



ACCOUNTING

CONTINUING EDUCATION

Governmental Update

(GU4)

Governmental Update

(GU4)

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GOVERNMENTAL UPDATE (GU4)
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Unit

1

Industry Update

LEARNING OBJECTIVE

After completing this unit, participants will be able to:

- **Understand** the challenges facing not-for-profit (NFP) entities in 2022 to assess risk to the entity.

INTRODUCTION

This year's industry update focuses on the evolving landscape of NFP entities. The following topics are discussed:

- Fundraising and donor engagement opportunities
- Programming and services delivery
- Succession planning
- Impact of government reform initiatives
- Cyber threats

STATE OF NFPs

The lessons learned during the COVID-19 pandemic will shape NFPs in 2022 and beyond. NFPs will not experience a quick return to the way things used to be pre-pandemic. Instead, brand-new opportunities now exist. Changes in how NFPs operate, what they focus on, how they deliver programs, how they raise money, and how they involve and connect with constituents are part of the new environment.

Fundraising & Donor Engagement Opportunities

Giving USA 2021: The Annual Report on Philanthropy for the Year 2020,¹ reports that individuals, bequests, foundations, and corporations gave an estimated \$471.4 billion to charities in 2020. Total charitable giving grew 5.1% measured in current dollars over the \$448.7 billion contributed in 2019.

¹ <https://store.givingusa.org/collections/home-page-2021/products/2021-annual-report?variant=39329211613263>

Adjusted for inflation, total giving increased 3.8%. Three of the four sources of charitable giving grew during 2020 (adjusted for inflation), with foundations leading the way:

- Foundations, \$88.6 billion, up 15.6%
- Bequests, \$41.2 billion, up 9%
- Individuals, \$324.1 billion, up 1%
- Corporations, \$16.9 billion, down -7.3%

Giving to seven of the nine major types of recipient charitable organizations grew in 2020, including double-digit increases in several areas as follows:

- Public-society benefit, \$48 billion, up 14.3%
- Environment and animals, \$16.1 billion, up 10.3%
- Human services, \$65.1 billion, up 8.4%
- International affairs, \$25.9 billion, up 7.8%
- Education, \$71.3 billion, up 7.7%
- Foundations, \$58.2 billion, up 0.8%
- Religion, \$131.1 billion, down -0.2%
- Health, \$42.1 billion, down -4.2%
- Arts, culture, and humanities, \$19.5 billion, down -8.6%

As noted in *The Annual Report on Philanthropy for the Year 2020*, extraordinary advancements in 2020, including the global COVID-19 pandemic, the resulting financial crisis, and attempts to improve racial justice, generated a strong, pervasive need and substantially expanded the need for NFP organizations. Surprisingly, charitable giving together with the stock market turnaround in the final months of 2020 boosted contributions. Consequently, 2020 became the highest year of charitable giving on record.

Giving in 2020 followed some established patterns for what is expected in recessionary years, such as raises in basic-needs giving and reductions to the arts. However, there were other factors at play in 2020. For example, giving to religious organizations is typically least affected by economic changes; however, other causes, such as the shutdown that prevented in-person services from occurring, had a significant impact on some religious NFPs. Additionally, there was also a digital divide in 2020 between NFPs that were able to pivot their fundraising and services to online and those that were more severely limited by the effects of the COVID-19 pandemic.

Forward thinking NFPs are recognizing that the way they approach their donors, volunteers, and beneficiaries may not yield the same results as in the past. Communication needs, donation mechanisms, and constituent preferences are different now and will continue to evolve in the future as millennials take a larger role and members of the silent generation and baby boomers age out.

For NFPs that continue to have challenges with fundraising, certain risks can occur as outlined in the table below:

NFPs May Need To:	This Could Lead To:
Have a certain level of donations or other revenue sources in order to obtain matching grants.	Misclassifying funding
Pay operating expenses when cash is tight.	Using donor-restricted net assets for unrestricted purposes
Show a level of contributions that may be needed to demonstrate they are a viable entity.	Inflating contributions or revenue through receivables
Obtain additional financing to stay afloat.	Altering the books and records to inflate assets or minimize liabilities
Meet debt covenants.	Altering the books and records to improve ratios or other metrics
Cover certain operating expenses when unrestricted revenue sources have declined.	Categorizing some expenses as allowable for grant purposes when they are not or overallocating payroll or other costs to grants

Some NFPs “borrowed” from restricted funding to pay operating expenses believing that they would be able to pay it back. This has not happened for some NFPs, as the underlying problem of decreased funding remains.

Fundraising involves building relationships, so it’s important for NFPs to find creative, new ways to promote donations. For instance, hosting virtual fundraisers can be a way to expand your targeted demographics and build a new extensive contributor base. An in-person fundraiser allows only a limited number of people to get involved. A virtual fundraising event could have limitless attendees from every corner of the globe all participating at once, and without the added operating costs of an in-person event.

Many NFPs unexpectedly found that virtual events could be very effective and could potentially raise more funds than traditional in-person events. Great leaders know that holding on to the past is not the safest way forward. NFPs are well past the point of expecting that things will return to the way they were before the COVID-19 pandemic began in the spring of 2020. As NFPs look at fundraising expansion prospects in 2022 and beyond, they need to become versatile and respond to the rise of online and mobile giving. According to a Wipfli survey,² the share of gifts given through these mediums continue to increase year after year. NFPs will have to adapt to this shift in giving which may require an upfront financial investment in technology and time commitment.

Programming & Services Delivery

The COVID-19 pandemic fast-tracked virtual meetings and events and the need to utilize and leverage technology for NFP organizations. NFPs will need to be proactive with technology rather than reactive. Technology should be part of a NFP’s long-term budget planning, both in terms of cost and staffing. Leveraging online tools, such as websites and social media platforms, builds greater support and increases the opportunity to reach and engage new volunteers and donors. Technology

² <https://nff.org/covid-19-survey-results>

can develop unexpected efficiencies and opportunities. For example, Church of God Ministries, an NFP religious organization headquartered in Anderson, Indiana, built a portal to connect its network of pastors, churches, and state assemblies to operate as one unit more than ever before.

The COVID-19 pandemic created a huge need for certain NFPs as demands soared for health care, food, career counseling, disaster relief, small business loans, and many other social services. Fortunately, many NFPs were able to meet that demand with new service and delivery methods. For example, the Community Action Network reported that its local agencies shifted to home delivery for food and diapers and implemented rapid response techniques with social distancing to deliver services efficiently and safely. In another example, the Ohio District 5 Area Agency on Aging embraced online data capture and backed away from in-person and over-the-phone contact that often resulted in voicemail queues and multiple touchpoints. The move streamlined the intake process to free up front-line staff for other important work.

While many of the innovations discussed above were created to respond to the COVID-19 pandemic, the success that NFPs have experienced means that these new innovations will stick around into the foreseeable future. NFPs will have to continue their shifts in programming and service delivery as they work toward a “new norm.”

Succession Planning

In today’s very competitive marketplace, employers (both NFPs and for-profit entities) are struggling to find talent. This is due to several factors. One of the reasons for this is the low number of people in this country who are over the age of 18. Another reason is a direct result of the COVID-19 pandemic. Specifically, individuals are reassessing their lives because of their experiences during the COVID-19 pandemic. Many individuals are making drastic changes, which include dropping out of the job market altogether. The Department of Labor published data demonstrating that in the months of April, May, and June 2021, 11.5 million people self-selected out of the marketplace.³ Furthermore, according to Gallup researchers, 48 percent of employees are actively looking to make a change.⁴ According to Personio researchers, nearly 1:4 employees will look for a new job in the next six months.⁵ Those looking for changes will find ripe opportunities. In June 2021, the U.S. employment marketplace hit an all-time high of 10.1 million job openings. The employment marketplace is facing a talent predicament that will continue into the foreseeable future.

The best way to stabilize an NFP’s workplace is to have an effective succession plan and strategies in place to decrease attrition and increase retention. When employees of NFPs feel valued and are provided with a future vision of their opportunities, they are more inclined to stay for the long term. When an employee leaves an NFP organization, it is normal practice to reallocate the workload until the entity hires a replacement. Unfortunately, in today’s challenging marketplace, hiring a replacement employee can take months (if it even happens at all).

Creating a robust organizational succession plan, together with career paths and individual coaching and mentoring, can go a long way toward sustaining institutional knowledge and reducing turnover. A robust succession planning process should include the following:

³ <https://www.bls.gov/news.release/jolts.t04.htm>

⁴ <https://www.gallup.com/workplace/351545/great-resignation-really-great-discontent.aspx>

⁵ https://hr.personio.de/hubfs/EN_Downloads/202104_HRStudy_UKI.pdf

- *Identifying key positions or roles in the NFP.* An NFP should document and explain the skills, knowledge, and attributes needed for success in key roles in the organization. This includes determining competencies important to the NFP as well as leadership competencies for various roles.
- *Identifying high-performing employees.* An NFP should identify resources who have potential to develop the necessary talents, expertise, and characteristics to succeed in each key position identified. The NFP should focus on retaining these employees first. It's important to assess successor candidates against the competencies to identify gaps to develop a career blueprint for each potential replacement.
- *Evaluating the employee composition.* An NFP should seek out highly skilled individuals and those with unique knowledge to determine who would replace them should they leave. To identify these individuals, NFPs should identify employees who would leave a significant void should they quit.
- *Determining successor candidates' willingness to move to another position.* Readiness charts can help an NFP identify its strengths and development needs as well as track who is ready to assume a position, who may be able to serve in an interim capacity, and who may be ready over time.

Not having the right resources in the right quantities in the right positions to get the job done creates significant inefficiencies for NFPs. Succession planning will help NFPs control what they can. By looking inside its organization and thinking long term, an NFP may be able to reduce its rate of turnover.

Impact of Government Reform Initiatives

The COVID-19 pandemic has created an environment of unrest and uncertainty for some NFPs that has called into question the sustainability and survivability of some of these organizations. NFPs have never been under greater pressure to improve their internal management. This pressure, coupled with various governmental reform initiatives, makes it necessary for NFPs to have conversation about the costs and benefits of each new reform, subjecting each new idea to its own internal scrutiny. The following are selected reform topics that NFPs should be mindful about.

Simplification of Excise Taxes on Private Foundations

One area of change for NFP entities from recent legislation deals with the simplification of excise taxes on private foundations. Since 1969, private foundations have been subject to a two-tiered tax approach. Under the old rules (for tax years beginning on or before December 31, 2019), the private foundation paid either a 1% or 2% tax on net investment income depending on the private foundation's charitable expenditures. This two-tiered tax approach has now been eliminated. Excise tax on net investment income for private foundations is changed to a single rate of 1.39% for tax years beginning after December 31, 2019.

