

The first area of concern for cost-sharing employers is obtaining the information they need to measure their OPEB liabilities and OPEB expense or expenditures. It may be a challenge for these governments to obtain the information they need to successfully comply with GASB Statement No. 75 in a timely manner. The later they receive the information needed to meet the requirements of this statement, the less time they will have to communicate the effect of the statement to their significant stakeholders.

Determining how to measure the proportionate share of the various required amounts is likely the second area of concern for cost-sharing employers. Fortunately, a cost-sharing employer is able to address this issue without necessarily needing information from the cost-sharing plan sponsor. Unfortunately, information about all employers and all nonemployer contributing entities will be necessary to actually determine the proportional percentage to use in measuring the various OPEB amounts.

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<sup>3</sup> If the government employer references the website for the plan's financial report in the notes to its financial statements, the government employer will need to ensure the plan's report has actually been posted to the referenced website. There is often a delay in the issuance of a plan's report and the posting of the report to the applicable website.

# GASB Statement No. 81

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## Why was this statement issued?

In March 2016, GASB issued GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, to improve accounting and financial reporting by establishing recognition and measurement requirements for irrevocable split-interest agreements.

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## Who is affected by this statement?

This statement applies to state and local governments that are a party to an irrevocable split-interest agreement. Irrevocable split-interest agreements are a specific type of giving arrangement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements have been popular with not-for-profit entities and there has been a recent increase in governmental entities being named beneficiaries to these agreements. Examples of irrevocable split-interest agreements include charitable lead trusts, charitable remainder trusts, and life interests in real estate.

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## What are the main provisions of this statement?

Donors create irrevocable split-interest agreements by creating trusts that are irrevocable and the resources are transferred to an intermediary. The intermediary administers the resources for the unconditional benefit of a government and at least one other beneficiary.

An irrevocable split-interest agreement can terminate after a certain period of time, upon a life-contingent term (that is, the death of either the donor) or a combination of both.

### **A government is the intermediary and is the remainder interest beneficiary**

If a government is both the intermediary and the remainder interest beneficiary, the government should recognize the following:

- Assets for resources received or receivable
- A liability for the lead interest that is assigned to other beneficiaries
- A deferred inflow of resources for the government's unconditional remainder interest

Although the government is acting as the intermediary, any changes in the value of the asset or resulting from interest or dividends should be recognized as an increase or a decrease in the related deferred inflow of resources.

The liability is recognized based on the settlement amounts (that is, the stream of payments that is expected to be provided to other beneficiaries).

At the termination of the irrevocable split-interest agreement, the amount reported as a deferred inflow of resources should be recognized as revenue. The remaining liability should be recognized as a gain.

### **A government is the intermediary and is the lead interest beneficiary**

If a government is both the intermediary and the lead interest beneficiary, the government should recognize the following:

- Assets for resources received or receivable
- A deferred inflow of resources for the government's unconditional lead interest
- A liability for the remainder interest that is assigned to other beneficiaries

Changes in assets should be recognized as an increase or a decrease in the related liability. The deferred inflow of resources should be measured based on a settlement amount (the stream of payments that is expected to be provided to the government beneficiary). At termination, the assets are disbursed to other beneficiaries and the liability and any remaining deferred inflow of resources related to the agreement should be eliminated.

### **A third party is the intermediary**

If the government is not the intermediary, then the government has a beneficial interest in the trust. A beneficial interest is the right to a portion of the benefits from donated resources. The government should recognize an asset and a deferred inflow of resources when the government is notified of the agreement and has sufficient information to measure the beneficial interest.

Assets should be recognized for beneficial interests that meet all of the following:

- The government is named as beneficiary in the legal donation document.
- The donation agreement is irrevocable.
- The donor has not granted the power to the intermediary to redirect the resources or change the beneficiary.
- The donor does not control the intermediary, such that the actions of the intermediary are not influenced by the donor beyond the specified stipulations of the agreement.
- The irrevocable split-interest agreement establishes a legally enforceable right for the government's benefit (an unconditional beneficial interest).

The beneficial interest asset should be measured at fair value and updated each financial reporting date. Changes in the fair value should be recognized as an increase or a decrease in the related deferred inflow of resources.

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## **When is this statement effective?**

The provisions of the statement are effective for periods beginning after December 15, 2016.

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## Knowledge check

6. If the government is not the intermediary in a split-interest agreement, then what should the government recognize?
  - a. A beneficial interest in trust.
  - b. A deferred outflow of resources.
  - c. A liability for the lead interest.
  - d. A liability for the remainder interest.

# GASB Statement No. 83

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## Why was this statement issued?

In November 2016, GASB issued GASB Statement No. 83, *Certain Asset Retirement Obligations*, to provide financial statement users with information about asset retirement obligations (AROs) that were not addressed in previous GASB standards.

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## Who is affected by this statement?

GASB Statement No. 83 applies to all state and local governments. An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. AROs result from the normal operations of tangible capital assets and include legally enforceable liabilities associated with the following:

- Retirement of a tangible capital asset
- Disposal of a replaced part that is a component of a tangible capital asset
- Environmental remediation

This statement does not apply to the following:

- Obligations that arise solely from a plan to sell or otherwise dispose of a tangible capital asset
  - Obligations associated with the preparation of a tangible capital asset for an alternative use
  - Obligations for pollution remediation, such as asbestos removal, that result from the other-than-normal operation of a tangible capital asset
  - Obligations associated with maintenance, rather than retirement, of a tangible capital asset
  - The cost of a replacement part that is a component of a tangible capital asset
  - Landfill closure and postclosure care obligations, including those not covered by GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*
  - Conditional obligations to perform asset retirement activities
- 

## What are the main provisions of this statement?

A government should recognize an ARO when the liability is incurred and reasonably estimable. A liability is incurred by the occurrence of either an external obligating event or an internal obligating event resulting from normal operations. When an ARO is recognized, a government also should recognize a corresponding deferred outflow of resources measured at the amount of the liability. If a tangible capital asset is permanently abandoned before it is placed into operation, report an outflow of resources instead of a deferred outflow of resources when an ARO is recognized.

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An external obligating event is one of the following:

- Approval of federal, state, or local laws or regulations
- Creation of a legally binding contract
- Issuance of a court judgment

An internal obligating event is one of the following:

- For contamination-related AROs, the event is the occurrence of contamination.
- For noncontamination-related AROs
  - if the pattern of incurrence of the liability is based on the use of the tangible capital asset, the event is placing that capital asset into operation and consuming a portion of the usable capacity by the normal operations of that capital asset.
  - if the pattern of incurrence of the liability is not based on the use of the tangible capital asset, the event is placing that capital asset into operation.
  - if the tangible capital asset is permanently abandoned before it is placed into operation, the event is the permanent abandonment itself.
- For AROs related to acquired tangible capital assets, the event is the acquisition of the tangible capital asset.

### **Initial measurement of an ARO**

The measurement of an ARO should be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should be determined using all available evidence using a probably weighted average. There is an exception for minority owners (less than 50 percent ownership). If the majority share is owned by nongovernmental entity, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner following the guidance of another recognized accounting standards setter.

### **Subsequent measurement and recognition of an ARO**

A government should adjust the current value of the ARO at least annually for the effects of general inflation or deflation. At least annually, a government also should evaluate whether a significant increase or decrease in the estimated outlays has occurred. A government should remeasure the ARO only when the results of the evaluation indicate there is a significant change in the estimated outlays.

Factors to consider including are as follows:

- Price changes due to factors other than general inflation or deflation for specific components of the estimated outlays
- Changes in technology
- Changes in legal or regulatory requirements
- Changes in the types of equipment, facilities, or services that will be used to meet the obligations to retire the tangible capital asset
- Changes in the estimated outlays should be recognized as an increase or decrease in the carrying amount of the ARO

The government should also adjust the corresponding deferred outflow of resources.

## Subsequent measurement and recognition of a deferred outflow of resources

A government should recognize a reduction of the deferred outflow of resources as an outflow of resources in a systematic and rational manner over a period of time similar to depreciation.

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## When is this statement effective?

The provisions of the statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

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## Knowledge check

7. What should the initial measurement of an ARO be based on?
  - a. The highest estimate of the current value of outlays expected to be incurred.
  - b. The lowest estimate of the current value of outlays expected to be incurred.
  - c. The best estimate of the current value of outlays expected to be incurred.
  - d. The weighted average of the current value of outlays expected to be incurred.

# GASB Statement No. 84

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## Why was this statement issued?

In January 2017, GASB issued GASB Statement No. 84, *Fiduciary Activities*, to enhance the consistency and comparability of fiduciary activity reporting by state and local governments. This statement provides guidance regarding what constitutes fiduciary activities for accounting and reporting purposes and how they should be reported by establishing criteria for identifying and reporting fiduciary activities of all state and local governments.

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## Who is affected by this statement?

A primary government or its component units may be engaged in fiduciary activities.

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## What are the main provisions of this statement?

### Component units

An organization that meets the component unit criteria is a fiduciary activity if it is one of the following:

- A pension plan that is administered through a trust
- An OPEB plan that is administered through a trust
- A circumstance in which assets from entities that are not part of the reporting entity are accumulated for pensions (see paragraph 116 of GASB Statement No. 73)
- A circumstance in which assets from entities that are not part of the reporting entity are accumulated for OPEB (see paragraph 59 of GASB Statement No. 74)

A component unit that is not a pension or OPEB plan is a fiduciary activity if the assets associated with the activity have one or more of the following characteristics:

- The assets are administered through a trust where the government is not a beneficiary, dedicated to providing benefits to recipients in accordance with the benefit terms, and legally protected from the creditors of the government.
- The assets are for the benefit of individuals and the government does not have administrative involvement with the assets or direct financial involvement with the assets. The assets are not derived from the government's delivery of goods or services to those individuals.
- The assets are for the benefit of organizations or other governments that are not part of the financial reporting entity. The assets are not derived from the government's delivery of goods or services to those organizations or other governments.

Note: In determining whether a component unit is a fiduciary component unit, control of the assets of the component unit by the primary government is not a factor to be considered.

### Not a component unit

Pension and OPEB arrangements are fiduciary activities if the government controls<sup>4</sup> the assets of the arrangement.

Otherwise, the activity is a fiduciary activity if all the following criteria are met according to paragraph 11 of the statement:

- The assets associated with the activity are controlled by the government
- The assets associated with the activity are *not* derived either
  - solely from the government's own-source revenues, or
  - from government-mandated nonexchange transactions or voluntary nonexchange transactions (there is an exception for pass-through grants for which the government does not have administrative involvement or direct financial involvement).
- The assets associated with the activity have one or more of the following characteristics:
  - The assets are administered through a trust in which the government itself is not a beneficiary, dedicated to providing benefits to recipients in accordance with the benefit terms, and legally protected from the creditors of the government.
  - The assets are for the benefit of individuals and the government does not have administrative involvement with the assets or direct financial involvement with the assets. In addition, the assets are not derived from the government's delivery of goods or services to those individuals.
  - The assets are for the benefit of organizations or other governments that are not part of the financial reporting entity. In addition, the assets are not derived from the government's delivery of goods or services to those organizations or other governments.

### Reporting fiduciary activities in fiduciary funds

Governments should report fiduciary activities in the fiduciary fund financial statements of the basic financial statements.

**Pension (and other employee benefit) trust funds** are used to report fiduciary activities for the pension plans and OPEB plans that are held in a trust.<sup>5</sup>

**Investment trust funds** are used to report fiduciary activities from the external portion of investment pools and individual investment accounts that are held in a trust.

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<sup>4</sup> GASB Statement No. 84 indicates that a government controls the assets of an activity if the government holds the assets or has the ability to direct the use, exchange, or employment of the assets in a manner that provides benefits to the specified or intended recipients. Restrictions from legal or other external restraints that stipulate the assets can be used only for a specific purpose do not negate a government's control of the assets.

<sup>5</sup> The trust may be a qualifying trust as defined in GASB Statement No. 67 or No. 74 or a trust as defined in GASB Statement No. 84.

**Private-purpose trust funds** are used to report all fiduciary activities that are not required to be reported in pension or OPEB trust funds or investment trust funds and are held in a trust.

**Custodial funds** are used to report fiduciary activities that are not required to be reported in pension or OPEB trust funds, investment trust funds, or private-purpose trust funds. The external portion of investment pools that are not held in a trust should be reported in a separate external investment pool fund column, under the custodial funds classification.

When reported in the fiduciary fund financial statements of a primary government, a fiduciary component unit should include the combined information of its own component units that are fiduciary component units.

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## When is this statement effective?

The provisions of the statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

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## Knowledge check

8. Which is NOT a criterion to be a fiduciary activity (activity is not a component unit)?
- The assets associated with the activity are controlled by the government.
  - The assets associated with the activity are not derived solely from the government's own-source revenues.
  - The assets are administered through a trust in which the government itself is not a beneficiary, dedicated to providing benefits to recipients in accordance with the benefit terms, and legally protected from the creditors of the government.
  - The assets associated with the activity are not derived from government-mandated nonexchange transactions.

# GASB Statement No. 85

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## Why was this statement issued?

In March 2017, GASB issued GASB Statement No. 85, *Omnibus 2017*, to address a variety of practice issues. GASB Statement No. 85 addresses a misinterpretation regarding blending of component units. It also addressed a practice issue related to goodwill that was on the governments books prior to the issuance of GASB Statement No. 69, which was applied prospectively and did not provide guidance on what to do with existing goodwill. Finally, the standard addresses some of the implementation issues for OPEB that were addressed in prior GASB statements for pensions relating to employer pickup, multiple-employer plans, and covered payroll verses covered employee payroll.

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## Who is affected by this statement?

Because this statement is an omnibus and addresses many different topics, all governments should review the contents to determine if any of the topics will affect them.

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## What are the main provisions of this statement?

### Blending component units

The statement clarifies that the original intent was to give business-type governments the choice of either providing the blended component unit information in a separate column or consolidating the data into the single column of the primary government. It was specific to business-type governments and not applicable to all component units.

### Goodwill

GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, requires that excess consideration paid in an acquisition be reported as a deferred outflow of resources. GASB Statement No. 69 was to be applied prospectively. It requires entities to report existing goodwill as a deferred outflow of resources and to systematically amortize it. Negative goodwill should not be reported.