This tax must be reported on Form 990-PF, *Return of Private Foundation*. Payment of the tax is subject to estimated tax requirements.⁶ Nonexempt private foundations are also subject to this tax, but only to the extent that the sum of the excise tax plus tax on unrelated business income, applied as if the foundation were tax-exempt, is greater than income tax liability for the year.

⁶ For more information concerning payment of estimated tax, see the Instructions for Form 990-PF at <https://www.irs.gov/pub/irs-pdf/i990pf.pdf>.

While this change means a private foundation can no longer qualify for a reduced 1% net investment income tax, it also streamlines the tax and allows private foundations to increase distributions in times of need without a penalty.

Payments in Lieu of Taxes (PILOTs)

Every state exempts some or all of the property owned by charitable NFPs from property taxes. Even though they do not have the legal authority to do so, some municipalities attempt to impose discriminatory taxes or fees on NFPs by demanding so-called “voluntary” PILOTs. The assessment may be called by different terms (e.g., taxes, fees, or PILOTs).

Many NFPs pay little or no property tax since they rent or own small amounts of property. Colleges, universities, hospitals, independent schools, and churches may own significant amounts of land so the payments could be substantial.

Governments are looking for ways to fund services and their costs are rising, so over the last several years, more of them have been requesting PILOTs or fees to cover the costs of government services. Grant Thornton conducted a survey to see how prevalent the activity was. In that survey, which included NFPs across the United States, 3% were paying service fees, 8% were making PILOTs, and 31% were paying taxes.

Some entities believe they should be making payments because it is the right thing to do and their missions support that. Not all feel that way and two universities hired a consultant to show the city how much it benefitted from having the university as a resident. The study confirmed that the positive economic impact (jobs, etc.) benefitted the government more than the cost of the services provided by the city.⁷

Since there has been an increase in the prevalence of PILOTs, NFPs should be prepared for the likelihood they will be asked to provide them.

Health Insurance Portability & Accountability Act Compliance

The Health Insurance Portability and Accountability Act (HIPAA) sets strict guidelines for safeguarding personal health information an entity may interact with. HIPAA is comprised of different components that regulate how certain types of organizations are required to handle health information. NFP compliance to HIPAA is required if the NFP interacts with health information in any way. For instance, compliance is required if an NFP

- procures health insurance for its employees;
- obtains medical information from its clients (or volunteers);
- provides health care services; or
- provides services to others in the health care field.

⁷ Payments in Lieu of Taxes, a whitepaper available to members of the not-for-profit section. <https://www.aicpa.org/interestareas/notforprofit/resources/financialaccounting/pilot.html>

NFPs must implement and maintain compliance with HIPAA requirements. This not only includes protection of health information in physical form but also includes the network and processes over which health information is handled.

HIPAA violations are categorized in four tiers based on the violators' level of culpability for the violation as follows:

- Tier 1: the person did not know (and, by exercising reasonable diligence, would not have known) that the person violated the provision;
- Tier 2: the violation was due to reasonable cause, and not willful neglect;
- Tier 3: the violation was due to willful neglect that is timely corrected; and
- Tier 4: the violation was due to willful neglect that is not timely corrected.

As of April 2019, the annual penalty limit imposed by the Department of Health and Human Services for Tier 1 violations is \$25,000. The annual penalty limits for Tier 2 and 3 violations are \$100,000 and \$250,000, respectively. The penalty limit for Tier 4 violations is set at \$1.5 million. These limits are adjusted for inflation annually. State attorney generals also have the authority under the Health Information Technology for Economic and Clinical Health (HITECH) Act to hold NFPs accountable for the exposure of the protected health information of state residents and can file civil actions with the federal district courts. HIPAA violation fines can be issued up to a maximum level of \$25,000 per violation category, per calendar year. An NFP impacted by a data breach that affects residents in multiple states could also be ordered to pay HIPAA violation fines to attorney generals in multiple states.

EXAMPLE

The Arc of Erie County, an NFP in Buffalo, NY, was fined \$200,000 in penalties for violating HIPAA. In February 2018, the Arc of Erie County learned clients' protected health information, including full names, Social Security numbers, gender, race, primary diagnosis codes, IQ scores, insurance information, addresses, phone numbers, dates of birth, and ages, were exposed on its website.

Even though the NFP reported that the site was only for internal use, HIPAA has strict guidelines on how covered organizations need to handle protected health information. HIPAA mandates a thorough risk analysis of electronic systems storing and transmitting health data. Had the Arc of Erie County conducted such analysis, they would have been aware of their vulnerability due to an openly accessible patient record system. Since 2015, 3,751 of the NFP's clients were affected when unauthorized third parties accessed information.

Source: <https://ag.ny.gov/press-release/2018/ag-underwood-announces-200000-settlement-buffalo-non-profit-exposing-clients>

Cyber Threats

NFPs face many similar challenges and opportunities as for-profit entities. Technology is improving the capability for entities to connect both within an organization and external to the organization. If utilized appropriately, technology can increase efficiency, facilitate partnerships across time zones, and provide supplementary avenues to increase fundraising. Several cloud-based accounting systems that are available to NFPs have integrated accounting and compliance platforms that will make daily

tasks effortless. Additionally, many other systems used by NFPs (i.e., payroll, expense tracking, payment systems, etc.) can be incorporated with a cloud technology enterprise system. This could make an NFP more effective with its data being made accessible for faster decision making. The challenge for NFPs is to identify ways technology can modernize practices and change how they are executing strategy in terms of scope, impact, and price. NFPs should ensure that they have appropriate IT personnel, policies, and infrastructure to promote strategic positioning to maximize efficiency. For instance, NFPs should consider having appropriate IT strategy, suitable capital for hardware and software, a gateway for the board/management to track documents, and policies and procedures implementing controls for data access and security. At the same time, NFPs need to also consider their cybersecurity defenses as they continue to rely on technology to enhance their missions. In recent years, many NFPs have been targets of hackers.

Ten years ago, this issue plagued larger companies but did not register very high on the NFP risk scale. Today, data breaches can cause significant financial and reputational damage to an NFP. NFPs collect personally identifiable information such as health information, social security numbers, employee and volunteer records, and billing information, and this information, even with a good internal control system, is subject to breach. The impact on the entity and its employees can be damaging. Stolen data can be sold or used by the hackers. Sometimes what hackers want is payment. Organizations, particularly hospitals, are being blackmailed into paying ransom to hackers in order to regain access to data and in the case of a Muncie, Indiana, NFP, to return the data and not publish it.⁸ There can also be legal and regulatory ramifications.

According to Verizon's *2021 Data Breach Investigations Report*, ransomware attacks are still going strong, accounting for nearly 61.2% of incidents where malware was used. Ransomware has become so commonplace that it is less frequently mentioned in the media unless there is a high-profile target in the mix. However, it is still a serious threat to all industries, including NFPs. Ransomware can stop the processing of an entity until a ransom is paid to unlock the system. Most NFPs will pay the ransom to get back up and running again. Ransomware is predicted to cost its victims around \$265 billion annually by 2031, according to Cybersecurity Ventures, with a new attack every two seconds as ransomware perpetrators progressively refine their malware payloads and related extortion activities. The dollar figure is based on 30 percent year-over-year growth in damage costs over the next 10 years. The cost was \$325 million in 2015 and \$11.5 billion in 2019.

Cybersecurity and data security are related but deal with different aspects of information technology management. Cybersecurity focuses on protecting network and infrastructure from attacks. Data security focuses on securing personal information. There are a variety of laws regulating both types of issues.

According to Venable, a national law firm, cybercrimes affect approximately one million victims daily and cost over \$450 billion a year, globally. This is a 200% increase in cost from 2010 to 2015.⁹ Allianz Group, a leading global corporate insurance carrier, noted that in 2020, cyber incidents ranks as the most important business risk in its annual risk barometer. Compare this with 2013, where cyber incidents were ranked 15th in its annual risk barometer.¹⁰ This increase risk is driven by organizations' increasing reliance on their data and IT systems. Overall, cyber incidents are becoming more sophisticated and targeted as criminals seek higher rewards with extortion demands. The

⁸<https://nonprofitquarterly.org/2017/06/08/nonprofit-cybersecurity-pay-attention/>

⁹<https://www.venable.com/files/Event/8f068f95-0d0d-47c1-8045-df53e73a1445/Presentation/EventAttachment/c3d6a15c-9bd9-429d-a4ba-b9c18afc604b/Top-Ten-Cybersecurity-Tips-for-Nonprofits-Managing-Your-Technical-and-Legal-Risks-handouts-02-02-2.pdf>

¹⁰<https://www.agcs.allianz.com/news-and-insights/expert-risk-articles/allianz-risk-barometer-2020-cyber-incidents.html>

Ponemon Institute identified that the three main causes of data breach from its study, *2020 Cost of Data Breach Report*,¹¹ are:

¹¹<https://www.ibm.com/security/digital-assets/cost-data-breach-report/#/pdf>

- Malicious attack (52%)
- System glitch (25%)
- Human error (23%)

This illustrates that cybersecurity threats are escalating, unnerving the boards of directors, managers, investors, and other stakeholders of organizations of all sizes—whether public or private.

NFP organizations are under pressure to demonstrate that they are managing threats and that they have effective processes and controls in place to detect, respond to, mitigate, and recover from cybersecurity events. Where appropriate, organizations can consider obtaining an SOC for Cybersecurity.¹²

The COVID-19 pandemic has had a significant impact on the way many NFPs operate, with large numbers of employees working remotely. This has caused an increased demand for video conferencing, cloud applications, and network resources. Seventy-six percent of organizations that participated in the Ponemon Institute study indicated that remote work make responding to a potential data breach a much more difficult ordeal. The study found that remote work during the COVID-19 pandemic would increase the time to identify and contain a potential data breach. The study also found that by having a remote workforce, the total average cost of a data breach increased by nearly \$137,000.

The degree of complexity of data security solutions and the skilled employees it takes to monitor and manage them is a barrier to implementation. The cost is also a factor for many NFPs. The following table outlines several threats that NFPs face:

Threat	Defined
Hackers/hacktivists	Hackers are people who use computers to gain unauthorized access to data. They can be criminal groups, cyber criminals, script kiddies (a person who uses existing computer scripts or code to hack into computers because they don't have the expertise to write their own). A hacker is a hacker with a political agenda.
Insiders	Insiders look for deficiencies in internal controls to gain unauthorized access to data, or if they are authorized to have access, use the data for gain.
Spyware/malware	Spyware is a type of software that enables a user to obtain covert information about another's computer activities by transmitting data covertly from their hard drive. Malware is software that is intended to damage or disable computers and computer systems.
Ransomware	Ransomware is a type of malicious software from crypto virology that threatens to publish the victim's data or perpetually block access to it unless a ransom is paid.

¹² AICPA. "SOC for Cybersecurity: Information for Organizations." AICPA. Accessed January 16, 2022. <https://us.aicpa.org/interestareas/frc/assuranceadvisoryservices/cybersecurityfororganizations>.

Threat	Defined
Social engineering	Social engineering is psychological manipulation of people into performing actions or divulging confidential information. Examples: posing as IT personnel to get employees to divulge their passwords, learning the company lingo to convince employees they are legitimate, pretending to be law enforcement, IRS, or other types of agents. These threats can be in person, via email, other electronic means, or on the phone.

A risk assessment is an important step in identifying all of the areas where the network is vulnerable starting with an inventory of digital assets. The Nonprofit Technology Network (NTEN) suggests that the first step in assessing a NFP’s data risks is to take inventory of all the data the NFP collects and identify where it is stored.¹³ NFPs should answer these questions:

- What data do we collect?
- What do we do with it?
- Where do we store it?
- Who do we share it with?
- Who is responsible for it?
- What do we do when we are done with it?
- Do data we collect about individuals or other entities know we have it?
- Do they know what we do with it?
- Does it identify them personally?
- What do we do if they want their data back?

As part of its data inventory assessment, NFPs should consider the cost associated with maintaining all the data it maintains as well as the associated benefits of maintaining such data. Many NFPs may find that there is data that is kept that may not be needed. In such instances, NFPs should decrease or limit the data they amass and modernize their storage process (as well as their process for destroying data). One helpful approach is to divide data identified into the following three categories: (1) data that cannot be lost, (2) data that cannot be exposed, and (3) nonessential data. In some instances, some data identified may be classified as both data that cannot be lost *and* exposed. This would indicate that these items are the NFP’s highest priority to protect. This is the first step towards mitigating risks.

NFPs will continue to confront new and evolving cyber risks that they will need to mitigate. To help address these challenges, NFPs should consider utilizing the guidance *Managing Cyber Risks in a Digital Age*, released by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)

¹³ <https://www.nten.org/article/assessing-risk-protect-valuable-data/>

in collaboration with Deloitte Risk & Financial Advisory in December 2019.¹⁴ The guidance provides insight into how NFPs can leverage the five components and 20 principles of the Enterprise Risk Management (ERM) Framework to identify and manage cyber risks. The guidance notes that the fast-evolving cyber threat landscape makes it imperative for organizations to increase their cyber proficiencies and capabilities so that they may effectively assess how well these risks are being addressed.

As part of its assessment, NFPs should consider its need for insurance. Cybersecurity insurance is available, and while it may not mitigate reputational risk, it can be very helpful in paying for the remediation that will need to be performed after an attack. It is important to develop policies and procedures and then provide security awareness training to users. The NFP should also develop an incident response plan to help contain any breach that occurs.

It is important to evaluate the NFP's firewalls and spam filtering system. In addition, it is important to perform operating system updates. Intrusion prevention and detection software could be used in addition to next-generation anti-virus/anti-malware software. Many entities are using multi-factor authentication. Some fixes are as easy as forcing staff to use different and changing passwords and ensuring that the training that should be given to all employees on cybersecurity is thoroughly understood so it can be implemented. This includes verifying when transactions involve cash as noted in the illustration that follows.

EXAMPLE

A hacker infiltrated the IT system of a NFP and was able to read email and interoffice communications on the entity's server. The Controller and the CFO were having a series of discussions over email and through interoffice communications about a wire transfer that was to occur when the amount became known. One day the Controller got an email from the CFO instructing him to transfer \$200,000 to the vendor as they had previously discussed. The email sounded like it came from the CFO (the hacker had learned the entity lingo and acronyms). The Controller made the transfer to the vendor with the routing number and account specified in the email. It was not until later that day when he saw the CFO that he learned that the email was not real.

Note that hackers have the ability to do new things every day. In a similar instance, a vendor made a communication to a NFP asking them to change the payment routing instructions. The employee hovered the cursor over the email address to ensure it was from a bona fide employee at the vendor. Noting no discrepancy but still wanting to confirm that the instructions were authorized, the employee called the vendor. There she learned that no such instructions had been sent to the NFP.

¹⁴ To access this guidance, visit: <https://www.coso.org/Documents/COSO-Deloitte-Managing-Cyber-Risk-in-a-Digital-Age.pdf>

Unit 2

GASB Update

LEARNING OBJECTIVES

After completing this unit, participants will be able to accomplish the following:

- Identify** and **describe** selected issues affecting the governmental accounting profession currently.
- Recognize** and **apply** major accounting and disclosure issues affecting government clients or entities.
- Prepare** complete and accurate financial disclosures for government entities based on new GASB developments.

GASB UPDATE

COVID-19 Implications

The novel coronavirus disease, COVID-19, has created a unique environment of unrest and uncertainty for many state and local governmental entities, including special purpose governments, public benefit corporations and authorities, utilities, hospitals and other healthcare providers, and colleges and universities. Many of these organizations engaged in transactions related to the Coronavirus Aid, Relief, and Economic Act (CARES Act) and certain outflows incurred in response to the pandemic. As a result, many questions have been raised by practitioners on the application of existing GASB standards to transactions related to the pandemic.

In June 2020, Technical Bulletin No. 2020-1, *Accounting and Financial Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and Coronavirus Diseases*, was issued by the GASB. This bulletin clarifies the application of existing recognition requirements of Statements 33, 56, and 70 to resources received from certain programs established by the CARES Act. It also clarifies how existing presentation requirements apply to certain inflows of CARES Act resources and to the unplanned and additional outflows of resources incurred in response to the pandemic. Guidance for the presentation of inflows of resources as operating or nonoperating provided in Statement 34 is based on the classifications established in Statement 9 and is further clarified in Implementation Guide 2015-1. Guidance for the presentation of outflows of resources as special or extraordinary items is provided in Statement 34 and expanded in Statement 62.

GASB has also established a webpage¹⁵ to provide stakeholders with accounting and financial reporting relief and other resources for practitioners and stakeholders.

Recent GASB Pronouncements

The following is a discussion of recently issued GASB pronouncements. Effective dates and implementation requirements are summarized in the table below. A more robust discussion of each of these standards follows.

Pronouncement	Effective Date	Implementation
<p>GASB 98, <i>The Annual Comprehensive Financial Report</i></p>	<p>Effective for fiscal years ending after December 15, 2021. Earlier application is encouraged.</p>	<p>This standard establishes the term <i>annual comprehensive financial report</i> and its acronym, <i>ACFR</i>. That new term and acronym replace instances of <i>comprehensive annual financial report</i> and its acronym in generally accepted accounting principles for state and local governments.</p>
<p>GASB 97, <i>Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans</i></p>	<p>The requirements that (a) exempt primary governments that perform the duties that a governing board typically performs for certain requirements and (b) limit the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet certain criteria, are effective immediately (June 2020).</p> <p>The requirements that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021. Early application is permitted.</p>	<p>Apart from a defined contribution plan that has a separate governing board, it's probable that those plans will not meet the definition of a component unit, thereby eliminating one of two ways that these plans could come into a government's financial statements as a fiduciary activity. Governmental entities with these defined contribution plans will still need to consider the concept of control within GASB Statement 84 before making a final conclusion as to the treatment of these types of plans.</p> <p>An entity with a 457 plan will need to first determine whether that plan meets the definition of a pension plan. If it does, the concepts related to defined contribution plans would apply, unless the 457 plan isn't a defined contribution plan (very infrequent). If the Section 457 plan doesn't meet the definition of a pension plan, entities would treat it like any other employee benefit plan for accounting and financial reporting purposes and analyze it under GASB 84 accordingly.</p>

¹⁵ <https://www.gasb.org/COVID19>

Pronouncement	Effective Date	Implementation
GASB 96, <i>Subscription-Based Information Technology Arrangements</i>	Fiscal years beginning after June 15, 2022, and all reporting periods thereafter.	This standard (a) defines a subscription-based information technology arrangement (SBITA); (b) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (c) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (d) requires note disclosures regarding a SBITA.
GASB 95, <i>Postponement of the Effective Dates of Certain Authoritative Guidance</i>	Effective immediately upon issuance (May 2020).	The standard provides relief to governments and other stakeholders in light of the COVID-19 pandemic by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.
GASB 94, <i>Public-Private and Public-Public Partnerships and Availability Payment Arrangements</i>	Fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged.	PPPs should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or if applicable to earlier periods, the beginning of the earliest period restated).
GASB 93, <i>Replacement of Interbank Offered Rates</i>	Reporting periods beginning after June 15, 2020. The specific guidance related to the removal of LIBOR as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021. Earlier application of the guidance is allowed and encouraged. <i>Effective date for certain aspects of this standard have been delayed for one year by GASB 95.</i>	Changes adopted to conform to the provisions of this statement should be applied retroactively by restating financial statements, if practicable, for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect, if any, of applying this statement should be reported as a restatement of beginning net position (or fund net position) for the earliest period restated. In the first period that this statement is applied, the notes to financial statements should disclose the nature of the restatement and its effect. Also, the reason for not restating prior periods presented should be disclosed.
GASB 92, <i>Omnibus 2020</i>	Requirements related to the effective date of Statement 87 and Implementation Guide 2019-3, reinsurance recoveries, and	Provisions related to government acquisitions should be applied prospectively, consistent with the manner in which Statement 69 was applied. For all other provisions, retroactive application is required, if practicable.

Pronouncement	Effective Date	Implementation
	<p>terminology used to refer to derivative instruments are effective upon issuance.</p> <p>Requirements related to intra-entity transfers of assets and those related to the applicability of Statements 73 and 74 are effective for fiscal years beginning after June 15, 2020.</p> <p>Requirements related to application of Statement 84 to postemployment benefit arrangements and those related to nonrecurring fair value measurements of assets or liabilities are effective for reporting periods beginning after June 15, 2020.</p> <p>Requirements related to the measurement of liabilities and assets associated with asset retirement obligations in a government acquisition are effective for government acquisitions occurring in reporting periods beginning after June 15, 2020.</p> <p>Effective date delayed for one year by GASB 95.</p>	
<p>GASB 91, <i>Conduit Debt Obligations</i></p>	<p>Reporting periods beginning after December 15, 2020. Earlier application encouraged.</p> <p><i>Effective date delayed for one year by GASB 95.</i></p>	<p>Retroactively, unless it is deemed to be impracticable. Then a cumulative effect adjustment, if any, is made on the beginning balance of the earliest year presented.</p>
<p>GASB 89, <i>Accounting for Interest Cost Incurred</i></p>	<p>Reporting periods beginning after</p>	<p>Changes adopted to conform to the provisions of this Statement should be applied</p>

Pronouncement	Effective Date	Implementation
<i>before the End of a Construction Period</i>	December 15, 2019. Earlier application encouraged. <i>Effective date delayed for one year by GASB 95.</i>	prospectively. For construction-in-progress, interest cost incurred after the beginning of the first reporting period to which this Statement is applied should not be capitalized.
GASB 87, <i>Leases</i>	Reporting periods beginning after December 15, 2019. <i>Effective date delayed for eighteen months by GASB 95.</i>	Leases should be recognized and measured using the facts and circumstances that exist at the beginning of the period of implementation (or, if applied to earlier periods, the beginning of the earliest period restated). However, lessors should not restate the assets underlying their existing sales-type or direct financing leases. Any residual assets for those leases become the carrying values of the underlying assets.