### Fair value measurement and application

GASB Statement No. 85 also addresses implementation issues with GASB Statement No. 72, *Fair Value Measurement and Application*, and conflicting guidance. It indicates that entities should use GASB Statement No. 72 to determine if real estate held by insurance entities should be classified either as an investment or as a capital asset and not prior real estate guidance from GASB Statement No. 62. In

addition, it also clarifies that GASB Statement No. 72 provides an alternative to measure certain money market funds at amortized cost instead of requiring amortized cost. Amortized cost is permitted but not required, ultimately not changing the provision of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

## OPEB

Finally, GASB clarified the timing of the measurement of defined benefit postemployment benefit liabilities recognized in financial statements prepared using the current financial resources measurement focus by measuring the liability as of the end of the reporting period and expenditures for the reporting period. Furthermore, it addresses on-behalf payments and payroll related matters for postemployment benefits other than pensions (OPEB) that were addressed for pensions in GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*. Finally, it also addresses the issue identified for pensions in GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, for OPEB.

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## When is this statement effective?

The provisions of the statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

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## Knowledge check

9. Which was NOT a topic addressed by the 2017 Omnibus GASB statement?
- Fair Value.
  - OPEB.
  - Leases.
  - Goodwill.

# GASB Statement No. 86

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## Why was this statement issued?

GASB Statement No. 86, *Certain Debt Extinguishment Issues*, was issued in May 2017. There was a lack of guidance regarding accounting for transactions where governments defease debt using only existing resources. Guidance existed only when there was a refunding or advanced refunding with new debt being issued.

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## Who is affected by this statement?

This statement affects governments who have in-substance defeasance of debt using only existing resources.

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## What are the main provisions of this statement?

GASB Statement No. 86 establishes essentially the same requirements as GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*. When a government places cash and other monetary assets acquired with only existing resources in an irrevocable trust to extinguish the debt it would be treated as an in-substance defeasance. When using the economic resources measurement focus, entities should recognize any difference between the reacquisition price and the net carrying amount of the debt defeased as a separately identified gain or loss. The standard also requires note disclosures regarding a general description of the transaction and the amount of debt that remains outstanding.

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## When is this statement effective?

The provisions of the statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.

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# GASB Statement No. 87

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## Why was this statement issued?

GASB originally used FASB guidance (GASB Statement No. 62) as the basis for leases. Because FASB has issued ASU 2016-02, *Leases* (Topic 842), it gave GASB the opportunity to reconsider lease accounting. Although initially a convergence project, FASB and the IASB did not ultimately converge regarding new lease standard provisions. GASB wanted to increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. They also wanted to enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. Note disclosures was another area frequently cited by users as being inadequate. GASB hoped to enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

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## Who is affected by this statement?

State and local governments that enter into lease contracts.

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## What are the main provisions of this statement?

GASB decided to establish a single model for lease accounting that is derived from the concept that leases are financings of the right to use an underlying asset. A lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources.

### Definition

- A *lease* would be defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Any contract that meets this definition would be accounted for under the leases guidance, unless specifically excluded.
  - Leases that transfer ownership or contain a bargain purchase option would be accounted for as financed purchases and would not be accounted for under the leases guidance.
- Contracts that contain both lease and service components generally would be separated so that each component is accounted for on its own. Contracts that contain leases of multiple assets should generally be accounted for as separate contracts. The contract price would be allocated to each component using a contract price for the individual components (assuming they are reasonable). If a contract price is not available, a best estimate may be used. If determining a best estimate is not practicable, multiple components in a lease contract should be accounted for as a single lease unit.

- Contracts entered into at or near the same time with the same counterparty and that meet certain criteria should be considered part of the same lease contract and should be evaluated in accordance with the guidance for contracts with multiple components.

### **Lease term**

- The lease term would be defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following, if applicable:
  - Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option
  - Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will not exercise that option.
  - Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option
  - Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option.
- Fiscal funding or cancellation clauses would be considered only for financial reporting purposes if is reasonably certain to be exercised.
- A government (lessee and lessor) would reassess the lease term only if one of the following specific circumstances occurs:
  - The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.
  - The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.
  - An event specified in the lease contract that requires an extension or termination of the lease takes place.

### **Lessee accounting**

Lessees would recognize a lease liability and an intangible lease asset at the beginning of a lease, unless it is a short-term lease or a lease that transfers ownership. The liability would be measured at the present value of certain lease payments to be made over the lease term. The lease asset would be measured at the value of the lease liability plus any prepayments and certain initial direct costs. Interest expense would be recognized on the lease liability and amortization expense on the lease asset. Disclosures would include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

### **Lessor accounting**

Lessors would recognize a lease receivable and a deferred inflow of resources at the beginning of a lease, unless it is a short-term lease, a regulated lease, a lease of assets held as investments, or a lease that transfers ownership. The receivable would be measured at the present value of certain lease payments to be received over the lease term. The deferred inflow of resources would be measured at the value of the lease receivable plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods. Interest revenue on the lease receivable would be recognized, and revenue from the deferred inflow of resources would be amortized over the term of the lease. A lessor would not derecognize the underlying asset in the lease. Disclosures would include a description of

leasing arrangements, the total amount of revenue recognized from leases, and a schedule of future lease payments to be received.

### Short-term lease exception

A *short-term lease* would be defined as a lease that, at commencement of the lease term, has a maximum possible term under the lease contract, including any options to extend (regardless of their probability of being exercised), of 12 months or less. A lessee in a short-term lease would not follow the regular accounting for leases. Instead, the lessee in a short-term lease would recognize lease payments as expenses or expenditures based primarily on the payment terms of the contract. A lessor in a short-term lease would not follow the regular accounting for leases. Instead, the lessor in a short-term lease would recognize lease payments as revenue based primarily on the terms of the contract.

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## When is this statement effective?

The provisions of the statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

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## Knowledge check

10. A government lessee currently recognizes its lease as an operating lease. What journal entry would it enter to bring the lease onto the statement of financial position?
- Debit Lease Payable.
  - Debit Deferred Inflows of Resources.
  - Debit Deferred Outflows of Resources.
  - Debit Intangible Asset.

# Recent GASB Implementation Guides

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## Implementation Guide No. 2017-1

In April 2017, GASB issued Implementation Guide No. 2017-1, *Implementation Guidance Update—2017*. The implementation guide provided new questions and answers (Q&As) regarding cash flows reporting, the financial reporting entity, pensions, certain investments and external investment pools, and tax abatement disclosures. It also amended prior Q&As related to investments, risk financing, the financial reporting entity, pensions, management's discussion and analysis, nonexchange transactions, and intangible assets. The guide was effective for reporting periods beginning after June 15, 2017.

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## Implementation Guide No. 2017-2

Also, in April 2017, GASB issued Implementation Guide No. 2017-2, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which provides guidance that clarifies, explains, or elaborates on the requirements of GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended. Most questions are effective for reporting periods beginning after December 15, 2016, with a few exceptions.

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## Implementation Guide No. 2017-3

In November 2017, GASB issued Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*. The guide provides guidance that clarifies, explains, or elaborates on the requirements of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, as amended, and GASB Statement No. 74, as amended. Most questions were effective for reporting periods beginning after June 15, 2017, with a few exceptions.

## Appendix A

# STATUS OF CURRENT GASB PROJECTS

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**This appendix is required reading for CPE credit.**



# Status of current GASB projects

As of January 2018 when this chapter was updated, GASB had a number of documents in various stages of due process. These projects are briefly discussed in the following paragraphs. The current status of these exposure documents can be found on the "Projects" page at [www.gasb.org](http://www.gasb.org).

## Exposure draft – Debt disclosures, including direct borrowing

In June 2017, GASB issued an exposure draft titled *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements— an amendment of GASB Statements No. 34 and No. 38*. Comments were due in September 2017. This exposure draft is meant to clarify which liabilities should be considered debt for disclosure purposes. It addresses direct borrowings as well as direct placements. The exposure draft would define *debt* (for disclosure purposes) as "a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of payment of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established." New disclosures were also proposed related to unused lines of credit, collateral pledged, and significant acceleration clauses. The exposure draft also confirms that the existing disclosures as well as the newly proposed disclosures would apply to direct borrowings and direct placements but would be made separately from other debt.

## Exposure draft – Equity interest ownership issues

In November 2017, GASB issued an exposure draft titled *Accounting and Financial Reporting for Majority Equity Interests— an amendment of GASB Statement No. 14*. Comments were due in January 2018. This exposure draft was intended to reduce confusion regarding what some felt was conflicting guidance. It indicates that a majority equity interest in a legally separate organization that meets the definition of an investment should be treated as an investment for reporting purposes. The general rule would be that these investments would be measured using the equity method unless it was an endowment, fiduciary fund, permanent fund, or a special-purpose government that engages only in fiduciary activities. The exceptions would be measured at fair value. If the organization does not meet the definition of an investment, it would report the organization as a component unit. The government (or fund) would report an asset using the equity method. Separately, the exposure draft also requires the use of acquisition value (as opposed to fair value) for the acquisition of a component unit when 100 percent of the entity is acquired (consistent with GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*).

## Exposure draft – Capitalization of interest costs

Also, in November 2017, GASB issued an exposure draft titled *Accounting for Interest Cost During the Period of Construction*. Comments were due in March 2018. This exposure draft would change the accounting for interest incurred during the construction period. Currently, this interest is capitalized, and many feel the cost of tracking the capitalization outweighs the benefits. In addition, different types of funds treated interest differently. The exposure draft would simplify the accounting by expensing all

interest incurred during the construction period. Governmental funds would continue to treat the interest costs as an expenditure.

You are encouraged to follow the status of these exposure drafts at [www.gasb.org](http://www.gasb.org).

### **Preliminary views—Recognition**

In June 2011, GASB issued *Preliminary Views, Conceptual Framework—Recognition*, to seek feedback on GASB's initial views on recognition criteria for the following:

- What information should be reported in the financial statements of state and local governments
- When such information should be reported

Comments on the Preliminary Views were due September 2011 and user interviews regarding the Preliminary Views were conducted in late 2011. This project was put on hold in January 2012, pending the re-examination of the financial reporting model.

This project was initially included in GASB's measurement project but was separated from that project in December 2011. Ultimately, this project will lead to a concepts statement identifying what information should be recognized in the financial statements of state and local governments and specifying when that information should be reported.

Deliberations have recommenced in conjunction with the Financial Reporting Model project discussed as follows.

You are encouraged to follow the status of this project at [www.gasb.org](http://www.gasb.org) and to respond to the exposure draft when issued.

### **Invitation to comment—Financial reporting model**

GASB began the pre-agenda research process on this project in August 2013. During the fall of 2014, an online survey was conducted, and 176 useable responses were received. Upon completion of the research, a research memorandum will be prepared for and considered by GASB. GASB issued an Invitation to Comment in December 2016. Currently, GASB expects to issue a preliminary views in mid-2018, an exposure draft in early 2020, and a Final Standard by 2022.

The objective of this pre-agenda research is to reexamine the financial reporting model, including the following statements:

- Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as well as reporting model-related pronouncements including Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*



- Statement No. 37, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments: Omnibus*
- Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences*
- Statement No. 46, *Net Assets Restricted by Enabling Legislation*
- Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*

The major provisions of these statements that will be reconsidered are those related to the following:

- Management’s discussion and analysis
- Government-wide financial statements
- Fund financial statements
- Capital asset reporting
- Budgetary comparisons
- Special purpose government reporting
- Related notes to financial statements

#### Invitation to Comment—Financial Reporting Model Improvements—Governmental Funds

An Invitation to Comment, *Financial Reporting Model Improvements—Governmental Funds*, was issued in December 2016. The Board proposed three general approaches to the recognition of elements of financial statements and presentation for governmental fund financial statements: near-term financial resources, working capital, and total financial resources.

GASB is looking for stakeholder feedback on potential improvements to the existing financial reporting model for governmental funds. These potential improvements include the following:

- Recognition approaches (measurement focus and basis of accounting)
- Format of the governmental funds statement of resource flows
- Specific terminology
- Reconciliation to the government-wide statements
- For certain recognition approaches, a statement of cash flows

You are encouraged to follow the status of this project at [www.gasb.org](http://www.gasb.org) and to respond to the exposure documents when issued.

#### Invitation to comment—Revenue and expense recognition

The objective of this project is to develop a comprehensive application model for the recognition of revenues and expenses that arise from nonexchange, exchange, and exchange-like transactions, including guidance for exchange transactions that has not been specifically addressed in the current literature. The goal is to evaluate revenue and expense recognition in the context of a conceptual framework, thereby improving user information.

This project was prompted by three factors:

- Common exchange transactions that are not specifically addressed in existing GASB literature
- Results of the Financial Accounting Foundation's (FAF) Post-Implementation Review (PIR) of GASB Statements No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* and No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues—an amendment of GASB Statement No. 33*
- Development of GASB's conceptual framework

In addition, FASB issued FASB ASC Topic 606, *Revenue from Contracts with Customers* in 2014. GASB is considering a performance obligation approach to GASB's standards similar to that proposed within Topic 606. Unlike the FASB project, GASB is considering expenses and revenues together in the same project.

This project was added to the project agenda in April 2016. As of January 2018, an invitation to comment is being considered for release. A final standard is not expected before 2023.

### Other practice issues

GASB issued an exposure draft in November 2017 related to Implementation Guides as part of the annual update.

GASB also added to its standard setting agenda a project called *Conduit Debt-Reexamination of Interpretation*. The project is going to

- address the definition of a *conduit debt obligation*,
- address the impact of commitments to cover debt service,
- discuss when a conduit debt obligation should be reported as a liability and
- establish note disclosures.

An exposure draft is expected in the mid-2018.

In January 2018, GASB added the development of Implementation Guides on *Fiduciary Activities* and *Leases* to the standard-setting agenda.

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## Pre-agenda research projects

As of the date this chapter was updated, GASB is conducting research in several areas to determine whether there is a need to establish a formal project to address the issue. The issues for which research is currently being conducted include the following:

- Going Concern Disclosures
- Cloud Computing
- Note Disclosures Reexamination
- Public-Private Partnerships

# GASB resources

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## Comprehensive implementation guide

Each year, GASB staff updates the GASB *Comprehensive Implementation Guide*. This guide not only codifies the questions and answers from the original implementation guides, but it also updates questions and answers to recognize the effects of standards that have been issued since the release dates of the individual guides and adds questions about pronouncements that are not the subject of stand-alone guides. Under the requirements of GASB Statement No. 76, all implementation guides have authoritative status (Category B GAAP) following all GASB statements (Category A). The GASB *Implementation Guide No. 2016-1*, and all other implementation guides, are available at [www.gasb.org](http://www.gasb.org).

In January 2014 GASB announced its new electronic quarterly publication, which features a combination of articles and videos focusing on what to watch with respect to upcoming proposals and standards. The publication uses plain English to “decode” what preparers, auditors, and users of governmental financial reports need to know, as well as the expected impact.

In addition, GASB discontinued the printed version of *The GASB Report* and replaced it with a new periodic electronic form focusing on technical issues and developments. Both *The GASB Report* and the electronic quarterly publication are free of charge to those registered as a GASB subscriber.



## Appendix B

# **GASB CASE STUDY**

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**This appendix is required reading for CPE credit.**



## Facts

Richmond County enters into a contract on January 1, 20X1, with a commercial entity to lease a floor of a building in the county. The lease does not transfer ownership of the building at the end of the lease. The building is expected to have a 40-year life.

The contract has an initial lease term of 10 years with the option to extend for an additional five years. Richmond County believes that the value of the property will increase over the next two decades and that the contractual terms will continue to be advantageous to the county. As such, they believe it is probable that they will exercise the option to extend. There is a \$1,000 fee to exercise the extension option.

The contract indicates that building A has a lease price of \$100,000 which also includes common area maintenance. The lease indicates that 10 percent of the lease price is for common area maintenance (CAM). Richmond County believes these prices to be reasonable. Rent payments are due December 31 of each year.

The rate implicit in the lease is not known to Richmond County. Its incremental borrowing rate is 8 percent, and the prime rate is 2 percent. Richmond County must pay a real estate commission to the broker who identified the building of \$5,000.

## Given

The present value factor for an annuity at 8 percent for 10 years is 6.7101. The present value factor for an annuity at 8 percent for 15 years is 8.5595. The present value factor for an annuity at 2 percent for 10 years is 8.9826. The present value factor for an annuity at 2 percent for 15 years is 12.8493.

The present value of \$1 for 10 years at 8 percent is .4632. The present value of \$1 for 15 years at 8 percent is .3152. The present value of \$1 for 10 years at 2 percent is .8203. The present value of \$1 for 15 years at 2 percent is .7430.

## Requirements: For building A (round all answers to nearest dollar)

Step 1 – Determine the lease term and explain why.

Step 2 – Determine the value of the lease liability for Richmond County.

Step 3 – Determine the value of the lease asset for Richmond County.

Step 4 – Prepare the journal entry for the December 31, 20X1, asset amortization.

Step 5 – Prepare the journal entry for the December 31, 20X1, lease payment.





## Chapter 3

# AICPA Activities

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### Learning objectives

- Identify the requirements of recently issued Statements on Auditing Standards (SASs) and Statements on Standards for Attestation Engagements (SSAEs).
- Identify recent Technical Questions and Answers that affect not-for-profit entities.
- Recall the changes to the AICPA Code of Professional Conduct.

The AICPA's Center for Plain English (the CPEA) is available to AICPA members that are also members of the Firm Practice Management section (PCPS). The AICPA intends the CPEA to act as a "national office" for small- and medium-sized CPA firms providing accounting and auditing services.

# Recently issued auditing and attestation standards

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## Overview

As of January 2018, the Auditing Standards Board (ASB) had recently issued the following SASs and SSAEs:

- SSAE No. 18, *Attestation Standards: Clarification and Recodification*
  - SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
  - SAS No. 133, *Auditor Involvement with Exempt Offering Documents*
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## Statements on auditing standards

### SAS No. 132

Issued in February 2017, SAS 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* addresses the auditor's responsibilities during a financial statement audit relating to an entity's ability to continue as a going concern as well as the impact on the auditor's report. SAS 132 supersedes SAS No. 126, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. The SAS is effective for audits of financial statements for periods ending on or after December 15, 2017.

The ASB addressed issues that arose with the issuance of ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, through a variety of audit interpretations. SAS No. 132 provides a more comprehensive look at the responsibilities of the auditor as well as the impact of the financial reporting framework's requirements.

SAS No. 132 applies to all audits of a complete set of general purpose or special purpose framework financial statements. A complete set of general purpose financial statement is prepared using the going concern basis of accounting, unless the liquidation basis is more appropriate. Some special purpose frameworks do not require the use of a going concern basis of accounting. In the case where a special purpose framework does not require a going concern basis, the auditor should still conclude on whether substantial doubt exists and evaluate possible financial statement impacts. The auditor would not be required to conclude on the appropriateness of management's use of the going concern basis. The SAS does not apply to an audit of financial statements prepared using the liquidation basis of accounting.

Some general-purpose frameworks (like those issued by FASB, GASB, and IASB) include specific guidance about management's assessment regarding going concern. Each has their own period of reference for that evaluation. Even if the applicable financial reporting framework does not include an explicit requirement for management to make an evaluation of the entity's ability to continue as a going

concern, this SAS would still apply assuming the framework uses a going concern basis of accounting. The going concern basis is a fundamental principle in the preparation of financial statements; so even if the financial reporting framework does not explicitly require management to make an assessment, the act of preparing the financial statements fundamentally requires management to make an assessment.

During normal risk assessment procedures, the auditor should consider whether there is substantial doubt about the entity's ability to continue as a going concern. They should make their evaluation using the same time period that was used by management, if applicable. If management has performed an evaluation, the auditor should discuss the evaluation with management and understand management's plans. The auditor should evaluate management's assessment and determine whether the assessment is complete and accurate. If an evaluation has not been performed, the auditor should inquire of management about whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern. The standard provides a list of procedures that would help identify conditions or events that would raise substantial doubt, including analyzing cash flow forecasts, reading debt agreements, and reviewing board minutes. The impact of subsequent event testing should also be considered.

If conditions or events are identified that raise substantial doubt, the auditor should evaluate management's plan and determine whether it is probable that management can effectively implement the plan and whether it is probable that the plan would mitigate the conditions or events. If management has prepared a cash flow forecast, the auditor should evaluate the reliability of the underlying data, determine whether the assumptions are adequately supported and consider any additional facts or circumstances. If management's plan includes the financial support by third parties or the owner-manager, the auditor should obtain sufficient appropriate evidence to support both the intent and the ability. Evidence regarding intent must be in writing. The standard provides examples of a support letter as well as procedures to perform to validate the intent and ability of the third party.

If the auditor believes (before consideration of management's plan) that substantial doubt exists, they should request written representations regarding management's plan and a statement that the financial statement disclosures are complete and adequate. The auditor may also consider other representations to be necessary. If after considering management's plan, the auditor concludes there is still substantial doubt, the auditor should include an emphasis of matter paragraph in the auditor's report.

The auditor is required to obtain sufficient appropriate evidence to conclude on the appropriateness of management's use of the going concern basis of accounting (with the exception noted previously for certain special purpose frameworks). If management prepares the financial statements using a going concern basis and its use is inappropriate, the auditor should express an adverse opinion. If the use of the going concern basis is appropriate whether or not substantial doubt has been alleviated, the auditor should evaluate the adequacy of the disclosures. If adequate disclosures are not made, then the auditor should express a qualified or adverse opinion.

The auditor must also independently conclude, based on audit evidence, whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists. A *reasonable period of time* is defined as the period one year from the date of issuance (or the date the

report was available to be issued) unless the applicable financial reporting framework uses a different period at which point the framework's timeframe would be used. If a going concern basis was appropriate but conditions and events were identified, and doubt was NOT alleviated, then the auditor should include an emphasis of matter paragraph. If a going concern basis was appropriate but conditions and events were identified and the doubt WAS alleviated, the auditor **may** include an emphasis-of-matter paragraph but is not required to. If conditions or events are identified that raise substantial doubt about an entity's ability to continue as a going concern, the auditor should document the conditions or events that led to that belief, elements of management's plans the auditor considered, the audit procedures performed and the auditor's conclusion about whether substantial doubt remains or is alleviated. The auditor should also conclude on the effects on the auditor's report. The SAS also addresses periods beyond management's evaluation, communication with those charged with governance, comparative presentations, reissuing reports, and significant delays in the issuance of financial statements.

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## Knowledge check

1. Which is NOT a responsibility of the auditor related to evaluation of an entity's ability to continue as a going concern?
  - a. Obtain sufficient appropriate evidence to conclude on management's use of the going concern basis of account.
  - b. Select the appropriate financial reporting framework.
  - c. Conclude whether substantial doubt exists.
  - d. Evaluate the effect on the financial statements including disclosure.

### SSAE No. 18

SSAE 18, *Attestation Standards—Clarification and Recodification* (AICPA, *Professional Standards*) was issued in April 2016 and is effective for reports issued on or after May 1, 2017. Unlike SSARS or SASs, the subject matter for SSAE engagements is not historical financial statements. Therefore, the effective date is not driven by the date of the financial statements but by the date the report is issued. SSAE 18 is the culmination of the SSAE clarity project. Following the clarity projects for the SASs and SSARS, the AICPA completed this project to ensure all AICPA issued standards are in the same format. Similar to the SASs and the SSARs, the SSAE standards use "AT-C" to differentiate the clarified standards from prior guidance.

SSAE 18 supersedes SSAE 10 through 17, with the exception of SSAE No. 15—*An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*. SSAE 15 will be superseded by the implementation of SAS No. 131 described already. In addition, chapter 7, *Management's Discussion and Analysis* (AT section 701) was not clarified because the standard is so rarely used. However, the ASB decided not to delete or supersede the standard so that practitioners still have the opportunity to use the guidance should they be engaged to opine on MD&A.

The organization of the SSAEs is important to understand. Guidance in the 100s section applies to all engagements no matter the service type or subject matter. Topics include use of professional judgment, the AICPA Code of Professional Conduct, and professional skepticism. The 200s section provides guidance by type of service. There are three service types in the SSAEs—examination, review, and agreed-upon procedures (AUPs). Each level of service provides a different level of assurance and therefore has different performance and reporting requirements.

The SSAEs are unique because there are sections on various subject matters. The SASs provide guidance only for one type of service and one subject matter (audits of historical financial statements), whereas the SSARS provides guidance on multiple engagement types but the subject matter is always a financial statement (does not have to be historical). The SSAEs, on the other hand, have multiple service levels and multiple subject matters. The 300s section provides guidance by subject matter (prospective financial statements, pro forma financial statements, compliance attestation, and so on) If you are performing an engagement that is not one of these subject matters you would follow only the 100s and 200s sections. If you were to perform an engagement on compliance, for example, you would follow the 100s, the appropriate 200 section, and then the appropriate 300 section.

New numbering	
AT-C Section 105	Concepts Common to All Attestation Engagements
AT-C Section 205	Examination Engagements
AT-C Section 210	Review Engagements
AT-C Section 215	Agreed-Upon Procedures Engagements
AT-C Section 305	Prospective Financial Information
AT-C Section 310	Reporting on Pro Forma Financial Information
AT-C Section 315	Compliance Attestation
AT-C Section 320	Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting
AT-C Section 395	Designated for AT Section 701, "Management's Discussion and Analysis"

The purpose of the attestation standards is to provide users with an opinion [examination], conclusion [review], or findings [AUP] regarding the reliability of the subject matter or an assertion about the subject matter as measured against suitable and available criteria. In an attestation engagement, you can opine either on the subject matter directly or on management's assertion about the subject matter.

## Key definitions

- Assertion—Any declaration or set of declarations about whether the subject matter is in accordance with (or based on) the criteria.
- Criteria—The benchmarks used to measure or evaluate the subject matter.
- Subject matter—The phenomenon that is measured or evaluated by applying criteria. Examples of possible subject matter include corporate governance, compliance with laws and regulations, prospective financial statements, or performance measurements.

Often three parties are involved in SSAE engagements, instead of just two.

- Engaging party—The party or parties that engages the practitioner to perform the attestation engagement. The engaging party can be those charged with governance, a governmental body or agency, the intended users, or another third party.
- Responsible party—The party or parties responsible for the subject matter. If the nature of the subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the subject matter may be deemed to be the responsible party.
- Specified party—The intended users to whom use of the written practitioner's report is limited.

The engaging party can also be the responsible party. Having a three-way communication system can make these engagements more difficult, especially when the responsible party is not supportive of having an outside practitioner perform investigative procedures on them.

Similar to how AU-C section 210 added preconditions to performing an audit, the attestation standards now also have certain preconditions. First, the practitioner must be independent (except when the practitioner is required by law or regulation to accept the engagement and report on the subject matter or assertion). The practitioner should also determine that the responsible party is a party other than the practitioner and takes responsibility for the subject matter. Additionally, the practitioner should ensure the criteria is suitable and will be available to the intended users.

Suitable criteria exhibit all of the following characteristics:

- Relevance—Criteria are relevant to the subject matter.
- Objectivity—Criteria are free from bias.
- Measurability—Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- Completeness—Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect the decision-making of the intended users.

The practitioner must be able to obtain the appropriate level of evidence on which to base their opinion, conclusion, or findings. This requires the practitioner to have access to all information of which the responsible party is aware that is relevant to the measurement, evaluation, or disclosure of the subject matter, as well as access to additional information that the practitioner may request from the responsible party for the purpose of the engagement. Practitioners are required to provide a written report at the conclusion of their engagement.

The practitioner should accept an attestation engagement only when the practitioner

- believes that relevant ethical requirements, including independence, will be satisfied;
- is satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities;
- has determined that the engagement to be performed meets all the preconditions for an attestation engagement; and
- and has reached a common understanding with the engaging party of the terms of the engagement, including the practitioner's reporting responsibilities.

## Level of service

### Examination

Examinations are similar to an audit in that they result in providing an opinion to the client. In order to provide reasonable assurance, the practitioner must obtain sufficient appropriate evidence and perform a full risk assessment.

### Review

Similar to a review performed under SSARS, a Review under the SSAEs provides limited assurance and results in the practitioner expressing a conclusion. The primary performance requirements include inquiry and analytical procedures. Because the subject matter is not a historical financial statement, there may be times when other appropriate procedures would be required.

### Agreed upon procedures (AUP)

AUPs are very unique. This level of service provides no assurance about the subject matter. Instead, the practitioner applies procedures that were determined by the specified parties. The practitioner is not responsible for the sufficiency of the procedures. The report describes the procedures performed and the results of procedures.

### Major changes in SSAE 18

- Requires CPAs to request a written assertion from the responsible party about whether the subject matter is measured or evaluated in accordance with the criteria
- Requires a written representation letter in all attestation engagements
- Increases the understanding required in an examination regarding the subject matter

The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. If the engaging party is the responsible party and they refuse to provide a written assertion, the practitioner should withdraw. If the engaging party is not the responsible party and the responsible party refuses to provide a written assertion, the practitioner is not required to withdraw. However, they must disclose the refusal in the report and restrict the use of the report to the engaging party. Because the practitioner is already required to request a written representation from the responsible party, that written representation can also serve as the responsible

party's assertion and therefore a separate written assertion would not be needed (unless called for by specific engagement circumstances).

In addition, the practitioner is required to obtain a written representation letter from the responsible party. If the engaging party is the responsible party and one or more of the requested written representations are not provided or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should discuss the matter with the appropriate party(ies). The practitioner should reevaluate the integrity and evaluate the effect that this may have on the reliability of representations and evidence in general. If the matters cannot be resolved, the practitioner should take appropriate action. When the engaging party is not the responsible party, the practitioner should request a written representation letter from the engaging party as well as the responsible party. If the responsible party refuses to provide the representations in writing, the practitioner is permitted to make verbal inquiries of the responsible party and seek oral responses. If the practitioner receives satisfactory oral responses, the practitioner's report should restrict the use of the report to the engaging party. However, if one or more of the requested representations are provided neither in writing nor orally from the responsible party, a scope limitation exists, and the practitioner should determine the effect on the report or should withdraw.