GASB 98, *The Annual Comprehensive Financial Report*

GASB Statement 98, *The Annual Comprehensive Financial Report*, establishes the term *annual comprehensive financial report* and its acronym, ACFR. That new term and acronym replace instances of *comprehensive annual financial report* and its acronym in generally accepted accounting principles for state and local governments.

This new term was developed in response to concerns raised by stakeholders that the common pronunciation of the acronym for *comprehensive annual financial report* sounds like a profoundly objectionable racial slur.

Little to no direct cost will be incurred because of instituting the new term. Additionally, there will be no direct benefits in the form of new or improved information for making decisions or assessing accountability.

GASB 97, CERTAIN COMPONENT UNIT CRITERIA, AND ACCOUNTING AND FINANCIAL REPORTING FOR INTERNAL REVENUE CODE SECTION 457 DEFERRED COMPENSATION PLANS

When GASB Statement 84, *Fiduciary Activities*, was issued it impacted how many entities had been handling defined contribution plans. Many governments utilize defined contribution plans (e.g., 457, 401(a), 403(b), and health savings plans) as part of its compensation package to its employees. It was uncommon to see defined contribution plans reported in the financial statements of those government sponsors. After GASB 84, GASB issued a series of questions and answers in Implementation Guide No. 2019-2, *Fiduciary Activities*, which created problems for many practitioners. The answer to two questions in that Implementation Guide would have caused most governmental defined contribution plans to be classified as a component unit of the government. This would have required the defined contribution plan to be included in the government's financial statements as a fiduciary activity.

Many practitioners and other stakeholders noted that many of the defined contribution plans had never been audited before. Consequently, there were many impediments inherent in including them in the employer's financial statements. As a result, GASB led a project to perform a cost benefit analysis of including these defined contribution plans in the government's financial statements. At the end of the project, GASB concluded that the cost did not outweigh the benefits and took to issuing amendments to its standards to address the challenging provisions.

GASB 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, was issued in June 2020. This statement allows for favorable treatment of defined contribution plans when applying GASB 84. It serves as an amendment of GASB Statements No. 14 and No. 84 and supersedes GASB Statement No. 32. The purposes of this Statement are to:

- increase consistency and comparability associated to the reporting of fiduciary component units in situations in which a possible component unit does not have a governing board and the primary government executes the duties that a governing board typically would perform;
- alleviate costs connected with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and
- improve the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

GASB 97 also specifies the following:

- For purposes of determining whether a primary government is financially accountable for a potential component unit (except for a potential component unit that is a defined contribution pension plan), a defined contribution OPEB plan, or another employee benefit plan (for example, certain Section 457 plans), the lack of a governing board should be treated the same as the selection of a voting majority of a governing board if the primary government executes the duties that a governing board typically would perform.
- The financial burden criterion in paragraph 7 of Statement No. 84 is applicable only to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement No. 67, *Financial Reporting for Pension Plans*, or paragraph 3 of Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, respectively.
- A Section 457 plan may be classified as either a pension plan or another employee benefit plan depending on whether the plan meets the definition of a pension plan.
- GASB 84, as amended, should be applied to all arrangements organized under IRC Section 457 to determine whether those arrangements should be reported as fiduciary activities.

GASB 97 supersedes the remaining provisions of Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, as amended, concerning investment valuation requirements for Section 457 plans. As a result, investments of all Section 457 plans should be measured as of the end of the plan's reporting period in all circumstances.

Effective Date and Transition

The requirements that (a) exempt primary governments that perform the duties that a governing board typically performs from treating the absence of a governing board the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans and (b) limit the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74, respectively, are effective immediately (June 2020).

The requirements that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021.

For purposes of determining whether a primary government is financially accountable for a potential component unit, the requirements that provide that for all other arrangements, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform, are effective for reporting periods beginning after June 15, 2021. Earlier application of those requirements is encouraged and permitted.

GASB 96, SUBSCRIPTION-BASED INFORMATION TECHNOLOGY ARRANGEMENTS

GASB 96, *Subscription-Based Information Technology Arrangements*, was issued in May 2020. The purpose of Statement No. 96 is to provide guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs). Several of the accounting provisions included in GASB 96 for SBITAs are analogous to the provisions in GASB Statement No. 87, *Leases*. Similarities include the determination of the length of the contract, the initial and subsequent recording of an intangible asset and liability, and the bifurcation of contracts containing multiple components.

GASB 96 does the following:

- defines a SBITA;
- establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability;
- provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and
- requires note disclosures of essential information regarding a SBITA.

The following are key takeaways from GASB 96:

- A SBITA is defined as a contract that conveys control of the right to use another party's (a SBITA vendor) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.

- The subscription term includes the period during which a government has a noncancellable right to use the underlying IT assets. The term also includes periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government or SBITA vendor will not exercise that option).
- An exception was provided to capitalization for short-term SBITAs, which have a maximum possible term under the SBITA contract of 12 months (including any options to extend, regardless of their probability of being exercised). Subscription payments for short-term SBITAs are recognized as outflows of resources (i.e., as an expense).
- For SBITAs other than short-term SBITAs, a government recognizes the subscription liability at the commencement of the subscription term. The subscription liability is measured at the present value of subscription payments expected to be made during the subscription term. Future subscription payments are discounted using the interest rate the SBITA vendor charges the government or the government's incremental borrowing rate if the interest rate is not readily determinable. In subsequent financial reporting periods, as payments are made under the SBITA, a portion of the payment is treated as a reduction of the principal balance of the subscription liability, and the remainder is treated as interest expense.
- The subscription asset is recognized and initially measured as the sum of (a) the initial subscription liability amount (recorded at the present value of future subscription payments, as described in the paragraph above), (b) payments made to the SBITA vendor before commencement of the subscription term, and (c) capitalizable implementation costs. A government recognizes amortization of the subscription asset as an outflow of resources over the subscription term.
- Activities associated with a SBITA, other than making subscription payments, are grouped into the following three stages, and their costs are accounted for accordingly:
 - Preliminary Project Stage, including activities such as evaluating alternatives, determining needed technology, and selecting a SBITA vendor. Outlays in this stage should be expensed as incurred.
 - Initial Implementation Stage, including all ancillary charges necessary to place the subscription asset into service. Outlays in this stage generally should be capitalized as an addition to the subscription asset.
 - Post-Implementation/Operation Stage, including activities such as maintenance and other activities for a government's ongoing operations related to a SBITA. Outlays in this stage should be expensed as incurred unless they meet specific capitalization criteria.
- In classifying certain outlays into the appropriate stage, the nature of the activity is the determining factor. Training costs, regardless of which stage they are in, are expensed as incurred.
- If a SBITA contract contains multiple components—such as both a subscription component and a nonsubscription component, or multiple underlying hardware or software components—a government accounts for each component as a separate SBITA component and allocates the contract price to the different components. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government accounts for those components as a single SBITA unit.

- Governments must disclose descriptive information about its SBITAs other than short-term SBITAs, such as the amount of the subscription asset, accumulated amortization, other payments not included in the measurement of a subscription liability, principal and interest requirements for the subscription liability, and other essential information.

The provisions of GASB 96 are effective for fiscal years beginning after June 15, 2022. Earlier application is permitted.

GASB 95, POSTPONEMENT OF THE EFFECTIVE DATES OF CERTAIN AUTHORITATIVE GUIDANCE

GASB 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, was issued in May 2020. It provides temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

The effective dates of certain provisions contained in the following standards were postponed by one year:

- GASB 83, *Certain Asset Retirement Obligations*;
- GASB 84, *Fiduciary Activities*;
- GASB 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*;
- GASB 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*;
- GASB 90, *Majority Equity Interests*;
- GASB 91, *Conduit Debt Obligations*;
- GASB 92, *Omnibus 2020*;
- GASB 93, *Replacement of Interbank Offered Rates*;
- Implementation Guide 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan Reporting)*;
- Implementation Guide 2018-1, *Implementation Guidance Update—2018*;
- Implementation Guide 2019-1, *Implementation Guidance Update—2019*; and
- Implementation Guide 2019-2, *Fiduciary Activities*.

The effective dates of the following pronouncements are postponed by 18 months:

- GASB 87, *Leases*; and
- Implementation Guide 2019-3, *Leases*.

Earlier application of the provisions is encouraged and is permitted to the extent specified in each pronouncement as it was originally issued.

GASB 94, PUBLIC-PRIVATE AND PUBLIC-PUBLIC PARTERSHIPS AND AVAILABILITY PAYMENT ARRANGEMENTS

GASB 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, was issued in March 2020. It improves accounting and reporting by establishing definitions of public-private and public-public partnerships (PPPs) and availability payment arrangements (APAs) and provides uniform guidance on accounting and financial reporting for transactions that meet those definitions.

Previous Guidance

This statement supersedes Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements; Implementation Guide No. 2015-1, Question Z.60.1; and Implementation Guide No. 2016-1, Implementation Guidance Update—2016, Question 4.74. This statement amends Statement No. 38, Certain Financial Statement Note Disclosures, paragraph 10; Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, paragraphs 11 and 12; Statement No. 51, Accounting and Financial Reporting for Intangible Assets, paragraph 3; Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, paragraph 135; Statement No. 87, Leases, paragraph 8; and Statement No. 91, Conduit Debt Obligations, paragraph 19.

New Guidance

GASB 94 establishes the following definitions:

PPP—An arrangement in which a government (the transferor) contracts with an operator (may be a governmental entity or a nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset for a period of time in an exchange or exchange-like transaction. Some PPPs are service concession arrangements (SCAs).

PPP term—The period during which an operator has a noncancelable right to use an underlying PPP asset, plus, if applicable, certain periods if it is reasonably certain, based on all relevant factors, that the transferor or the operator either will exercise an option to extend the PPP or will not exercise an option to terminate the PPP.

SCA—A PPP arrangement between a transferor and an operator in which all the following criteria are met:

- The transferor conveys to the operator the right and related obligation to provide public services through the use and operation of an underlying PPP asset in exchange for significant considerations, such as an up-front payment, installment payments, a new facility, or improvements to an existing facility.
- The operator collects and is compensated by fees from third parties (excluding custodial relationships).

- The transferor determines or could modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services.
- The transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

APA—An arrangement in which a government compensates an operator for activities that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange-like transaction. The payments by the government are based entirely on the asset’s availability for use rather than on tolls, fees, or similar revenues or other measures of demand.