When performing examination procedures, SSAE 18 increases the amount of work to be performed in the risk assessment phase. Similar to the addition of the risk-based standards to audits, the new examination requirements necessitate that a practitioner document attestation risk. Attestation risk is comprised of inherent risk and control risk and are offset by detection risk. If a practitioner plans to rely on controls to reduce attestation risk, controls must be tested. The practitioner should obtain an understanding of the subject matter and other engagement circumstances sufficient to allow the practitioner to identify and assess the risks of material misstatement in the subject matter and provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's opinion. Practitioners should obtain an understanding of internal control over the preparation of the subject matter relevant to the engagement, evaluate the design of those controls relevant to the subject matter, and determine whether they have been implemented by performing procedures in addition to inquiry of the personnel responsible for the subject matter. As a result, more work will likely be performed on internal controls under the new standard.

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## Knowledge check

2. Which is NOT a type of engagement performed under SSAEs?
  - a. Examination.
  - b. Review.
  - c. Preparation.
  - d. Agreed-Upon Procedures.



## SAS No. 133

In June 2017, in an effort to establish auditor procedures for when an auditor is involved with an exempt offering document, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 133, *Auditor Involvement with Exempt Offering Documents* (AICPA, *Professional Standards*, AU-C section 945).

Included in the scope of the SAS are municipal bonds, securities issued by not-for-profit religious, education or charitable organizations, crowd funding, small issues of securities (such as Regulation A offerings), and franchise offerings.

The standard applies only when an auditor is involved in an exempt offering. The standards establish auditor involvement as when the auditor's report on the financial statement (or the auditor's review report on interim financial information) is included or incorporated by reference in an offering document relating to an exempt offering **and** the auditor performs certain activities with respect to the exempt offering document.

When an auditor is involved with exempt offerings, SAS No. 133 requires the auditor to perform (a) procedures described in paragraphs 6-18 of AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*, on the exempt offering; and (b) procedures designed to identify events occurring between the date of the auditor's report and the date of the distribution, circulation, or submission of the exempt offering document that (had they been known to the auditor as of the date of the auditor's report) may have caused the auditor to revise the auditor's report.

The SAS also discusses requirements and considerations when the auditor identifies subsequent events or subsequently discovered facts. These include obtaining an understanding of any procedures that management may have performed to identify sub events, inquiries of management regarding events, reading board minutes and interim financial statements, and obtaining new written representations.

This SAS is effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018.

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## Knowledge check

3. Which is NOT an exempt offering?
  - a. Securities issued or guaranteed by the state of North Carolina.
  - b. Securities issued by an employee benefit plan.
  - c. Securities issued by a publicly traded company.
  - d. Securities issued by a nonprofit educational institution.

# Outstanding exposure documents

As of early January 2018, the following items were outstanding:

- Proposed Statement on Auditing Standards—Omnibus Statement on Auditing Standards—2018
- Proposed Statements on Auditing Standards, Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements
- Proposed Statement on Auditing Standards—The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports
- Proposed Statement on Standards for Attestation Engagements—Selected Procedures
- Proposed Statement on Standards for Accounting and Review Services—Omnibus Statement on Standards for Accounting and Review Services—2018
- Professional Ethics Division—Proposed Interpretation—Long Association of Senior Personnel With an Attest Client
- Proposed Revisions to the AICPA Code of Professional Conduct—Leases Interpretation (ET sec. 1.260.040)
- Professional Ethics Division—Exposure Draft—Responding to Non-Compliance with Laws and Regulations
- Professional Ethics Division—Proposed Interpretation and Other Guidance—State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)

# Recently issued guidance

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## AICPA - Technical questions and answers (TQA) Section 2220: Long-term investments

### TQA Section 2220.28, Definition of readily determinable fair value and its interaction with the NAV practical expedient

A question was posed as to how readily determinable fair value interacts with the NAV practical expedient.

The AICPA responded that the FASB ASC Master Glossary defines *readily determinable fair value*, which was amended by FASB ASU No. 2015-10, Technical Corrections and Improvements. Condition, as (c) "The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions." Whether an equity security has a readily determinable fair value (RDFV) in accordance with condition (c) is a facts and circumstances determination and requires judgment. Stakeholders questioned whether certain investments (such as common collective trusts and pooled separate accounts) meet condition (c) and, therefore, would be considered to have RDFV.

The conclusion reached regarding RDFV is important because it determines whether an investment is eligible to estimate fair value using the NAV practical expedient. If an investment has RDFV, it cannot be measured using the NAV practical expedient and would be subject to the fair value measurement disclosures.

FASB discussed questions raised in connection with condition (c) of the definition of RDFV and indicated the following:

"The Board could not identify a pervasive measurement issue on the basis of outreach conducted with stakeholders. While the Board acknowledged that the interpretation of the Master Glossary definition of readily determinable fair value could have implications on which set of disclosures may be used for certain investments (that is, fair value measurement disclosures or net asset value per share practical expedient disclosures), some Board members concluded that users of the financial statements would not be misled when provided either set of disclosures. Therefore, the Board would encourage entities to provide the disclosures that are consistent with the conclusions previously reached on the measurement of the investment."

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## Knowledge check

4. If a security has a readily determinable fair value, which is NOT a method that can be used to measure it?
- Fair Value.
  - Equity Method.
  - Net Asset Value per Share.
  - Cost.

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## AICPA - Technical questions and answers (TQA) Section 7100.01-16: Definition of a public business entity

**TQA Section 7100.01: "Use of the term 'security' in the definition of a public business entity"**  
Inquiry—The FASB ASC glossary definition of a *public business entity* (PBE) uses the term "security." ASU No. 2013-12 does not reference a specific definition of "security." How should entities evaluate whether their financing instruments are securities?

Reply—The evaluation of financing instruments should use the definition of a security in FASB ASC 320, *Investments—Debt and Equity Securities*, which is the second definition of security in the FASB ASC glossary. Specifically, a security is defined as

"A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

- It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
- It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
- It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations."

In FASB ASC Editorial and Maintenance Update No. 2017-06, FASB linked to the term "security" within the definition of a public business entity to the preceding definition of a security in the FASB ASC glossary.

### **TQA Section 7100.03: "Use of the term 'over-the-counter market' in the definition of a public business entity"**

Inquiry—Criterion (d) of the FASB ASC glossary definition of a PBE states that a business entity (an entity other than a not-for-profit entity within the scope of FASB ASC 958, *Not-for-Profit Entities*, or an employee benefit plan accounted for under FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*; FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*, or FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*) that "has issued, or is a conduit bond obligor for,

securities that are traded, listed, or quoted on an exchange or an over-the-counter market" is a PBE. How should an entity evaluate whether its securities (or securities for which it is a conduit bond obligor) meet this criterion?

Reply—The types of securities referenced in criterion (d) might include, for example, securities issued in public offerings that are exempt from registration under Sections 3 and 4 of the Securities Act of 1933. A business entity (an entity other than a not-for-profit entity within the scope of FASB ASC 958 or an employee benefit plan within the scope of FASB ASC 960, FASB ASC 962, or FASB ASC 965) should evaluate whether its issued securities (as defined in FASB ASC 320) are traded, listed, or quoted on an exchange or over-the-counter (OTC) market.

One of the factors considered by FASB in defining a public business entity is noted in paragraph BC16 of ASU No. 2013-12:

"...consistent with the existing definitions of nonpublic entity and public entity in the Accounting Standards Codification, entities that have securities that are traded, listed, or quoted on an exchange or an OTC market should be considered public." Paragraph BC16 further indicates that "an OTC market includes an interdealer quotation or trading system for securities that are not listed on an exchange (for example, OTC Markets Group Inc., including the OTC Pink Markets, or the OTC Bulletin Board)."

It is important to note that each of the example OTC markets are accessible by the public to execute trades. Further, the example OTC markets generally make various data points, including security listing, bid/ask pricing, or trade data (price and volume) publicly available. Based on discussions with FASB staff, markets that are **not generally accessible by the public or that do not publish such data points** are not OTC markets for the purposes of the PBE definition. Markets accessible only by certain investors (for example, qualified institutional or accredited investors) are not considered accessible by the public (that is, trading activity in nonpublic markets would not meet criterion [d]). Further, we understand that, based upon discussions with FASB staff, securities that can **be purchased only by certain investors**, such as 144A securities, are not securities that can be traded by the public and are not subject to criterion (d), but are considered in the analysis of the other criteria. Throughout section 7100, the term *public OTC market* is used to draw a distinction between applicable and nonapplicable OTC markets (public and nonpublic).

#### TQA Section 7100.04: "Use of the term 'conduit bond obligor' in the definition of a public business entity"

Inquiry—What is the meaning of the term *conduit bond obligor* within the FASB ASC glossary definition of a PBE? Are all entities that are conduit bond obligors considered PBEs?

Reply—As used in criterion (d) within the FASB ASC glossary definition of a PBE, the term *conduit bond obligor* refers to entities that are obligated for the repayment of conduit debt securities. As defined in the FASB ASC glossary, *conduit debt securities* are municipal securities (for example, certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments) issued by state or local governments, agencies, or instrumentalities (government entities) on behalf of a third-party such as a not-for-profit entity or for-profit entity. Municipal securities are exempt from registration under

Section 3 of the Securities Act of 1933. Municipal securities issued in public offerings (when an underwriter purchases municipal securities from an issuer for reoffering to the public) trade thereafter in the public OTC market. Municipal securities issued in **private placements generally are sold directly to qualified investors; they are not deemed to trade in public OTC markets** because the markets in which they are available are limited only to certain investors.

Typically, a PBE conduit bond obligor is a third party on whose behalf industrial development revenue bonds or similar securities have been issued. The definition of PBE excludes conduit bond obligors that meet the definition of a not-for-profit entity in the FASB ASC glossary and are within the scope of FASB ASC 958. Certain entities, such as certain healthcare entities, can be accounted for both within FASB ASC 958 and other industry specific guidance such as FASB ASC 954, *Healthcare Entities*. In certain cases, the industry specific guidance can apply to both a for-profit entity or a not-for-profit entity; however, only not-for-profit entities accounted for within FASB ASC 958 are scoped out of the definition of a public business entity.

The definition of not-for-profit entity does not apply to entities that "provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants," such as mutual insurance entities, credit unions, and certain cooperatives. If such an entity is a conduit bond obligor in a public offering of municipal securities, it would fall within the scope of the PBE definition because it is not within the scope of FASB ASC 958 and an analysis should be completed under criterion (d) to determine if it is traded, quoted, or listed on a public OTC market. If the conduit debt security is not traded, quoted, or listed, then entities should consider the applicability of criterion (e) within the FASB ASC glossary definition of a PBE.

Financing instruments like a conduit debt security (that is, a financing instrument that provides indirect access to public debt markets such as a trust preferred security) should not analogize to conduit bond obligors for purposes of analyzing the definition of a PBE.

#### **TQA Section 7100.05: "FINRA TRACE and MSRB EMMA data and a public business entity"**

Inquiry—Are the Financial Industry Regulatory Authority (FINRA) Trade Reporting and Compliance Engine (TRACE) or Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) considered OTC markets? Should financial statements available in EMMA be considered under criterion (e) of the FASB ASC glossary definition of a PBE?

Reply—Trade reporting tools such as TRACE or the trade reporting feature within the EMMA are not themselves OTC markets. TRACE and EMMA report historical trades (price and volume) in eligible fixed-income securities, but neither allows execution of trades. TRACE is a FINRA-developed vehicle that facilitates the mandatory reporting of secondary market transactions in eligible fixed income securities. All broker-dealers who are FINRA member firms have an obligation to report transactions in corporate bonds to TRACE. Accordingly, TRACE can be a source of information for the analysis of criterion (d). EMMA includes similar trade reporting functionality to TRACE but is a repository for municipal securities with additional tools and reporting not available in TRACE. EMMA is the official SEC-designated repository for disclosure documents related to public offerings of municipal securities, and also provides historical trade prices, credit ratings, and other information related to those securities. EMMA trade data

or financial statement information is generally relevant for the determination of the PBE status for conduit bond obligors under criteria (d) or (e); however, entities should consider their specific facts and circumstances.

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## Knowledge check

5. Conduit debt securities are NOT subject to the definition of a public business entity when issued on behalf of
- Nonprofits.
  - Healthcare entities.
  - For Profit Entities.
  - Credit Unions.

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## AICPA - Technical questions and answers (TQA) Section 9160, other reporting issues

### TQA Section 9160.31: "Following accounting standards as promulgated by FASB by a state or local governmental entity"

**Inquiry**—How should an auditor determine whether an entity (or component thereof, such as a component unit) is a state or local government for purposes of determining whether the entity is following the appropriate accounting standards?

**Reply**—The auditor should evaluate the entity against the definition of a state or local government as found in several AICPA Audit and Accounting Guides (for example, State and Local Governments, Not-for-Profit Entities, and Health Care Entities). That definition has been cleared by GASB; and, therefore, according to GASB Statement No. 76, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, it is considered to be category (b) GAAP. As a result, an entity that meets the definition should follow accounting standards as promulgated by GASB to prepare its financial statements.

Entities are governmental or nongovernmental for accounting, financial reporting, and auditing purposes based solely on the application of the definition of a state or local government. Other factors are not determinative.

For example, the fact that an entity is incorporated as a not-for-profit entity and exempt from federal income taxation under the provisions of IRC Section 501 is not a criterion in determining whether an entity is governmental or nongovernmental for accounting, financial reporting, and auditing purposes.

### **TQA Section 9160.32: "Reporting on accounting standards as promulgated by FASB by a state or local government"**

Inquiry—An entity (or a component thereof, such as a component unit) that meets the definition of a state or local government prepares its financial statements in accordance with accounting standards as promulgated by FASB. How should an auditor report on such financial statements?

Reply—The auditor should evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the appropriate accounting standard setter. Because the appropriate accounting standards would be those as promulgated by GASB (not accounting standards as promulgated by FASB), the auditor should evaluate whether the financial statements are materially misstated from the appropriate GAAP (in this case accounting standards as promulgated by GASB). This evaluation would encompass the application of specific accounting principles as well as the form and content of the financial statement presentation. If the auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated from accounting standards as promulgated by GASB, the auditor should modify the opinion in the auditor's report, in accordance with AU-C section 705, Modifications to the Opinion in the Independent Auditor's Report (AICPA, Professional Standards).

### **TQA Section 9160.33: "Engagement acceptance when a state or local government elects to follow a special purpose framework"**

Inquiry—An entity (or a component thereof) that meets the definition of a state or local government elects to prepare its financial statements in accordance with a special purpose framework (SPF). What are the auditor's responsibilities concerning the acceptability of the SPF used by management?

Reply—As a precondition of an audit, AU-C section 210, Terms of Engagement (AICPA, Professional Standards), requires the auditor to establish whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable. Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
- Whether law or regulation prescribes the applicable financial reporting framework

If the auditor determines that the SPF is not acceptable in this circumstance, the auditor should not accept the engagement.



**TQA Section 9160.34: "Accounting standards as promulgated by FASB as a special purpose framework"**

Inquiry—An entity (or a component thereof) that meets the definition of a state or local government elects to prepare its financial statements in accordance with accounting standards as promulgated by FASB. Because the appropriate accounting standards are those promulgated by GASB, can the accounting standards as promulgated by FASB be considered a special purpose framework?

Reply—No. AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), defines a special purpose framework as

"A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. Cash basis. A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. Tax basis. A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. Regulatory basis. A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. Contractual basis. A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. Other basis. A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements."

**TQA Section 9160.35: "Reporting on Indian tribe financial statements prepared in accordance with accounting standards as promulgated by FASB"**

Inquiry—An Indian tribe (or a component thereof, such as a business component functioning like a commercial entity) that meets the GAAP definition of a state or local government prepares its financial statements in accordance with accounting standards as promulgated by FASB. In such situations, may an auditor report on whether the entity's financial statements are presented, in all material respects, in accordance with both the appropriate GAAP framework (that is, accounting standards as promulgated by GASB) and accounting standards as promulgated by FASB?

Reply—Generally accepted auditing standards do not prohibit an auditor from issuing a report containing two opinions—one opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the appropriate GAAP, and a second opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the accounting standards as promulgated by FASB.

# Recently issued changes to the code of conduct

## **New interpretation “hosting services” (ET sec. 1.295.143) 1 under the “Independence Rule” (ET sec. 1.200.001)**

Hosting services are nonattest services that involve a CPA accepting responsibility for the following:

- a.* Acting as the **sole host** of a financial or non-financial information system of an attest client
- b.* Taking custody of or storing an attest client's data or records whereby, that **data or records are available only to the attest client from the member**, such that the attest client's data or records are otherwise incomplete
- c.* Providing electronic security or back-up services for an attest client's data or records.”

The new interpretation indicates that hosting services that meet any of the preceding criteria would impair independence and could not be reduced by the application of safeguards.

This interpretation is effective September 1, 2018.

## **Revised interpretation “knowing misrepresentations in the preparation and presentation of information,” formerly “knowing misrepresentations in the preparation of financial statements or records” (ET sec. 2.130.010) under the “integrity and objectivity rule” (ET sec. 2.100.001)**

AICPA members who are responsible for recording, maintaining, preparing, approving, or presenting information are required to act with integrity and objectivity including the following:

- a.* Present information in accordance with a relevant reporting framework.
- b.* Do not prepare and present information that is intended to mislead.
- c.* Include all relevant information in preparing or presenting information.

### **Preparation and presentation of financial statements and records**

Preparing or presenting information may require members to exercise discretion and make professional judgments. Professional judgment is often necessary in financial reporting. Preparing or presenting information in compliance with the “Integrity and Objectivity Rule” means no judgments are made with the intention of misleading.

### **Preparation and presentation of information not subject to a reporting framework**

When an entity is not required to comply with a reporting framework to accomplish their task (such as for budgeting or pro forma reports), members must identify and take into account the purpose for which the information is to be used, the context in which it is provided, and the audience to whom it is addressed.

## Association with misleading information

If the member believes information that he or she is associated with is misleading, interpretation of the code requires the member to work to resolve the matter. Possible responses would include reviewing the entity's code of ethics, whistleblower policy, and the like; or discussing the misleading information with his or her boss or other member of management to resolve the issue.

If the member escalates his or her concerns internally within the organization and still determines that appropriate corrective action was not taken, the member should consider further escalation, including consulting with a professional body, internal or external auditor, as well as legal counsel.

If, after exhausting all feasible options, the member determines the information is still misleading, the member should refuse to be or to remain associated with the information up to and including quitting his or her job. However, resignation may not relieve the member of responsibilities including notifying regulatory authorities or the external auditor.

The member is encouraged to **document** the facts, the accounting principles or professional standards involved, and how the member attempted to address the matter.

When threats to compliance are due to good faith differences of opinion between a member and his or her supervisor, the member should follow the "Subordination of Judgment" interpretation.

This interpretation was effective August 31, 2017.

## New interpretation "pressure to breach the rules" (ET sec. 2.170.010) under the "Integrity and Objectivity Rule" (ET sec. 2.100.001)

Sometimes a member may feel pressure, undue influence, or threats from inside the organization as well as outside the organization (or even internally to meet a particular target or expectation) to not comply with the "Integrity and Objectivity Rule." These pressures may be explicit or implicit. A member should not allow these pressures to result in a breach or knowingly place pressure on others that would result in the other individuals breaching the rules of the AICPA Code of Professional Conduct.

Examples of pressure that could result in a breach include the following:

- a. Pressure related to conflicts of interest
- b. Pressure to influence presentation of information:
  - i. Pressure to report misleading financial results to meet investor, analyst, or lender expectations
  - ii. Pressure from elected officials on government accountants to misrepresent programs or projects to voters
  - iii. Pressure from colleagues to misstate income, expenditure, or rates of return to bias decision-making on capital projects and acquisitions
  - iv. Pressure from superiors to approve or process expenditures that are not legitimate business expenses
  - v. Pressure to suppress internal audit reports containing adverse findings

The member should consider the following:

- a.* The intent of the individual who is exerting the pressure and the nature and significance of the pressure
- b.* The application of relevant laws, regulations, and professional standards to the circumstances
- c.* The culture and leadership of the employing organization
- d.* Established policies and procedures, such as ethics or human resources policies

If the member believes that the pressure would result in a breach, he or she should consider safeguards including the following:

- a.* Discussing the matter with the individual who is exerting the pressure to seek to resolve it
- b.* Discussing the matter with the member's supervisor (so long as the supervisor is not the individual exerting the pressure)
- c.* Escalating the matter within the employing organization
- d.* Asking to restructure or segregate certain responsibilities and duties
- e.* Disclosing the matter through the ethics and whistleblowing lines or any other established mechanism
- f.* Consulting with legal counsel

If the pressure to breach is not eliminated, the member should stop performing the work—including reconsidering employment with the organization. The member is also encouraged to **document** the facts, the communications, the courses of action considered, the parties with whom these matters were discussed, and how the matter was addressed.

This interpretation was effective August 31, 2017.

## Other changes to the code

The Professional Ethics Executive Committee (PEEC) has adopted the following:

- Revised definitions
  - “Attest client” (ET sec. 0.400.03)<sup>1</sup>
  - “Client” (ET sec. 0.400.07)
  - “Joint closely held investment” (ET sec. 0.400.26)
  - “Key position” (ET sec. 0.400.27)
  - “Period of the professional engagement” (ET sec. 0.400.39)
  - “Public interest entities” (ET sec. 0.400.41)
- Revised “Introduction” (ET sec. 1.000)
- Revised interpretations under the “Independence Rule” (ET sec. 1.200.001)
  - “Entities Included in State and Local Government Financial Statements” (ET sec. 1.224.020)
  - “Simultaneous Employment or Association With an Attest Client” (ET sec. 1.275.005)
  - “Member of a Credit Union” (ET sec. 1.280.040)
  - “Actual or Threatened Litigation” (ET sec. 1.290.010)
  - “General Requirements for Performing Nonattest Services” (ET sec. 1.295.040)
  - “Bookkeeping, Payroll, and Other Disbursements” (ET sec. 1.295.120)
  - “Executive or Employee Recruiting” (ET sec. 1.295.135)
  - “Forensic Accounting” (ET sec. 1.295.140)
  - “Internal Audit” (ET sec. 1.295.150)

- “Application of the Independence Rule to Engagements Performed in Accordance with Statements on Standards for Attestation Engagements” (ET sec. 1.297.010)
- Revised interpretation “Records Requests” (ET sec. 1.400.200) under the “Acts Discreditable Rule” (ET sec. 1.400.001)
- Revised interpretations under the “Contingent Fees Rule” (ET sec. 1.510.001)
  - “Services Performed by a Member’s Spouse for a Contingent Fee” (ET sec. 1.510.030)
  - “Contingent Fee Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client” (ET sec. 1.510.040)
  - “Investment Advisory Services” (ET sec. 1.510.050)
- Revised interpretations under the “Commissions and Referral Fees Rule” (ET sec. 1.520.001)
  - “Services Performed by a Member’s Spouse for a Commission” (ET sec. 1.520.030)
  - “Referral of Products of Others” (ET sec. 1.520.040)
  - “Commission Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client” (ET sec. 1.520.050)
- Revised interpretation “Disclosing Information to Persons or Entities Associated with Clients” (ET sec. 1.700.030) under the “Confidential Client Information Rule” (ET sec. 1.700.001)

These changes were effective on December 31, 2017.

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## Knowledge check

6. Acting as the sole host of a financial or non-financial information system of an attest client is what type of service?
- a. Permitted Attest service.
  - b. Not Permitted Nonattest service.
  - c. Permitted Nonattest service.
  - d. Not Permitted Attest service.

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## Government audit competency resources

AICPA Governmental Audit Quality Center (GAQC)

The GAQC keeps members informed about the latest developments through a number of resources. The GAQC also provides member firms with tools to help them better manage their audit practices. CPA firms and state audit organizations must agree to adhere to certain membership requirements above the basic requirements of the AICPA Code of Professional Conduct. Launched in September 2004, GAQC membership accounts for more than 91 percent of the total federal expenditures covered in single audits performed by CPA firms in the Federal Audit Clearinghouse database ([harvester.census.gov/sac/](http://harvester.census.gov/sac/)) for the year 2013. The GAQC’s focus is to promote the highest quality audits and save members time by providing a centralized place to find information.

Center resources and benefits include the following:

- Email alerts with the latest audit and regulatory developments
- Exclusive webcasts and webinars on compliance auditing and timely topics relevant to governmental financial statement audits (Optional CPE is available for a small fee, and events are archived online.)
- Dedicated GAQC website at <http://www.aicpa.org/GAQC> with resources, community, events, products, and a complete listing of GAQC member firms in each state
- An Auditee Resource Center containing practice aids and other resources to keep auditees well informed about audit requirements and other issues related to their audits
- A “GASB Matters” page, which lists resources found on the website related to GASB topics of current interest
- Single audit practice aids and tools
- Advocacy regarding issues related to the audit and regulatory environment facing auditors
- A marketing toolkit for member firms
- Savings on professional liability insurance

Working together, the AICPA's Member and Learning Competency Team and the Government Audit Quality Center (GAQC) developed a number of tools and resources over the past year relating to competency in government auditing. The following discusses the tools and resources resulting from this collaboration.

### **Governmental competency model**

The *AICPA Competency Framework: Governmental Auditing* will help CPAs understand the knowledge and skills needed to perform high-quality audits of the financial statements of state and local governments. Competencies are organized into five core skill sets—client acceptance, engagement planning, engagement analysis and testing, concluding the engagement, and guiding principles—and the specific skills within each. For each core skill, skill levels are identified as foundational, intermediate, advanced, and expert. The *AICPA Competency Framework: Governmental Auditing* may be downloaded at no cost at [www.aicpa.org](http://www.aicpa.org).

### **Knowledge checks and targeted learning resources**

Knowledge checks and targeted learning resources relating to government engagements are now included in the AICPA/CIMA Competency and Learning web site. Currently, the following topics and subtopics have been addressed in the knowledge checks.

- Government Financial Statement Audits
  - GASB accounting requirements
  - Audit risk assessment
  - Opinion units and materiality
  - Sampling
  - Group audits
  - Pensions
  - Fair value
- Single Audits
  - Single audit requirements
  - Major program determination

- Schedule of expenditures of federal awards
- Materiality
- Internal control
- Compliance testing
- Sampling
- Findings

### Single audit certificate programs

The AICPA offers two exam-based single audit certificate programs as another way for highly proficient practitioners to distinguish themselves in the marketplace and among their peers and colleagues. There are two programs—Intermediate Single Audit Certificate and Advanced Single Audit Certificate. The certificates are designed for CPAs specializing in single audits. CPAs can earn the certificate(s) by passing the respective online exam which is in a multiple-choice format. The intermediate level exam is generally for individuals with three to seven years of single audit experience. The advanced level exam is generally for individuals with seven or more years of single audit experience. CPAs can take one or both exams, which are available on demand. Upon passing the exam, you will receive a digital badge, which acknowledges your achievement by visually declaring your commitment to quality and communicating your knowledge and expertise for clients and peers to see.

There are no education requirements to take the exams. However, the course, *Applying the Uniform Guidance For Federal Awards in Your Single Audit*, is available for those wishing to study for the intermediate exam. For the advanced exam, the course, *Advanced Topics in a Single Audit*, is available.

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## Knowledge check

7. GAQC membership accounts for more than what percentage of the total federal expenditures covered in single audits performed by CPA firms in the Federal Audit Clearinghouse database for the year 2013?
  - a. 65 percent.
  - b. 75 percent.
  - c. 90 percent.
  - d. 100 percent.

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## Not-for-profit accounting and auditing competency resources

### NFP member section

In May 2015, the AICPA launched a new membership section for CPAs in public practice as well as those who work with or for a not-for-profit. The AICPA's Not-for-Profit Section (NFP Section) provides support and resources in the areas of audit, financial accounting, and tax for members and other finance professionals. Those who have management or governance responsibilities, including those who serve

as board members or as volunteers, are eligible to join the AICPA as a non-CPA associate. AICPA members, including, associates and non-CPA associates are eligible to join the NFP Section.

Benefits for NFP Section members include the following:

- Timely communications covering breaking news. E-alerts and interactive webcasts will inform members when standard setters and regulatory agencies issue new guidance.
- Tools and resources. There is a wide-range of information including articles and tools that provide a deeper dive into topics such as risk management, communicating with audit committees, allocation of functional expenses, and Form 990 red flags.
- Sample financial statements and note disclosures.
- Board governance and accounting policy examples.
- Tools including a Form 990 worksheet, internal control checklists, example management letter comments, and reference charts.
- Continuing professional education (CPE)-eligible courses

### **NFP certificate programs**

The AICPA offers two certificate programs for not-for-profit professionals. These programs are available to anyone with an interest in learning more about financial management of NFPs.