The guidance establishes that a government that has a PPP that meets the definition of a lease should apply the accounting and financial reporting guidance in Statement 87, *Leases*, as amended, if (a) existing assets of the transferor are the only underlying PPP assets, (b) improvements are not required to be made by the operator to those existing assets as part of the PPP arrangement, and (c) the PPP does not meet the definition of an SCA.

All other PPPs, as well as those that meet the definition of an SCA, should be accounted for under this statement.

A transferor should recognize an underlying PPP asset as an asset in financial statements prepared using the economic resources measurement focus.

Exception: If a PPP asset is not owned by the transferor or is not the underlying asset of an SCA:

- Transferor should recognize a receivable measured based on the operator’s estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership.
- Transferor should recognize a receivable for installment payments, if any, to be received from the operator in relation to the PPP.
 - Measurement of a receivable for installment payments should be at the present value of the payments expected to be received during the PPP term.
- Transferor should recognize a deferred inflow of resources for the consideration received or to be received by the transferor as part of the PPP.
- Transferor should recognize revenue in a systematic and rational manner over the PPP term.

This new statement requires that a transferor recognize the following to account for a PPP in financial statements prepared using the current financial resources measurement focus:

- A receivable for installment payments
- Deferred inflow of resources
- Government fund revenue should be recognized in a systematic and rational manner over the PPP term

The statement also does the following:

- Provides specific guidance in financial statements prepared using the economic resources measurement focus for a government that is an operator in a PPP that either (1) meets the definition of an SCA or (2) is not within the Scope of Statement 87, as amended
- Requires a government to account for PPP and non-PPP components of a PPP as separate contracts
- Requires an amendment to a PPP to be considered a PPP modification, unless the operator's right to use the underlying PPP asset decreases, in which case, it should be considered a partial or full PPP termination
 - PPP termination is accounted for by a transferor reducing, as applicable, any receivable for installment payments or any receivable related to the transfer of ownership of the underlying PPP asset and by reducing the related deferred inflow of resources.
 - PPP termination is accounted for by an operator by reducing the carrying value of the right-to-use asset and, as applicable, any liability for installment payments or liability to transfer ownership of the underlying PPP asset.
 - PPP modification that does not qualify as a separate PPP should be accounted for by remeasuring PPP assets and liabilities.

This statement now requires that a government that engages in an APA that contains multiple components recognize each component as a separate arrangement. An APA that is related to designing, constructing, and financing a nonfinancial asset in which ownership of the asset transfers by the end of the contract should be accounted for as a financed purchase of the underlying nonfinancial asset. An APA related to operating or maintaining a nonfinancial asset should be reported as an outflow of resources in the period to which payments relate.

Effective Date and Transition

This guidance is effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged.

Transition should occur using the facts and circumstances that exist at the beginning of the period of implementation to recognize and measure PPPs (or if applicable to earlier periods, the beginning of the earliest period restated).

GASB 93, REPLACEMENT OF INTERBANK OFFERED RATES

GASB 93, *Replacement of Interbank Offered Rates*, was issued in March 2020. It provides guidance to state and local governments to transition away from certain existing benchmark reference rates, notably the London Interbank Offered Rate (LIBOR). Additionally, LIBOR is expected to cease to exist in its current form at the end of 2021. GASB 93 was deemed necessary by the Board because financial institutions have begun to transition to newer reference rates that are less likely to be subjected to market manipulation in response to the global reference rate reform. The guidance helps enhance comparability in the application of reference rates and will improve the usefulness of information for users of state and local government financial statements.

Previous Guidance

GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, previously required a state and local government to terminate hedge accounting whenever it changed the reference rate of a hedging derivative instrument's variable payment. Likewise, GASB 87, *Leases*, previously required state and local governments that replaced the rate on which variable payments depend within a lease contract to apply the provisions for lease modifications, including remeasurement of the lease liability or lease receivable.

New Guidance

GASB 93 addresses the previous guidance and other accounting and financial reporting implications of the replacement of an interbank offered rate (IBOR). Specifically, GASB 93:

- offers exceptions for certain hedging derivative instruments to the hedge accounting termination provisions when an IBOR is replaced as the reference rate of the hedging derivative instrument's variable payment;
- clarifies the hedge accounting termination provisions when a hedged item is amended to replace the reference rate;
- clarifies that the uncertainty pertaining to the continued availability of IBORs doesn't, by itself, impact the assessment of whether the occurrence of a hedged expected transaction is likely;
- removes LIBOR as an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap;
- identifies Secured Overnight Financing Rate (SOFR) and the Effective Federal Funds Rate (EFFR) as appropriate benchmark interest rates for the qualitative evaluation of the effectiveness of an interest rate swap;
- clarifies the definition of "reference rate," as it is used in Statement 53; and
- provides an exception to the lease modifications guidance GASB 87, *Leases*, for certain lease contracts that are amended solely to replace an IBOR as the rate upon which variable payments depend.

Effective Date and Transition

This guidance is effective for reporting periods beginning after June 15, 2020. The specific guidance related to the removal of LIBOR as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021. Earlier application of the guidance is allowed and encouraged.

NOTE: GASB 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, postponed the effective date of paragraphs 13 and 14 (Lease Modification) of GASB 93 to fiscal years beginning after June 15, 2021, and all reporting periods thereafter.

GASB 92, OMNIBUS 2020

GASB 92, *Omnibus 2020*, was issued in January 2020 and addresses an assortment of topics and includes specific provisions about:

- the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports;
- reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan;
- the applicability of Statements No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, as amended, and No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for postemployment benefits;
- the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefit arrangements;
- measurement of liabilities and assets related to asset retirement obligations (AROs) in a government acquisition;
- reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; and
- terminology used to refer to derivative instruments.

Statement No. 87 and Implementation Guide No. 2019-3 Effective Date

The requirements of Statement 87 are effective for fiscal years beginning after December 15, 2019. Earlier application is encouraged. The requirements of Implementation Guide 2019-3 are also effective for fiscal years beginning after December 15, 2019. Earlier application is encouraged if Statement 87 has been implemented by the entity.

Intra-Entity Transfer of Assets

The difference between the amount paid by a pension plan or OPEB plan (exclusive of amounts that may be refundable) and the carrying value of capital or financial assets transferred between a governmental employer or nonemployer contributing entity and a defined benefit pension plan or an OPEB plan that are within the same financial reporting entity are required to be reported:

- As an employer contribution or a nonemployer contributing entity contribution to the pension plan or OPEB plan in the separately issued statements of the employer or nonemployer contributing entity and in the financial statements of the reporting entity; or
- As an employer contribution or a nonemployer contributing entity contribution in the standalone statements of the pension plan or OPEB plan and in the financial statements of the reporting entity.

Reporting Assets Accumulated for Defined Benefit Postemployment Benefits Provided Through Plans That Are Not Administered Through Trusts

In certain situations, Statement 84 requires the reporting of assets that are accumulated for purposes of providing pensions or OPEB through defined benefit pension plans or defined benefit OPEB plans that are not administered through trusts that meet the criteria in paragraph 4 of Statement 73 or paragraph 3 of Statement 74, respectively. When these requirements are met, paragraph 116 of Statement 73, or paragraph 59 of Statement 74 should be applied.

Applicability of Certain Requirements of Statement 84 to Postemployment Benefit Arrangements

A government should apply the requirements in paragraph 21 of Statement 84 regarding recognition of a liability to the beneficiary (employer), if it reports a fiduciary activity for assets that are accumulated for purposes of providing pensions or OPEB through defined benefit pension plans or defined benefit OPEB plans that are not administered through trusts that meet the criteria in paragraph 4 of Statement 73 or paragraph 3 of Statement 74. A defined contribution pension plan or a defined contribution OPEB plan should apply the financial statement presentation requirements in paragraphs 20, 21, 23, and 24 of Statement 84 if it is reported as a fiduciary activity.

Exception to Acquisition Value in a Government Acquisition

In an acquisition, the acquiring government should measure liabilities and assets related to the acquired entity's AROs (that are within the scope of Statement No. 83, *Certain Asset Retirement Obligations*), using the accounting and financial reporting requirements of Statement 83 (discussed below).

Reinsurance Recoveries

In accounting for risk financing and insurance-related activities of public entity risk pools, amounts that are recoverable from reinsurers or excess insurers and relate to paid claims and claim adjustment expenses may be reported as reductions of expenses. This is not mandatory, however.

Terminology Used to Refer to Derivative Instruments

The terms "derivative" and "derivatives" in National Council on Governmental Accounting and GASB pronouncements are now replaced with "derivative instrument" and "derivative instruments."

Effective Date and Transition

Requirements related to the effective date of Statement 87 and Implementation Guide 2019-3, reinsurance recoveries, and terminology used to refer to derivative instruments are effective upon issuance.

Requirements related to intra-entity transfers of assets and those related to the applicability of Statements 73 and 74 are effective for fiscal years beginning after June 15, 2020. *Note: GASB 95, Postponement of the Effective Dates of Certain Authoritative Guidance, postponed the effective date to fiscal years beginning after June 15, 2021, and all reporting periods thereafter.*

Requirements related to application of Statement 84 to postemployment benefit arrangements and those related to nonrecurring fair value measurements of assets or liabilities are effective for reporting periods beginning after June 15, 2020. *Note: GASB 95, Postponement of the Effective Dates of Certain Authoritative Guidance, postponed the effective date to reporting periods beginning after June 15, 2021.*

Requirements related to the measurement of liabilities and assets associated with asset retirement obligations in a government acquisition are effective for government acquisitions occurring in reporting periods beginning after June 15, 2020. *Note: GASB 95, Postponement of the Effective Dates of Certain Authoritative Guidance, postponed the effective date to reporting periods beginning after June 15, 2021.*

Provisions related to government acquisitions should be applied prospectively. Retroactive application would be impractical and burdensome for many governments because the information needed may not exist or may no longer be readily available. For all other provisions, retroactive application is required, if practicable.

GASB 91, CONDUIT DEBT OBLIGATIONS

GASB 91, *Conduit Debt Obligations*, was issued in May 2019. It addresses variations in practice by providing a single method of reporting conduit debt obligations and related commitments. The guidance helps eliminate diversity in practice associated with conduit debt obligations.

Current Guidance

GASB's Interpretation No. 2, *Disclosure of Conduit Debt Obligations*, allows variation in practice among governments that issue conduit debt obligations. As a result, comparability of financial statement information is adversely impacted. The variation in practice arises from the option for government issuers either to recognize conduit debt obligations as their own debt or to simply disclose them. GASB 91 addresses this variation.

Single Method of Reporting Conduit Debt Obligations by Issuers

GASB 91 clarifies the existing definition of a conduit debt obligation; establishes that a conduit debt obligation is not a liability of the issuer; establishes standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improves required note disclosures.

GASB 91 defines a conduit debt obligation as a debt instrument having *all* of the following characteristics:

- There are at least three parties involved: (1) an issuer, (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer nor is it cross-collateralized with other debt of the issuer.

- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

Pursuant to the new guidance, an issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. If a conduit debt obligation is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntary commitment.

GASB 91 also addresses arrangements (often characterized as leases) that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors during their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers should not report those arrangements as leases, nor should they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following provisions apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer should not recognize a capital asset.
- If the title does not pass to the third-party obligor and the third party has exclusive use of the entire capital asset during the arrangement, the issuer should not recognize a capital asset until the arrangement ends.
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception of the arrangement, should recognize the entire capital asset and a deferred inflow of resources. The deferred inflow of resources should be reduced, and an inflow recognized, in a systematic and rational manner over the term of the arrangement.

GASB 91 now requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

Effective Date and Transition

This guidance is effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged. Changes adopted to conform to the provisions of this guidance should be applied retroactively by restating financial statements for all prior periods presented. If restatement for prior periods is not practicable, the cumulative effect of applying this guidance should be reported as a restatement of beginning net position (or fund balance or fund net position) for the earliest period restated. Also, the reason for not restating prior periods presented should be disclosed.

NOTE: GASB 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, postponed the effective date of GASB 91 to reporting periods beginning after December 15, 2021.

GASB 89, ACCOUNTING FOR INTEREST COST INCURRED BEFORE THE END OF A CONSTRUCTION PERIOD

GASB 89 was issued in June 2018. It is intended to (1) enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) simplify accounting for interest cost incurred before the end of a construction period. It is effective for reporting periods beginning after December 15, 2019, with earlier application encouraged. The statement should be applied prospectively. For construction-in-progress, interest cost incurred after the beginning of the first reporting period to which this Statement is applied should not be capitalized.

Current Guidance

Current guidance requires that interest begin to be capitalized when three conditions are present:

- Outlays for the asset have been made
- Activities that are necessary to get the asset ready for its intended use are in progress
- Interest cost is being incurred

Interest capitalization continues until the asset is substantially complete. This includes all the steps to prepare the asset for intended use.

Recognize as Expense

GASB 89 requires interest cost incurred before the end of a construction period to be recognized as an expense in the period incurred for financial statements prepared using the economic resources measurement focus. Accordingly, the capital asset will not be increased by the interest cost when reported in an enterprise fund or a business type activity. However, in governmental fund financial statements, interest cost incurred before the end of a construction period is recognized as an expenditure.

Board Perspective

The GASB Board concluded that interest cost incurred before the end of a construction period is a financing activity that is separate from the asset. It notes that the asset will have the same ability to

provide services regardless of whether interest cost is incurred. This is a very different perspective than the FASB where the interest capitalized on tax-exempt borrowings is likened to an opportunity cost.

NOTE: GASB 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, postponed the effective date of GASB 89 to reporting periods beginning after December 15, 2020.

GASB 87, LEASES

GASB 87, *Leases*, was issued in June 2017. It is effective for reporting periods beginning after December 15, 2019. Governments typically have a significant number of leases so they should inventory them and understand the amount that debt will be increased since it could have an effect on debt covenants, limits and statutes.

The statement was written to reflect the GASB's position that leases are financings of the right-to-use an underlying asset. It requires recognition of certain lease assets and liabilities that were previously classified as operating leases. It also recognizes inflows of resources or outflows of resources based on the payment provisions of the contract.

Where the FASB established two models for lease accounting, the GASB uses a single model. 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 is a contract that conveys control of the right to use another entity's nonfinancial asset for a period of time in an exchange or exchange-like transaction. Governments lease numerous financial assets including buildings, land, vehicles, and equipment.

Term

The lease term is defined as the noncancelable period during which the lessee can use an asset. The following are also included in the lease period:

- Periods covered by a **lessee's** option to **extend** the lease if it is reasonably certain that the lessee will exercise that option
- Periods covered by a **lessee's** option to **terminate** the lease if it is reasonably certain that the lessee will not exercise that option
- Periods covered by a **lessor's** option to **extend** the lease if it is reasonably certain that the lessor will exercise that option
- Periods covered by a **lessor's** option to **terminate** the lease if it is reasonably certain that the lessor will not exercise that option.

A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

- 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.

A lessor should recognize payments for the exercise of a purchase option and lease termination penalties upon exercise.

Short-Term Leases

A short-term lease is one that was written for a period of 12 months or less. This includes any options to extend no matter how likely they are to be exercised. Both parties should recognize short-term lease payments as outflows of resources (lessee) or inflows of resources (lessor).

Accounting—Lessee

A lessee should recognize a lease liability and a lease asset at the beginning of the lease term. The lease liability should be measured at the present value of payments expected to be made during the lease term less any lease incentives. The lease asset should be measured at the amount of the initial measurement of the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs. This does not apply to short term leases or those transfers ownership of the underlying asset.

As payments are made, the lessee reduces the lease liability and recognizes an outflow of resources (expense) for interest on the liability. The lessee amortizes the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. Note: disclosures include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Accounting—Lessor

The lessor should recognize a lease receivable and a deferred inflow of resources at the beginning of the lease term. The lessor does not derecognize the asset underlying the lease. The lease receivable is measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources is measured at the value of the lease receivable plus any payments received at or before the beginning of the lease term that relate to future periods. This does not apply to leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset.

A lessor recognizes interest revenue on the lease receivable and an inflow of resources from the deferred inflows of resources in a systematic and rational manner over the term of the lease. Disclosures include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

Contracts That Have Multiple Components and Combinations

A government will account for the lease and nonlease components of a lease contract separately. If the lease contains multiple underlying assets, in some cases, lessees and lessors would account for each underlying asset as a separate lease contract. When allocating the contract price to different components, the lessee or lessor will use contract prices for individual components, if they do not appear to be unreasonable. This is based on professional judgment. Where there are no underlying contract prices, the government will need to use professional judgment to estimate the amount.

If it is not practicable to make an estimate, multiple components in a lease contract should be accounted for as a single lease unit. Contracts that are 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 Modifications and Terminations

Even if a lease contract is amended, it is still considered a lease modification. However, if the lessee's right to use the underlying asset decreases, the amendment results in a full or partial termination. In this case, the termination is accounted for by reducing the carrying value of the lease liability and lease asset by the lessee. The lessor would reduce the lease receivable and deferred inflows of resources. The difference would be accounted for as a gain or a loss.

If the lease modification does not qualify as a separate lease, it is accounted for by the lessee by remeasuring the lease liability and adjusting the related asset. A lessor would remeasure the lease receivable and adjust the related deferred inflows of resources.

Other Transactions

If there are subleases or leaseback transactions, they are treated separately from the original lease. A transaction must include a sale, for it to be reported as a sale leaseback. If there is no sale, then it is a borrowing. In a sale leaseback, the difference between the carrying value of the capital asset that was sold and net proceeds from the sale is a deferred inflow of resources, recognized over the term of the lease.

If there is no sale, then the two are accounted for as a net transaction. The gross amounts are disclosed.

Inter-Entity and Related Party Leases

When the lessee or lessor is included as a blended component unit of the primary government, the provisions of GASB 87 do apply. If the lessor is the blended component unit, the debt and assets should be reported as if they were the primary government's debt and assets.

EXAMPLE

The primary government leases assets from one of its blended component units. The CFO reports the assets as capital assets and the debt as a long-term liability in the government-wide financial statements. The debt service activity is reported as debt service of the primary government.

Where there are leases with or between blended component units where eliminations would be required, the eliminations are made before the blended components are aggregated with the primary government. The remaining cash payments between the component units are reported as inflows of resources and outflows of resources.

When there are lease arrangements between the primary government and discretely presented component units (or between discretely presented component units), they are treated just like any other lease. However, related receivables and payables should not be combined with other amounts due to or due from discretely presented component units or with lease receivables and payables with organizations outside the reporting entity.

Related party leases should be accounted for and classified in the financial statements the same way as similar leases, unless the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. In these cases, the classification and accounting should be modified as necessary to recognize the substance of the transaction rather than merely its legal form.

EXAMPLE

A related party lease was structured to meet the definition of a short-term lease. However, the related parties have a mutual understanding that the lease contract will stay in effect for several more years. In this case, the lease should not be accounted for as a short-term lease. In addition, the nature and extent of leasing transactions with related parties should be disclosed.

Discount Rate

The lessee and lessor should use the rate charged by the lessor as the discount rate when computing the lessee's lease liability and a lessor's lease receivable. If that is not possible because a lessee can't determine that rate, the lessee should use its incremental borrowing rate. Discount rates should only be reassessed in the following instances:

- Lessee—When there is a change in the lease term or a change in determination as to whether the lessee is reasonably certain to exercise a purchase option.
- Lessor—When there is a change in lease term or a change in interest rate charged to the lessee.

If there is a change in the discount rate, a lessee's lease asset and lease liability or a lessor's lease receivable and deferred inflow of resources are adjusted using the revised discount rate in the period of change. The new rate is then used on a prospective basis.

Disclosure

Lessee's Disclosures	Lessor's Disclosures
Total amount of leased assets and accumulated amortization	Inflows of resources recognized in a reporting period from leases
Leased assets by major class of underlying asset	Inflows of resources recognized in a reporting period for variable payments and other payments not previously included in the measurement of the lease receivable

Lessee's Disclosures	Lessor's Disclosures
Outflows of resources recognized in a reporting period for variable payments and other payments not previously included in the measurement of the lease liability	Existence, term and conditions of lessee options to terminate a lease to abate payments, if the lessor has issued debt secured by the lease payments
Principal and interest requirements to maturity for each of the five subsequent fiscal years and in five-year increment thereafter	Relevant disclosures for: <ul style="list-style-type: none"> ■ Leases of assets that are investments ■ Certain regulated leases ■ Sublease ■ Sale leasebacks ■ Lease-leaseback transactions
Commitments under leases before the commencement of a lease term	
Components of any loss associated with impairment	
Relevant disclosures for: <ul style="list-style-type: none"> ■ Subleases ■ Sale-leasebacks ■ Lease-leasebacks 	

In an advisory¹⁶ dated September 2018, the Government Finance Officers' Association recommended that government management take the following actions.

- Identify who currently maintains the information on leases. Determine if all agreements are approved in one central location or are decentralized. Review the records for each location in which agreements are approved.
- Look for existing agreements not currently being recognized or disclosed as leases to ensure completeness. Consider searching vendor payments or general ledger charts of accounts, requesting lease reports from lessors to compare with government data. If the governing board is required to approve all leases, then review past board reports.
- Review the details of each lease contract.
 - If the contract has both lease and non-lease components (i.e., maintenance agreements), separate the lease components from the non-lease components, and treat as separate contracts.
 - If the contract has multiple underlying assets with different lease terms, then treat each underlying asset as a separate component and allocate the contract price to each component based on professional judgment and reasonableness.

¹⁶<http://www.gfoa.org/accounting-leases>.