#### **Not-For-Profit Certificate I**

The Not-for-Profit (NFP) Certificate I program is specially designed to help accountants and others build the knowledge needed to gain a basic understanding of these entities by providing a foundation in not-for-profit accounting, tax compliance, governance and assurance. The program provides 24 courses on demand, which total 40 hours of CPE delivered in three topical tracks.

Participants learn about GAAP reporting standards that apply to NFPs, including financial statement presentation and disclosure requirements, state and federal filing requirements for tax-exempt organizations, best practices in board governance, financial oversight, internal controls, fraud and other risks, and audit planning considerations.

#### **Not-for-Profit Certificate II**

A more advanced version, Not-For-Profit Certificate II provides 30 hours of CPE through 17 courses that build on the core principles presented in the first program. There is no requirement to complete Certificate I to take Certificate II. The program is offered online using video presented by leading NFP industry experts. Topics include how to prepare financial statements, how to complete IRS Form 990, how to build complex budgets, how to perform risk assessments, how to guide the strategic planning process, and how to work with an NFP's governing board. Learning exercises, targeted case studies, and detail-rich interpretations are interspersed throughout the video presentations.



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## Knowledge check

8. How many levels are currently offered for the Not-For-Profit Certificate program?
- 1.
  - 2.
  - 3.
  - 4.

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## 2017 status update – Enhancing audit quality

### Background

The AICPA launched its Enhancing Audit Quality (EAQ) Initiative in May 2014 and released a related EAQ discussion paper on August 7, 2014. The EAQ Initiative is a holistic effort to consider auditing of private entities through multiple touch points, especially where quality issues have emerged. The goal is to align the objectives of all audit-related AICPA efforts to improve audit performance.

The EAQ Initiative is a six-point plan to improve audit quality and therefore preserve the prominent and respected role the CPA in public practice plays in the business community. The objective of this program is to improve consistency of quality by focusing the attention of firms and peer reviewers on the following:

- New industries
- Industries with new/rising risks
- Employee benefit plans
- Municipalities
- Audit areas of increased risk
- Documentation of sufficient appropriate audit evidence
- Nonattest services to audit clients
- Areas with increased inspection areas in the past

The Six-Point Plan to Improve Audits, published in May 2015, addresses the following key areas:

- Pre-licensure
  - The AICPA CPA Examinations Team conducted a comprehensive research effort to develop the next version of the CPA exam. The vision for the new exam is to better evaluate not only the knowledge of CPA candidates, but also their ability to apply that knowledge using critical thinking skills and professional skepticism (both of which are important drivers of audit quality). The most significant change for the next version of the exam is an increased emphasis and focus on testing higher order skills such as analysis and evaluation. This will involve more task-based simulations in the exam.
  - The AICPA is also working with the College Board to establish a high school advanced placement (AP) course in accounting. The goal would be to attract highly talented students early and hopefully encourage them to seek the CPA credential. The AP course would demonstrate the extent of knowledge and commitment to the public trust required of the profession

- The Accounting Doctoral Scholars Program was launched in June 2008 to address the growing shortage of academically qualified university accounting faculty members, especially those with recent experience in the practice of auditing and tax.
- Standards and ethics
  - AICPA members are held to high ethical standards that are set forth in the AICPA Code of Professional Conduct. The code requires CPAs to act with integrity and objectivity, maintain independence, and exercise due professional care and competence. To make the code easier to use, the PEEC completed a five-year project in early 2014 to reorganize and restructure the AICPA Code of Professional Conduct.
  - The AICPA Auditing Standards Board (ASB) recently completed its Clarity Project to rewrite generally accepted auditing standards (GAAS) so auditors can better understand and apply them. The ASB's goal is to harmonize U.S. GAAS with the International Standards on Auditing (ISA) as much as possible while avoiding the creation of unnecessary differences with PCAOB standards. The ASB has also completed clarity projects for the SSARS and SSAEs.
- CPA learning and support
  - The AICPA launched the AICPA/CIMA Competency and Learning website, which offers a new way for CPAs to approach learning and competency development.
  - The AICPA created a task force on the Future of Learning to reinvent lifelong learning and competency in the CPA profession. Due to the rapid change in businesses, entities and rules are becoming more complex and globally focused. The Task Force is a diverse group of innovative thought leaders in public accounting, industry CPAs, state CPA society leaders, regulators, and educators. The group examined the impact of globalization, the rise of specialization, and the impact of the millennial generation.
- Peer review
  - Enhancing quality of peer reviewers—The AICPA is improving the quality of peer reviewers by increasing the qualifications required to perform a review.
  - Targeting firm quality and accountability—As part of the peer review process, the AICPA is now incorporating deep dive reviews for certain specialized industries and areas of practice, including audits of EBPs and single audits.

Firms' federal employer identification numbers (EIN)—These are now being used and compared with available databases (for example, Department of Labor's EFAST2 and the Federal Audit Clearinghouse) to help ensure that all firms that should be enrolled in peer review are enrolled.

- Practice monitoring of the future
  - As part of the process to incorporating continuous improvement in the peer review process, a new approach to practice monitoring would include a practice monitoring technology platform. The vision for this concept is to increase public protection through enhanced audit effectiveness by using risk indicators to identify potential quality issues earlier. It would review all firms and all engagements allowing for a risk-based approach as opposed to a sample of a single year's activity every three years.
- Enforcement
  - Beyond investigating cases involving deficient audits referred by Inspectors General and the U.S. Department of Labor (DOL), the AICPA Professional Ethics Division is proactively identifying deficient governmental and employee benefit plan audits by reviewing publicly available information on the Federal Audit Clearinghouse and DOL's EFAST2 websites. When an AICPA member is found to be in violation of the code, the member is subject to remediation (for example, continuing professional education, pre-issuance reviews of attest engagements by an

independent third party) and in some instances, disciplinary sanctions (such as admonishment, suspension, or expulsion from AICPA membership).

The plan consists of the following two phases:

- Phase I focuses on improving audit quality in the near term.
- Phase II centers on reforming the current peer review program.

The near- and longer-term plans and proposals that are expected to most significantly affect and change financial statement audits of private entities include the following:

- Competence and due care
- Auditing and quality control standards
- Guidance, tools, learning, and resources
- Practice monitoring (peer review)
- Ethics enforcement

Additional information regarding the EAQ Initiative is available at [www.aicpa.org](http://www.aicpa.org).

## Update

As part of the Enhancing Audit Quality Initiative, the AICPA issued a document titled "Enhancing Audit Quality: 2017 Highlights and Progress." The document provides insights into the reviews of Single Audits that received enhanced oversight. For all audits (including Single Audits), 55 percent of all audits reviewed were materially nonconforming in 2016.

The most common causes of non-conformity were

- inadequate or nonexistent audit documentation,
- no testing of internal controls over compliance in single audits, and
- no testing of one or more applicable compliance requirements in single audits.

The rate of non-conformity with professional standards peer reviewers detected on must-select engagements has more than tripled since 2015. Three percent of firms in the Federal Audit Clearinghouse (FAC) database were not properly enrolled in the peer review program or failed to report to their peer reviewer that they performed a single audit (evaluation performed in 2015–16 for year-ends in 2013).

Twenty-three percent of all single audits subject to enhanced oversight were materially non-conforming with professional standards due to failure to properly test controls over compliance. Sixteen percent of single audits subject to enhanced oversight were materially non-conforming due to failure to properly test direct and material compliance requirements.

The AICPA identified the following three key factors driving single audit quality:

- The more single audits a firm performed every year (regardless of firm size), the more likely a given single audit was to conform to professional standards.
- Governmental Audit Quality Center (GAQC) membership firm members had two times greater conformity than non-members.
- The number of single audits the engagement partner performed annually

GAQC members who performed 11 or more single audits annually were found to be in conformity 100 percent of the time. The theme is practice makes perfect, and commitment to quality is key to audit quality success.

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## Knowledge check

9. For all audits subject to enhanced oversight in 2016, what percent were materially nonconforming?
- a. 25.
  - b. 35.
  - c. 45.
  - d. 55.

## Appendix A

# EAQ INITIATIVE ACTIVITY

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This appendix is required reading for CPE credit.



### Case study

For each of the six points, identify possible barriers to implementation and describe what can be done to overcome these barriers.

Point	Barrier to implementation	How to overcome
Pre-licensure		
Standards and ethics		
CPA learning and support		
Peer review		
Practice monitoring of the future		
Enforcement		





# Exempt Organizations Glossary

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## Governmental Terminology

**Accounting system** – The methods and records established to identify, assemble, analyze, classify, record, and report a government's transactions and to maintain accountability for the related assets and liabilities.

**Accrual basis of accounting** – The recording of financial effects on a government of transactions and other events and circumstances that have consequences for the government in the periods in which those transactions, events, and circumstances occur, rather than only in the periods in which cash is received or paid by the government.

**Ad valorem tax** – A tax based on value (such as a property tax).

**Advance from other funds** – An asset account used to record noncurrent portions of a long-term debt owed by one fund to another fund within the same reporting entity. (See **Due to other funds** and **interfund receivable/payable**).

**Agency funds** – A fund normally used to account for assets held by a government as an agent for individuals; private organizations; or other governments or other funds, or both.

**Appropriation** – A legal authorization granted by a legislative body to make expenditures and to incur obligations for specific purposes. An appropriation is usually limited in the amount and time it may be expended.

**Assigned fund balance** – A portion of fund balance that includes amounts that are constrained by the government's intent to be used for specific purposes, but that are neither restricted nor committed.

**Basis of accounting** – A term used to refer to *when* revenues, expenditures, expenses, and transfers, and related assets and liabilities are recognized in the accounts and reported in the financial statements. Specifically, it relates to the timing of the measurements made, regardless of the nature of the measurement. (See **Accrual basis of accounting**, **cash basis of accounting**, and **modified accrual basis of accounting**).

**Bond** – A written promise to pay a specified sum of money (the face value or principal amount) at a specified date or dates in the future (the maturity dates[s]), together with periodic interest at a specified rate. Sometimes, however, all or a substantial part of the interest is included in the face value of the security. The difference between a note and bond is that the latter is issued for a longer period and requires greater legal formality.

**Business type activities** – Those activities of a government carried out primarily to provide specific services in exchange for a specific user charge.

**Capital grants** – Grants restricted by the grantor for the acquisition or construction, or both, of (a) capital asset(s).

**Capital projects fund** – A fund used to account for and report financial resources that are restricted, committed, or assigned to expenditures for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital project funds exclude those types of capital-related outflows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations, or other governments.

**Cash basis of accounting** – A basis of accounting that requires the recognition of transactions only when cash is received or disbursed.

**Committed fund balance** – A portion of fund balance that includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority.

**Consumption method** – The method of accounting that requires the recognition of an expenditure or expense as inventories are used.

**Contributed capital** – Contributed capital is created when a general capital asset is *transferred* to a proprietary fund or when a grant is received that is externally restricted to capital acquisition or construction. Contributions restricted to capital acquisition and construction and capital assets received from developers are reported in the operating statement as a separate item after nonoperating revenues and expenses.

**Debt service fund** – A fund used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years should also be reported as debt service funds.

**Deferred inflow of resources** – An acquisition of net assets by a government that is applicable to a future reporting period.

**Deferred outflow of resources** – A consumption of net asset by a government that is applicable to a future reporting period.

**Deficit** – (a) The excess of the liabilities of a fund over its assets. (b) The excess of expenditures over revenues during an accounting period or, in the case of proprietary funds, the excess of expenses over revenues during an accounting period.

**Disbursement** – A payment made in cash or by check. Expenses are only recognized at the time physical cash is disbursed.

**Due from other funds** – A current asset account used to indicate an account reflecting amounts owed to a particular fund by another fund for goods sold or services rendered. This account includes only short-term obligations on an open account, not interfund loans.

**Due to other funds** – A current liability account reflecting amounts owed by a particular fund to another fund for goods sold or services rendered. This account includes only short-term obligations on an open account, not interfund loans.

**Fund financial statements** – Each fund has its own set of self-balancing accounts and fund financial statements that focus on information about the government's governmental, proprietary, and fiduciary fund types.

**Enabling legislation** – Legislation that authorizes a government to assess, levy, charge, or otherwise mandate payment of resources from external resource providers and includes a legally enforceable requirement that those resources be used for the specific purposes stipulated in the legislation.

**Encumbrances** – Commitments related to unperformed (executory) contracts for goods or services. Used in budgeting, encumbrances are *not* generally accepted accounting principles (GAAP) expenditures or liabilities but represent the estimated amount of expenditures that will ultimately result if unperformed contracts in process are completed.

**Enterprise fund** – A fund established to account for operations financed and operated in a manner similar to private business enterprises (such as gas, utilities, transit systems, and parking garages). Usually, the governing body intends that costs of providing goods or services to the general public be recovered primarily through user charges.

**Expenditures** – Decreases in net financial resources. Expenditures include current operating expenses requiring the present or future use of net current assets, debt service and capital outlays, intergovernmental grants, entitlements, and shared revenues.

**Expenses** – Outflows or other consumption of assets or incurrences of liabilities, or a combination of both, from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

**Fund** – A fiscal and accounting entity with a self-balancing set of accounts in which cash and other financial resources, all related liabilities and residual equities, or balances, and changes therein, are recorded and segregated to carry on specific activities or attain certain objectives in accordance with special regulations, restrictions, or limitations.

**Fund balance** – The difference between fund assets and fund liabilities of the generic fund types within the governmental category of funds.

**Fund type** – The 11 generic funds that all transactions of a government are recorded into. The 11 fund types are as follows: general, special revenue, debt service, capital projects, permanent, enterprise, internal service, private purpose trust, pension trust, investment trust, and agency.

**GASB** – The Governmental Accounting Standards Board (GASB) was organized in 1984 by the Financial Accounting Foundation (FAF) to establish standards of financial accounting and reporting for state and local governmental entities. Its standards guide the preparation of external financial reports of those entities.

**General fund** – The fund within the governmental category used to account for all financial resources, except those required to be accounted for in another governmental fund.

**General-purpose governments** – Governmental entities that provide a range of services, such as states, cities, counties, towns, and villages.

**Governmental funds** – Funds used to account for the acquisition, use, and balances of spendable financial resources and the related current liabilities, except those accounted for in proprietary funds and fiduciary funds. Essentially, these funds are accounting segregations of financial resources. Spendable assets are assigned to a particular government fund type according to the purposes for which they may or must be used. Current liabilities are assigned to the fund type from which they are to be paid. The difference between the assets and liabilities of governmental fund types is referred to as *fund balance*. The measurement focus in these fund types is on the determination of financial position and changes in financial position (sources, uses, and balances of financial resources), rather than on net income determination.

**Government-wide financial statements** – Highly aggregated financial statements that present financial information for all assets (including infrastructure capital assets), liabilities, and net assets of a primary government and its component units, except for fiduciary funds. The government-wide financial statements use the economic resources measurement focus and accrual basis of accounting.

**Infrastructure assets** – Long-lived capital assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets. Examples of infrastructure assets are roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, are not considered infrastructure assets.

**Interfund receivable/payable** – Activity between funds of a government reflecting amounts provided with a requirement for repayment, or sales and purchases of goods and services between funds approximating their external exchange value (also referred to as **interfund loans** or **interfund services provided and used**).

**Internal service fund** – A generic fund type within the proprietary category used to account for the financing of goods or services provided by one department or agency to other departments or agencies of a government, or to other governments, on a cost-reimbursement basis.

**Investment trust fund** – A generic fund type within the fiduciary category used by a government in a fiduciary capacity, such as to maintain its cash and investment pool for other governments.

**Major funds** – A government's general fund (or its equivalent), other individual governmental type, and enterprise funds that meet specific quantitative criteria, and any other governmental or enterprise fund that a government's officials believe is particularly important to financial statement users.

**Management's discussion and analysis** – Management's discussion and analysis, or MD&A, is required supplementary information that introduces the basic financial statements by

presenting certain financial information as well as management's analytical insights on that information.

**Measurement focus** – The accounting convention that determines (a) which assets and which liabilities are included on a government's balance sheet and where they are reported, and (b) whether an operating statement presents information on the flow of financial resources (revenues and expenditures) or information on the flow of economic resources (revenues and expenses).

**Modified accrual basis of accounting** – The basis of accounting adapted to the governmental fund type measurement focus. Revenues and other financial resource increments are recognized when they become both *measurable* and *available to finance expenditures of the current period*. *Available* means collectible in the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recognized when the fund liability is incurred and expected to be paid from current resources, except for (a) inventories of materials and supplies that may be considered expenditures either when purchased or when used and (b) prepaid insurance and similar items that may be considered expenditures either when paid for or when consumed. All governmental funds are accounted for using the modified accrual basis of accounting in fund financial statements.

**Modified approach** – Rules that allow infrastructure assets that are part of a network or subsystem of a network not to be depreciated as long as certain requirements are met.

**Net Position** – the residual of all other elements presented in a statement of financial position.

**Nonspendable fund balance** – The portion of fund balance that includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

**Pension trust fund** – A trust fund used to account for a public employees retirement system. Pension trust funds use the accrual basis of accounting and the flow of economic resources measurement focus.

**Permanent fund** – A generic fund type under the governmental category used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs and, therefore, are for the benefit of the government or its citizenry. (Permanent funds do not include private-purpose trust funds, which should be used when the government is required to use the principal or earnings for the benefit of individuals, private organizations, or other governments).

**Private purpose trust fund** – A general fund type under the fiduciary category used to report resources held and administered by the reporting government acting in a fiduciary capacity for individuals, other governments, or private organizations.

**Proprietary funds** – The government category used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector (these are enterprise and internal service funds). All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business and quasi-business activities are accounted for

through proprietary funds. Proprietary funds should apply all applicable GASB pronouncements and those GAAP applicable to similar businesses in the private sector, unless those conflict with GASB pronouncements. These funds use the accrual basis of accounting in conjunction with the flow of economic resources measurement focus.

**Purchases method** – The method under which inventories are recorded as expenditures when acquired.

**Restricted fund balance** – Portion of fund balance that reflects constraints placed on the use of resources (other than non-spendable items) that are either (a) externally imposed by a creditor, such as through debt covenants, grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

**Required supplementary information** – GAAP specify that certain information be presented as required supplementary information, or RSI.

**Special-purpose governments** – Legally separate entities that perform only one activity or a few activities, such as cemetery districts, school districts, colleges and universities, utilities, hospitals and other health care organizations, and public employee retirement systems.

**Special revenue fund** – A fund that *must* have revenue or proceeds from specific revenue sources that are either restricted or committed for a specific purpose other than debt service or capital projects. This definition means that in order to be considered a special revenue fund, there must be one or more revenue sources upon which reporting the activity in a separate fund is predicated.

**Interfund Transfers** – All transfers, such as legally authorized transfers from a fund receiving revenue to a fund through which the resources are to be expended, where there is no intent to repay. Interfund transfers are recorded on the operating statement.

**Unassigned fund balance** – Residual classification for the general fund. This classification represents fund balance that has not been assigned to other funds and has not been restricted, committed, or assigned to specific purposes within the general fund. The general fund should be the only fund that reports a positive unassigned fund balance amount. In other funds, if expenditures incurred for specific purposes exceeded the amounts restricted, committed, or assigned to those purposes, it may be necessary to report a negative unassigned fund balance.

**Unrestricted fund balance** – The total of committed fund balance, assigned fund balance, and unassigned fund balance.

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## Not-for-Profit Terminology

**Board-designated endowment fund** – An endowment fund created by a not-for-profit entity's governing board by designating a portion of its net assets without donor restrictions to be invested to provide income for a long, but not necessarily specified, period.

**Board-designated net assets** – Net assets without donor restrictions subject to self-imposed limits by action of the governing board. Board-designated net assets may be earmarked for

future programs, investment, contingencies, purchase or construction of fixed assets, or other uses.

**Charitable lead trust** – A trust established in connection with a split-interest agreement in which the not-for-profit entity receives distributions during the agreement's term. Upon termination of the trust, the remainder of the trust assets is paid to the donor or to third-party beneficiaries designated by the donor.

**Charitable remainder trust** – A trust established in connection with a split-interest agreement in which the donor or a third-party beneficiary receives specified distributions during the agreement's term. Upon termination of the trust, a not-for-profit entity receives the assets remaining in the trust.

**Collections** – Works of art, historical treasures, or similar assets that are (a) held for public exhibition, education, or research in furtherance of public service, rather than financial gain, (b) protected, kept unencumbered, cared for, and preserved, and (c) subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections.

**Conditional promise to give** – A promise to give that depends on the occurrence of a specified future and uncertain event to bind the promisor.

**Contribution** – An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

**Costs of joint activities** – Costs incurred for a joint activity. Costs of joint activities may include joint costs and costs other than joint costs. *Costs other than joint costs* are costs that are identifiable with a particular function, such as program, fundraising, management and general, and membership development costs.

**Donor-imposed restriction** – A donor stipulation (*donors* include other types of contributors, including makers of certain grants) that specifies a use for the contributed asset that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws, or comparable documents for an unincorporated association. A restriction on an organization's use of the asset contributed may be temporary in nature or perpetual in nature.

**Donor-restricted endowment fund** – An endowment fund that is created by a donor stipulation (*donors* include other types of contributors, including makers of certain grants) that requires investment of the gift in perpetuity or for a specified term. Some donors or laws may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions.

**Donor-restricted support** – Donor-restricted revenues or gains from contributions that increase net assets with donor restrictions (*donors* include other types of contributions, including makers of certain grants).

**Economic interest** – A not-for-profit entity's interest in another entity that exists if any of the following criteria are met: (a) The other entity holds or uses significant resources that must be used for the purposes of the not-for-profit entity, either directly or indirectly, by producing income or providing services, or (b) the not-for-profit entity is responsible for the liabilities of the other entity.

**Endowment fund** – An established fund of cash, securities, or other assets that provides income for the maintenance of a not-for-profit entity. The use of the assets of the fund may be with or without donor-imposed restrictions. Endowment funds generally are established by donor-restricted gifts and bequests to provide a source of income in perpetuity or for a specified period.

**Functional expense classification** – A method of grouping expenses according to the purpose for which the costs are incurred. The primary functional classifications of a not-for-profit entity are program services and supporting activities.

**Funds functioning as endowment** – Net assets without donor restrictions (*donors* include other types of contributors, including makers of certain grants) designated by an entity's governing board to be invested to provide income for generally a long, but not necessarily specified, period.

**Joint activity** – An activity that is part of the fundraising function and has elements of one or more other functions, such as programs, management and general, membership development, or any other functional category used by the entity.

**Joint costs** – The costs of conducting joint activities that are not identifiable with a particular component of the activity.

**Management and general activities** – Supporting activities that are not directly identifiable with one or more programs, fundraising activities, or membership development activities.

**Natural expense classification** – A method of grouping expenses according to the kinds of economic benefits received in incurring those expenses. Examples of natural expense classifications include salaries and wages, employee benefits, professional services, supplies, interest expense, rent, utilities, and depreciation.

**Net assets** – The excess or deficiency of assets over liabilities of a not-for-profit entity, which is divided into two mutually exclusive classes according to the existence or absence of donor-imposed restrictions.

**Net assets with donor restrictions** – The part of net assets of a not-for-profit entity that is subject to donor-imposed restrictions (*donors* include other types of contributors, including makers of certain grants).

**Net assets without donor restrictions** – The part of net assets of a not-for-profit entity that is not subject to donor-imposed restrictions (*donors* include other types of contributors, including makers of certain grants).

**Permanently restricted net assets** – The part of the net assets of a not-for-profit organization resulting from (a) contributions and other inflows of assets whose use by the organization is



limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the organization, (b) other asset enhancements and diminishments subject to the same kinds of stipulations, and (c) reclassifications from (or to) other classes of net assets as a consequence of donor-imposed stipulations. Will be superseded upon implementation of FASB Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*.

**Programmatic investing** – The activity of making loans or other investments that are directed at carrying out a not-for-profit entity's purpose for existence, rather than investing in the general production of income or appreciation of an asset (for example, total return investing). An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.

**Promise to give** – A written or oral agreement to contribute cash or other assets to another entity. A promise to give may be either conditional or unconditional.

**Underwater endowment fund** – A donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions.

**Temporarily restricted net assets** – The part of the net assets of a not-for-profit entity resulting from (a) contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that either expire by the passage of time or can be fulfilled and removed by actions of the entity pursuant to those stipulations, (b) other asset enhancements and diminishments subject to the same kinds of stipulations, and (c) reclassifications to (or from) other classes of net assets as a consequence of donor-imposed stipulations, their expiration by passage of time, or their fulfillment and removal by actions of the entity pursuant to those stipulations. Will be superseded upon implementation of ASU No. 2016-14.

**Unrestricted net assets** – The part of net assets of a not-for-profit entity that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations. Will be superseded upon implementation of ASU No. 2016-14.

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## Single Audit and Yellow Book Terminology

**Attestation engagements** – Attestation engagements concern examining, reviewing, or performing agreed-upon procedures on a subject matter or an assertion about a subject matter and reporting on the results.

**Compliance supplement** – A document issued annually in the spring by the OMB to provide guidance to auditors.

**Data collection form** – A form submitted to the Federal Audit Clearinghouse that provides information about the auditor, the auditee and its federal programs, and the results of the audit.

**Federal financial assistance** – Assistance that nonfederal entities receive or administer in the form of grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, or other assistance, but does not include amounts received as reimbursement for services rendered to individuals in accordance with guidance issued by the Director.

**Financial audits** – Financial audits are primarily concerned with providing reasonable assurance about whether financial statements are presented fairly, in all material respects, in conformity with GAAP or with a comprehensive basis of accounting other than GAAP.

**GAGAS** – Generally accepted government auditing standards issued by the GAO. They are also commonly known as the Yellow Book.

**GAO** – The United States Government Accountability Office. Among its responsibilities is the issuance of GAGAS (that is, the Yellow Book).

**OMB** – The Office of Management and Budget. The OMB assists the President in the development and implementation of budget, program, management, and regulatory policies.

**Pass-through entity** – A nonfederal entity that provides federal awards to a subrecipient to carry out a federal program.

**Performance audits** – Performance audits entail an objective and systematic examination of evidence to provide an independent assessment of the performance and management of a program against objective criteria as well as assessments that provide a prospective focus or that synthesize information on best practices or cross-cutting issues.

**Program-specific audit** – A compliance audit of one federal program.

**Single audit** – An audit of a nonfederal entity that includes the entity's financial statements and federal awards.

**Single Audit Guide** – This AICPA Audit Guide, formally titled *Government Auditing Standards and Single Audits* (the Single Audit Guide), is the former Statement of Position (SOP) 98-3. The Single Audit Guide provides guidance on the auditor's responsibilities when conducting a single audit or program-specific audit in accordance with the Single Audit Act, GAGAS, and the Uniform Guidance.

**Subrecipient** – A nonfederal entity that receives federal awards through another nonfederal entity to carry out a federal program but does not include an individual who receives financial assistance through such awards.

**Uniform Guidance** – Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), sets forth the requirements for the compliance audit portion of a single audit.

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# **GOVERNMENTAL ACCOUNTING AND AUDITING UPDATE**

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**BY MELISA F. GALASSO, CPA**

Solutions

The AICPA publishes *CPA Letter Daily*, a free e-newsletter published each weekday. The newsletter, which covers the 10-12 most important stories in business, finance, and accounting, as well as AICPA information, was created to deliver news to CPAs and others who work with the accounting profession. Besides summarizing media articles, commentaries, and research results, the e-newsletter links to television broadcasts and videos and features reader polls. *CPA Letter Daily's* editors scan hundreds of publications and websites, selecting the most relevant and important news so you don't have to. The newsletter arrives in your inbox early in the morning. To sign up, visit [smartbrief.com/CPA](http://smartbrief.com/CPA).

Do you need high-quality technical assistance? The AICPA Auditing and Accounting Technical Hotline provides non-authoritative guidance on accounting, auditing, attestation, and compilation and review standards. The hotline can be reached at 877.242.7212.

# Solutions

## Chapter 1

### Exercise 1-1

#### Solution

Which cost principles apply to this award?		
Federal award funding period	Cost principles applicable to award	
	Circulars	Uniform guidance
December 01, 2016 – November 30, 2017		√
Incremental funding action dated March 1, 2017, based on an original award date of March 1, 2013. The award terms and conditions were modified upon the incremental funding action.		√
Incremental funding action dated November 1, 2016, based on an original award date of November 1, 2014. The award terms and conditions were not modified upon the incremental funding action.	√	
Incremental funding action dated September 1, 2017, based on an original award date of September 1, 2015. The award terms and conditions were not modified upon the incremental funding action.		√

### Knowledge check solutions

1.
  - a. Incorrect. The Uniform Guidance contains Subpart B, "General Provisions."
  - b. Incorrect. The Uniform Guidance contains Subpart D, "Post Federal Award Requirements."
  - c. Correct. The Uniform Guidance does not contain a Subpart G, "Hospital Cost Principles. Hospital Cost Principles are found in Appendix IX to Part 200."
  - d. Incorrect. The Uniform Guidance contains Subpart E, "Cost Principles."