- Use the price for each component in the contract, or standalone prices for similar assets. If unable to determine an allocation, then treat as a single-lease unit.
 - Determine the interest rate charged by the lessor in the agreement, if known, or an estimate of the interest rate the lessee would be charged to finance the lease is acceptable.
 - Assess all leases greater than twelve months.
 - Leases with multi-year contracts have implications on future periods for budgeting purposes. Their information is probably worth knowing, for management purposes.
 - Communicate with outside professionals to ensure broad understanding of the change across the enterprise.
- Work closely with the government’s independent auditor to provide training to professional staff as the government approaches implementation
 - Contact legal counsel and explain the new terms for accounting purposes. Short-term leases (contract term is for twelve months or less, including options to extend) will continue to be reported as an expense of the period.
 - Review debt limits (often set in state law), bond indentures, and other contractual limits on debt with legal counsel.
 - Since reported debt will increase by the present value of the future lease payments, it may be necessary to renegotiate contracts and seek legislative changes before the effective date.
 - Review laws and contracts, as well as internal policies, that refer to “capital leases,” which will no longer be an accounting term. Most leases will become “capital leases” under the definition; however, it is better to change the language than argue for or against the interpretation.
 - Communicate the requirements of the standard with all stakeholders including rating agencies, emphasizing why it is important to obtain information on all agreements, such as continuing disclosure requirements.
 - Review or establish a capitalization threshold that may be applied to leases. Consider using thresholds in line with capital assets for both assets and liabilities.
 - Review all lease agreements and consider renegotiating the terms to make them more explicit and easier to understand, for example, the length of the agreement, and the interest rate applied to the lease term.
 - Review the general ledger to collect all leases that were formerly reported as rent line items or expenses of the period. After reviewing the details of each agreement, determine whether it should be reported as a lease under GASB 87, or continue to be an expense of the period. Prepare the details of the lease agreement to be included in the notes to the financial statements, including a schedule of future lease payments of the lessee.

NOTE: GASB 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, postponed the effective date of GASB 87 to fiscal years beginning after June 15, 2021, and all reporting periods thereafter.

Unit 3

Single Audit Update

LEARNING OBJECTIVES

After completing this unit, participants will be able to:

- **Identify** and **understand** the impact of COVID-19 on single audits.
- **Identify** and **apply** the requirements of the newly issued Government Auditing Standards.
- **Understand** and **determine** the implications to NFP entities from changes made to the single audit process.

INTRODUCTION

The U.S. federal government awards nearly \$800 billion in grants annually, accounting for nearly 20 percent of the federal budget and approximately 1,800 grant programs. The federal government also provides other forms of financial assistance to NFP entities, state and local governments, Indian tribal governments, and even commercial entities in the form of loans, loan guarantees, interest subsidies, technical assistance, and insurance. These entities can also receive federal awards indirectly when they are passed through another entity. In FY 2020, the federal government issued more than \$3 trillion in financial assistance with the passage of the CARES Act and other supplemental appropriations in response to the pandemic.

To maintain accountability for these federal funds, audits may be required. Single audits are conducted using the U.S. Office of Management and Budget's (OMB's) Uniform Guidance (UG). The single audit consists of an audit of the financial statements under Government Auditing Standards (GAS) as well as a compliance audit under the Uniform Guidance.

COMPLIANCE SUPPLEMENT 2021 & OTHER CONSIDERATIONS

Federal awards can take the form of federal financial assistance or federal cost-based reimbursement contracts. Federal financial assistance is classified by Catalog of Federal Domestic Assistance (CFDA) number. Audit requirements for federal awards are contained in the annual Compliance Supplement. The Supplement is one of the most important documents that an auditor performing UG audits can have on hand. This eight-part document provides guidance on how to perform internal control and compliance testing and includes suggested internal controls and auditing procedures. The appendices of the document provide additional guidance. For example, Part 7 -

Appendix includes recent changes to guidance in one place to help auditors. The sections of the Compliance Supplement, with the most helpful ones noted, are:

1. Background, Purpose & Applicability
2. Matrix of Compliance Requirements (easy to view guide that lists the requirements for each CFDA number for which there is a supplement)
3. Compliance Requirements
4. Agency Program Requirements (provides lists of compliance procedures required for those programs with compliance supplements)
5. Clusters of Programs
6. Internal Control (very helpful section that includes sample controls over compliance for each compliance requirement)
7. Guidance for Auditing Programs Not Included in This Compliance Supplement (provides suggested procedures to use when a compliance supplement is not available)
8. Appendices

Compliance requirements are identified for most CFDA numbers in the Compliance Supplement. There are, however, programs without CFDA numbers and programs with CFDA numbers for which there are no compliance supplements. For these programs, the auditor would follow the guidance in Part 7 of the Compliance Supplement and modify it for the grant.

Another important part of the Compliance Supplement is **Part 7 - Appendix**. OMB alerts are included here. The author recommends checking Appendix 7 every year in case there have been alerts since the last time a single audit was performed.

OMB released the *2021 Compliance Supplement* in August 2021. This supplement is effective for audits of fiscal years beginning after June 30, 2020, and supersedes the 2020 Compliance Supplement and its Addendum. OMB is expected to issue more guidance in two future addenda (discussed below). Both the *2021 Compliance Supplement* and any future Supplement addenda are available on OMB's website.¹⁷

Some of the significant changes in the *2021 Compliance Supplement* follows:

- Identifies several programs that were part of the federal government's COVID-19 relief efforts as higher-risk programs (e.g., the Coronavirus Relief Fund, the Provider Relief Fund, and the Education Stabilization Fund). These designations will most likely affect the auditor's major program determination.
- Provides insights into the programs that may be incorporated/affected in future OMB addenda.
- Incorporates updates for the November 2020 revisions of the UG in the Compliance Requirements section of the Supplement.

¹⁷ <https://www.whitehouse.gov/omb/management/office-federal-financial-management/>

- Integrates requirements from the Federal Funding Accountability and Transparency Act (FFATA) along with guidance on when auditors must test FFATA in the Compliance Requirements section of the Supplement.
- Explains the important requirements outlined in the Provider Relief Fund program to determine when funding is included on an organization's Schedule of Expenditures of Federal Awards (SEFA). The Supplement also identifies what aspects of an organization's required reporting for this program the auditor is required to test.

General Changes and Updates

There are key changes to Part 3 *Compliance Requirements*. OMB's methodology in this section is different than its approach for prior UG implementation. Specifically, former and new requirements are not separately listed in Part 3 as was done previously. Instead, OMB instructs auditors to check the appropriate and relevant versions of the UG and the award terms and conditions that are dependent on the occurrence date of the transactions reviewed. Additionally, some federal agencies have been late in adopting the new 2020 UG into their regulations or had not adopted them as of the issuance of the 2021 Supplement. This inevitably is more challenging for auditors.

As noted earlier, FFATA requirements have been incorporated into the Supplement, along with guidance on when auditors must test FFATA. For programs that do not identify key line items for a performance or special report in Part 4, *Agency Program Requirements*, and Part 5, *Clusters of Programs*, the new guidance instructs auditors to only test that the report was submitted in a timely manner. Furthermore, if key line items are provided for a program for a performance or special report that would not be quantifiable and capable of evaluation against objective criteria (e.g., narratives, futuristic information, information that would require verification at the program beneficiary level, etc.), the auditors are not required to perform testing of such items. It is critical that auditors document their consideration of these problematic performance and special reporting situations when they are encountered.

Key Changes in COVID-19 Programs

There are several program additions and deletions as well as programs with significant changes. Practitioners should refer to Appendix V to identify these changes. The following key changes are provided for in the 2021 *Compliance Supplement*:

- Education Stabilization Fund (ESF) is identified as a higher-risk program and continues to be broken down into two sections covering its subprograms. Section 1 was revised for the implications of the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA) but has not been updated for implications of American Rescue Plan Act (ARP). Updates for ARP will be provided in a future Addendum. Section 2, which includes several detailed Higher Education Emergency Relief Fund (HEERF) subprograms, has, however, been updated for the implications of both CRRSAA and ARP (e.g., HEERF II and HEERF III). Auditors will need to carefully contemplate whether they can continue with single audits of entities where ESF is a major program.
- Coronavirus Relief Fund (CRF) is also identified as a higher-risk program and was updated to reflect provisions of CRRSAA that extended the CRF spend date from December 30, 2020, to December 31, 2021. Revisions were also made to modify program requirement references to the

January 2021 Treasury Federal Register notice, Coronavirus Relief Fund Program Guidance.¹⁸ Additionally, the CRF section clarifies that FFATA does not apply to CRF.

- Provider Relief Fund (PRF) is also identified as a higher-risk program. The “Other Information” section of PRF was revised to explain the amount of PRF outlays and lost revenue to be reported on the SEFA and the timing of when such expenditures and lost revenue are to be reported. Additionally, the Reporting section has been expanded to include a detailed list of key line items in the PRF Reporting Portal submission that auditor will focus on and the Special Tests and Provisions requirement has been made subject to audit because a new special test is added that relates to Out-of-Network Patient Out-of-Pocket Expenses.

Student Financial Assistance

The Student Financial Assistance program has several compliance requirement modifications. The more significant changes relate to the removal of the Matching, Level of Effort and Earmarking type of compliance requirement as subject to audit and in Special Tests and Provisions, where several requirements were revised and two new requirements were added. Additionally, auditors are directed to an Excel spreadsheet on the Department of Education website for purposes of providing the detailed sampling information the Department of Education has been collecting the last few years.

Other Clusters

A new program (Assistance Listing 10.579) was added to the Child Nutrition Cluster, and the Agriculture Foreign Food Aid Donation Cluster was deleted. Appendix VII, *Other Audit Advisories*, states that there will be no new other clusters formed by ARP Assistance Listing numbers, nor will any ARP Assistance Listing numbers be added to existing other clusters.

Appendix II, *Federal Agency Codification of Government-Wide Requirements and Guidance for Grants and Cooperative Agreements*, has been updated to reflect which agencies have adopted the 2020 revision to the Uniform Guidance in their own regulations.

Internal Reference Tables

Appendix IV, *Internal Reference Tables*, was greatly expanded to identify several programs as higher risk. In addition to ESF, CRF, and PRF (discussed above), the following programs (with Assistance Listing numbers) are considered higher risk: COVID-19 Uninsured Program (93.461), Airport Improvement Program (20.106), Federal Transit Cluster (20.500/20.507/20.252/20.526), Emergency Rental Assistance (21.023), and the Medicaid Cluster (93.778/93.777/93.775). The appendix also explains the meaning of the higher-risk designation, which is critical for auditors to understand, as it has major program determination implications. The following are key points from Appendix IV:

- A reminder that, generally, new ARP Type A programs will not have been audited in one of the two most recent audit periods subject to the 2021 Supplement and must be audited as a major program.
- For non-ARP Type A programs, the higher-risk designation will often result in the Type A program being audited as major. However, Appendix IV notes that the auditor is not precluded from determining that a higher-risk non-ARP type A program or other cluster qualifies as low risk if certain criteria are met.