2.
  - a. Incorrect. A nonfederal entity that expends \$750,000 or more in federal awards during the entity's fiscal year is required to have a single audit. \$500,000 was the threshold under Circular A-133.
  - b. Incorrect. A nonfederal entity that expends \$750,000 (not \$1,000,000) or more in federal awards during the entity's fiscal year must have a single audit.
  - c. Correct. A nonfederal entity that expends \$750,000 or more in federal awards during the entity's fiscal year must have a single audit.
  - d. Incorrect. A nonfederal entity is required to have a single audit if it expends \$750,000 or more in federal awards during the entity's fiscal year.
3.
  - a. Incorrect. A large loan program is a federal program providing loans that exceeds four times (not two times) the largest nonloan program.
  - b. Incorrect. A large loan program is a federal program providing loans that exceeds four times (not three times) the largest nonloan program.
  - c. Correct. A large loan program is a federal program providing loans that exceeds four times the largest nonloan program.
  - d. Incorrect. A large loan program is a federal program providing loans that exceeds four times (not five times) the largest nonloan program.
4.
  - a. Incorrect. Type A programs do not allow for more professional judgment than Type B programs.
  - b. Correct. Type A programs allow for less professional judgment than Type B programs.
  - c. Incorrect. Type A programs do not allow for the same amount of professional judgment than Type B programs.
  - d. Incorrect. Professional judgment is permitted in major program determination.
5.
  - a. Incorrect. Social Security numbers are protected personally identifiable information.
  - b. Incorrect. Passport numbers are protected personally identifiable information.
  - c. Correct. Email addresses are not protected personally identifiable information.
  - d. Incorrect. Place of birth is protected personally identifiable information.



6.
  - a. Incorrect. The corrective action plan is a separate document from the schedule of finding and questioned cost.
  - b. Correct. The corrective action plan is a standalone document.
  - c. Incorrect. The corrective action plan is not the responsibility of the auditor; it is the responsibility of the auditee.
  - d. Incorrect. The corrective action plan is optional.
  
7.
  - a. Correct. Procurement by macro-purchases is not an acceptable method.
  - b. Incorrect. Procurement by small purchase procedures is an acceptable method.
  - c. Incorrect. Procurement by sealed bid is an acceptable method.
  - d. Incorrect. Noncompetitive proposal is an acceptable method.

## Federal activities case study

### Case study

### Solution

NFP Entity programs and expenditures are listed in the *2018 Summary of Programs by CDFA Number*, which consists of summarized data collected by the auditor. NFP Entity does not meet the criteria as a low-risk auditee. In preparing for the audit, answer the following questions:

1. What is the type A threshold? \$750,000
2. Identify the type A programs:

Type A programs	10.557, 16.606, 66.039, 93.052, 93.667, 93.914, 93.919
-----------------	--

3. Identify the low-risk and other than low-risk type A programs:

Low Risk	10.557, 16.606, 66.039, 93.667, 93.914 (Note—Inherent risk is not a criterion that can be used in determining risk of type A programs.)
Other than low risk	93.052, 93.919

4. What is the maximum number of high-risk type B programs required to be identified?

Required number is: 5 low-risk type A programs  $\times$  0.25 = 2 (rounded)

5. Which type B programs do not require a risk assessment because they meet the criteria for a relatively small program (that is, are immaterial)?

10.572, 66.034, 93.243, 93.283, 93.563, 93.959, 93.991

6. Assuming the risk assessment is performed beginning at the top of the CFDA listing of programs, which type B programs would you considered high risk (and why)?

[The answers may vary due to auditor judgment. Also, starting at the top of the list is not the only way to begin the risk assessment process. For example, some auditors may look at highest dollars first, or some other risk factor. In any case, the solution that follows will give an indication of the types of things an auditor may consider in determining high-risk type B programs.]

High-risk type B program # 1: CFDA # 16.527 with expenditures of \$400,000

The program was assessed as high inherent risk and had a significant deficiency in 2016.

High-risk type B program # 2: CFDA # 93.069 with expenditures of \$600,000

The program has been assessed as moderately risky and had a material weakness in 2016.

Programs assessed for risk with no conclusion of high risk are 10.559, 66.001. This conclusion was based on an assessment of low inherent risk and no recent findings.

Programs not required to be assessed for risk because they have expenditures below the threshold of \$187,000 are 10.572, 66.034.

[The auditor is not required to identify more high-risk type B programs than one-quarter the number of low-risk type A programs. That requirement is now met, and risk assessment should stop.]

7. How many type B programs did you risk assess?

The number of programs assessed for risk in this scenario is four.

8. Which programs would you audit as major programs?

CFDA #	Dollars expended	Type A or B?	Why selected?
93.052	\$1,500,000	A	Has not been audited in either of the prior two fiscal periods
93.919	\$1,000,000	A	Has not been audited in either of the prior two fiscal periods

CFDA #	Dollars expended	Type A or B?	Why selected?
16.527	\$400,000	B	Determined to be high-risk as part of type B program risk assessment
93.069	\$600,000	B	Determined to be high-risk as part of type B program risk assessment
<p>Additional programs of your choice should be selected to test as major programs such that total expenditures being audited as major programs equal or exceed 40 percent of federal awards expended.  (\$13,381,000 × 0.40 = \$5,352,400) They can be selected in any manner the auditor chooses.</p>			

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## Chapter 2

### Knowledge check solutions

1.
  - a. Incorrect. GASB Statement No. 84, Fiduciary Activities is not effective for reporting periods beginning after June 15, 2017.
  - b. Incorrect. GASB Statement No. 84, Fiduciary Activities is not effective for reporting periods beginning after December 15, 2016.
  - c. Incorrect. GASB Statement No. 84, Fiduciary Activities is not effective for reporting periods beginning after June 15, 2018.
  - d. Correct. GASB Statement No. 84, Fiduciary Activities is effective for reporting periods beginning after December 15, 2018.
  
2.
  - a. Correct. DC plans are not defined benefit plans.
  - b. Incorrect. DC plans must disclose the authority under which the OPEB plan is established or may be amended.
  - c. Incorrect. DC plans must disclose the classes of plan members covered
  - d. Incorrect. DC plans must disclose the number of plan members, participating employers, and nonemployer contributing entities.

3.
  - a. Incorrect. The effects of automatic postemployment benefit changes should be projected.
  - b. Incorrect. Automatic COLAs should be projected.
  - c. Correct. Only ad hoc postemployment benefit changes that are substantively automatic should be projected.
  - d. Incorrect. Projected benefit payments should be projected.
4.
  - a. Incorrect. Current period service cost is included in OPEB expense in the current period.
  - b. Incorrect. Interest on the total pension liability is included in OPEB expense in the current period.
  - c. Incorrect. Projected earnings on plan investments is included in OPEB expense in the current period.
  - d. Correct. Actual earnings on plan investments are not included in OPEB expense in the current period. Differences in projected and actual returns are included in OPEB expense over a closed five-year period.
5.
  - a. Incorrect. OPEB plan's fiduciary net position is required to be disclosed.
  - b. Incorrect. Employer's proportionate share of the collective net OPEB liability is required to be disclosed.
  - c. Incorrect. Measurement date of the collective net OPEB liability is required to be disclosed.
  - d. Correct. This is not required to be disclosed. OPEB expense is a period expense.
6.
  - a. Correct. If the government is not the intermediary, then the government should recognize a beneficial interest in trust.
  - b. Incorrect. If the government is not the intermediary, then the government should not recognize a deferred outflow of resources.
  - c. Incorrect. If the government is not the intermediary, then the government should not recognize a liability for the lead interest.
  - d. Incorrect. If the government is not the intermediary, then the government should not recognize a liability for the remainder interest.

7.

- a. Incorrect. The initial measurement of an ARO should not be based on the highest estimate of the current value of outlays expected to be incurred.
- b. Incorrect. The initial measurement of an ARO should not be based on the lowest estimate of the current value of outlays expected to be incurred.
- c. Correct. The initial measurement of an ARO should be based on the best estimate of the current value of outlays expected to be incurred.
- d. Incorrect. The initial measurement of an ARO should not be based on the weighted average of the current value of outlays expected to be incurred.

8.

- a. Incorrect. The assets associated with the activity are controlled by the government is a criterion to be a fiduciary activity.
- b. Correct. The assets associated with the activity are not derived solely from the government's own-source revenues is NOT a criterion to be a fiduciary activity.
- c. Incorrect. The assets are administered through a trust in which the government itself is not a beneficiary, dedicated to providing benefits to recipients in accordance with the benefit terms, and legally protected from the creditors of the government is a criterion to be a fiduciary activity.
- d. Incorrect. The assets associated with the activity are not derived from government-mandated nonexchange transactions is a criterion to be a fiduciary activity.

9.

- a. Incorrect. Fair value was addressed in GASB Statement No. 85.
- b. Incorrect. OPEB was addressed in GASB Statement No. 85.
- c. Correct. Leases was not addressed in GASB Statement No. 85.
- d. Incorrect. Goodwill was addressed in GASB Statement No. 85.

10.

- a. Incorrect. Lease Payable would be credited.
- b. Incorrect. Lessees do not recognize Deferred Inflow of Resources.
- c. Incorrect. Lessees do not recognize Deferred Outflow of Resources.
- d. Correct. Lessees would debit Intangible Asset and credit Lease Liability.

## Appendix 2B case study solution

Step 1 – Determine the lease term and explain why.

Lease term is 15 years (10 standard, plus 1 renewal) (reasonably certain to exercise)

Step 2 – Determine the value of the lease liability for Richmond County.

Annual payments:

15 years, 8% = 8.5595

$100,000 \times .9 = 90,000$  (CAM of 10% is allocated separately)

$90,000 \times 8.5595 = 770,355$

Exercise price:

$1,000 \times .4632 = 463$

**Total lease liability = \$770,818**

Step 3 – Determine the value of the lease asset for Richmond County.

Liability = 770,818

Initial Direct Cost = 5,000 (broker commission)

Asset = 775,818

Step 4 – Prepare the journal entry for December 31, Year 1, asset amortization.

$775,818 \div 15 = 51,721$

Debit amortization expense 51,721

    Credit accumulated amortization 51,721

Step 5 – Prepare the journal entry for December 31, Year 1, lease payment.

Interest portion of \$100,000 payment is \$28,335 based on:

    Present value of lease = \$770,818, interest rate = 8%, number of periods = 15

Debit lease liability 28,335

Debit interest expense 61,665

Debit CAM expense 10,000

    Credit cash 100,000

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## Chapter 3

### Knowledge check solutions

1.
  - a. Incorrect. Obtaining sufficient appropriate evidence to conclude on management's use of the going concern basis of accounting is a responsibility of the auditor.
  - b. Correct. Selecting the appropriate financial reporting framework is the responsibility of management.
  - c. Incorrect. Concluding whether substantial doubt exists is the responsibility of the auditor.
  - d. Incorrect. Evaluating the effect on the financial statements including disclosure is the responsibility of the auditor.
2.
  - a. Incorrect. Examinations are performed under the SSAEs.
  - b. Incorrect. Reviews are performed under the SSAEs.
  - c. Correct. Preparation is not performed under the SSAEs.
  - d. Incorrect. Agreed-Upon Procedures are performed under the SSAEs.
3.
  - a. Incorrect. Securities issued or guaranteed by the state of North Carolina are exempt offerings.
  - b. Incorrect. Securities issued by an employee benefit plan are exempt offerings.
  - c. Correct. Securities issued by a publicly traded company do not qualify as exempt offerings.
  - d. Incorrect. Securities issued by a not-for-profit educational institution are exempt offerings.
4.
  - a. Incorrect. Fair value is appropriate for an investment that has a RDFV.
  - b. Incorrect. Equity method is appropriate for an investment that has a RDFV.
  - c. Correct. Net asset value per share is NOT appropriate for an investment that has a RDFV.
  - d. Incorrect. Cost is appropriate for an investment that has a RDFV.

5.
  - a. Correct. Not-for-profits by definition are not PBEs.
  - b. Incorrect. Healthcare entities who are conduit debt obligors do qualify as PBEs.
  - c. Incorrect. For profit entities who are conduit debt obligors do qualify as PBEs.
  - d. Incorrect. Credit unions who are conduit debt obligors do qualify as PBEs.
6.
  - a. Incorrect. Hosting services are NOT permitted attest service.
  - b. Correct. Hosting services are NOT permitted nonattest service.
  - c. Incorrect. Hosting services are NOT permitted nonattest service.
  - d. Incorrect. Hosting services are attest services.
7.
  - a. Incorrect. GAQC members made up more than 65 percent of the total federal expenditures covered in single audits.
  - b. Incorrect. GAQC members made up more than 75 percent of the total federal expenditures covered in single audits.
  - c. Correct. GAQC members make up approximately 90 percent of the total federal expenditures covered in single audits.
  - d. Incorrect. GAQC members do not comprise 100 percent of the total federal expenditures covered in single audits.
8.
  - a. Incorrect. There is not only one level of certificate.
  - b. Correct. There are two levels of certificates.
  - c. Incorrect. There are not three levels of certificates.
  - d. Incorrect. There are not four level of certificates.
9.
  - a. Incorrect. More than 25 percent were nonconforming.
  - b. Incorrect. More than 35 percent were nonconforming.
  - c. Incorrect. More than 45 percent were nonconforming.
  - d. Correct. Fifty-five percent were nonconforming.



## Appendix 3A case study solution

There are no “right” answers to this case study. Some common responses are listed as follows. Other answers may be acceptable.

Point	Barrier to implementation	How to overcome
Pre-licensure	<p>Lack of instructors qualified to teach accounting at the HS level</p> <p>Making the exam harder by requiring higher order thinking skills may discourage students from taking the CPA exam</p>	<p>Active recruiting of educators at the advanced education level of college accounting programs</p> <p>More involvement of the professional community in the formulation of exam questions</p>
Standards and ethics	<p>Requiring information on risk areas may increase lawsuits and make it more expensive to get insurance for CPAs in public practice</p>	<p>More extensive ethics education</p> <p>Increase ethics CPE requirements for CPAs</p>
CPA learning and support	<p>There is a lack of advanced courses for professionals with many years of experience.</p> <p>CPAs do not take courses that are applicable to their work. They take CPE for compliance, not true learning purposes.</p>	<p>More active involvement in the curriculum development of advanced accounting programs at colleges</p>
Peer review	<p>Being able to select your peer reviewer allows bias to enter the system.</p> <p>Making it harder to be a peer reviewer can lead to fewer peer reviewers and there is already a shortage of peer reviewers.</p>	<p>Change the process to select peer reviewers.</p>
Practice monitoring of the future	<p>Some firms are not using computerized systems.</p> <p>Smaller entities may decide to stop performing attestation engagements.</p>	<p>Offer more technology education at the CPE and university levels.</p>
Enforcement	<p>Regulators have different intentions than peer reviewers. What a regulator determines to be deficient is often not based on materiality.</p>	<p>More collaboration between regulators and peer reviewers</p>



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