¹⁸ https://home.treasury.gov/system/files/136/CRF-Guidance-Federal-Register_2021-00827.pdf

- For Type B ARP and non-ARP programs and other clusters, there are no changes to the normal risk-assessment process for higher-risk Type B programs. Specifically, the higher-risk identification must be considered with other factors in Section 200.519 of the UG. Moreover, the auditor is not required to prioritize the assessment of risk for higher-risk Type B programs over other Type B programs.
- Other Audit Advisories

Most of the changes and additions to Appendix VII, *Other Audit Advisories*, are to provide additional guidance on COVID-19 funding. A summary of key areas addressed follows:

- Donated Personal Protective Equipment (PPE) continues to be the same as the prior year. That is, donated PPE provided without compliance or reporting requirements or assistance listing is not counted for purposes of determining the threshold for a single audit or determining the Type A/B threshold for major programs. Nevertheless, emphasis is added that some PPE must appear on the SEFA as a federal program when the recipient uses funds provided under an Assistance Listing to purchase PPE.
- Agency Guidance Documents. In a section discussing the proliferation of agency guidance documents during the pandemic, the prior year guidance remains, advising that auditors may consider guidance documents in effect during the period to understand the program requirements but that auditors should refer to a statute, regulation, or term and condition as criteria for audit findings.
- New information added to Appendix VII states that OMB is currently working to issue a new summary to identify new ARP programs as well as which existing federal programs received COVID-19 funding from ARP. OMB states that it will post this information on cfo.gov as soon as it is available.
- Appendix VII includes instructions for how recipients should separately identify COVID-19–related awards on the SEFA and the Data Collection Form. The appendix also states that auditors should include the COVID-19 identification for audit findings.
- Appendix VII includes a listing of programs that are expected to be made available later. Even though the appendix states that it is providing a complete list of programs, it is important to know that this list may not actually be complete.

Appendix VII advises that the first release of the Supplement does not include new COVID-19–related programs funded under ARP or CRRSAA or information on modified compliance requirements relevant to the types of compliance requirements in Part 3 that are unique to COVID-19 for existing programs. It further elaborates that for new COVID-19–related programs that will not be included in the Addendum, the auditor must use the framework provided by Part 7, *Guidance for Auditing Programs Not Included in This Supplement*. For existing programs with incremental COVID-19 funding, the auditor must perform reasonable procedures to ensure that the compliance requirements are current.

Future Updates on the Horizon

OMB will likely issue two addenda. The first addendum will likely include two programs: (1) the Coronavirus State and Local Fiscal Recovery Fund (21.027) and (2) the update to ESF. The second addendum will include three Treasury programs (Capital Projects Fund [no Assistance Listing yet]; Homeownership Assistance Fund [21.026]; and the Local Assistance and Tribal Consistency Fund

[no Assistance Listing yet]). The second addendum may also include additional new programs. OMB is still working on identifying the full list.

The decision to issue two addenda was made by OMB after the first release of the 2021 Supplement was finalized. Consequently, Appendix VII of the 2021 Supplement indicates that there will be one addendum and that a complete list of the programs was provided in the 2021 Supplement. This is known to be incorrect due to OMB's recent decision to issue two addenda and to potentially expand the list of programs included the second addendum.

When available, the addenda are expected to be posted on cfo.gov. OMB has made clear that although the addenda will not be posted on the OMB website that they will still be reviewed by OMB prior to issuance and be considered an official part of the 2021 Supplement. Auditors should wait for the addenda when auditing one of the programs included as a major program. Waiting for the addenda is the best course of action, as it provides time for the agencies to finalize program rules and it also provides auditors with a much better understanding of agency expectations for the audits of these new programs.

YELLOW BOOK REVISIONS 2018

In July 2018, the GAO issued its 2018 Yellow Book, formally known as Generally Accepted *Government Auditing Standards* (GAGAS). The 2018 Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020, and performance audits beginning on or after July 1, 2019. In April 2021, GAO made modifications to a handful of paragraphs in the 2018 Yellow Book. The updates address the concept of equity, SKE for nonaudit services, and changes to the evaluation of internal controls for performance audits. Updates were effective upon issuance. The Yellow Book standards apply to audits of NFP organizations that expend \$750,000 or more in federal funds who are required to have an audit under the Uniform Guidance. The Yellow Book standards also apply to audits of NFP entities with state awards in certain states (amount may vary by state). Following are the major highlights of the 2018 Yellow Book.

The GAO has elected to use a format similar to the AICPA's Clarity Standards format. The guidance is contained within boxes and the application material follows. The chapters have been reorganized with certain significant concepts included in standalone chapters.

Independence is included with ethics and professional judgment in a distinct chapter. Two big changes are that the auditor should identify the preparation of financial statements and other bookkeeping activities to be significant threats and supplemental safeguards should be applied and documented. In addition, the client should be able to identify material issues (errors or omissions) when reviewing financial statements.

Competence and CPE are included in a distinct chapter. The GAO added application guidance to the CPE chapter related to courses on GAGAS. However, unlike the Exposure Draft, there is no requirement to take such CPE. The Yellow Book states, "Obtaining CPE specifically on GAGAS, particularly during years in which there are revisions to the standards, may assist auditors in maintaining the competence necessary to conduct GAGAS engagements."

Quality control and peer review are included together in a distinct chapter. The peer review guidance was modified to require audit organizations to comply with GAGAS requirements as well as those of affiliated organizations and provides guidance to nonaffiliated audit organizations.

The standards include a definition for waste. Unlike the Exposure Draft, the auditor is not required to perform specific procedures to detect waste or abuse in financial audits.

The Yellow Book added new standards for reviews of financial statements performed under GAGAS and updated performance audit standards with considerations for when internal control is significant to audit objectives.

These chapters are more robust than they were when the concepts were included as general standards:

- Chapter 1: Foundation and Principles for the Use and Application of GAS
- Chapter 2: General Requirements for Complying with GAS
- Chapter 3: Ethics, Independence, and Professional Judgment
- Chapter 4: Competence and Continuing Professional Education
- Chapter 5: Quality Control and Peer Review
- Chapter 6: Standards for Financial Audits
- Chapter 7: Standards for Attestation Engagements and Reviews of Financial Statements
- Chapter 8: Fieldwork Standards for Performance Audits
- Chapter 9: Reporting Standards for Performance Audits

Following are summaries of the major changes by chapter.

Chapter 1—Government Auditing: Foundation and Principles for GAGAS

- Integrated audit is added to the types of financial audits.
- Expanded definitions of engagement types (attestations, reviews of financial statements, and performance audits).
- New vocabulary—responsible party, engaging party, audited entity, and specialist.
- Introduced the concepts of effective, efficient, economy, and ethical as they relate to government functions and services. The April 2021 technical update adds equity to these concepts.
- Independence is by far the largest change. This is discussed later in this section.

Chapter 2—General Requirements

- GAGAS does not incorporate the AICPA *Code of Professional Conduct* by reference for financial audits, attestation engagements, and performance audits but recognizes that a CPA may be required to use those standards (GAAS, PCAOB, IASB).
- GAGAS incorporates the AICPA SAS, SSAE, and SSARS by reference.
- AICPA *Code of Professional Conduct* is not incorporated by reference, but the GAO recognizes that auditors may be required to use it. There are others, such as Guiding Principles for Evaluators, Standards for Educational and Psychological Testing, and so forth.

Chapter 3—Ethics, Independence, and Professional Judgment

Independence is included with ethics and professional judgment in a distinct chapter in the 2018 Yellow Book. Two big changes are that the auditor should identify the preparation of financial statements and other bookkeeping activities to be significant threats, and supplemental safeguards should be applied and documented. In addition, the client should be able to identify material issues (errors or omissions) when reviewing financial statements. A summary of the major changes regarding independence in the 2018 Yellow Book follows:

- Independence requirements—there is a distinction between the engaging party and responsible party. The independence requirements are between the responsible party and the auditor. For example, a legislative body might ask an auditor to conduct a performance audit or a state agency might ask for an attestation engagement to determine the validity of information provided to them by a local government. A government department may work an agency that conducts examination attestation engagements.
- Additional guidance when government auditors are in a situation where they are not independent.
- Management responsibilities – leading and directing the entity, making decisions regarding the acquisition, deployment and control of human, financial, physical, and intangible resources.
- Skills, Knowledge and Experience—Section 3.79 states that management must be able (or designate someone else) to effectively oversee the services, determine the reasonableness of the results, and be able to detect material errors, omissions, or misstatements.
- Auditors should conclude that any services related to preparing accounting records and financial statements are significant threats to independence.
- Auditors should document the threats as well as the safeguards applied to eliminate and reduce threats to an acceptable level. Otherwise, they should not perform the services.

Examples of safeguards that can be taken by auditors are:

- Removing an individual from an audit team when their financial or other interests/relationships could pose a threat.
- Consulting a third party; for example, a member of a professional association such as the AICPA or of a professional regulatory body such as the GAO or another auditor.

- Not including individuals who provide nonaudit services as engagement team members.
- Having another auditor review the audit and nonaudit work.
- Engaging another audit organization to evaluate the results of the nonaudit service.
- Having another audit organization reperform the nonaudit service.

Independence is a very significant area and a focus point at this time. Auditors can count on extensive scrutiny of their documentation by peer reviewers. Auditors are required to prepare appropriate documentation under the Yellow Book quality control and assurance requirements. The auditor should ensure that their workpapers:

- document threats to independence that require the application of safeguards, along with the safeguards applied to eliminate or reduce the threats to an acceptable level, in accordance with the conceptual framework for independence;
- document the evaluation of threats to independence even if the firm concludes that the threats are not significant;
- document the safeguards if an audit organization is structurally located within a government entity and is considered structurally independent based on those safeguards;
- document consideration of audited entity management's ability to effectively oversee a nonaudit service to be provided by the auditor;
- document the auditor's understanding with an audited entity for which the auditor will provide a nonaudit service; and
- document the evaluation of the significance of the threats created by providing any services related to preparing accounting records and financial statements.

The auditor should document the specific identification of any nonattest services in its engagement letter and in the management representation letter. Specifically, documentation should include:

- the objectives of the nonaudit service;
- the services to be provided;
- the client's acceptance of its responsibilities;
- the auditor's responsibilities; and
- any limitations on the provision of nonaudit services.

Documentation of independence considerations provides evidence of the auditor's judgments in forming conclusions regarding compliance with independence requirements.

Chapter 4—Competence and Continuing Professional Education (CPE)

- The audit team must collectively possess the competence needed to address the engagement objectives and perform work in accordance with GAGAS. The competence must be inherent in the team members **before** the beginning of the audit.
- Audit organization management must assign auditors who possess the competence for their assigned roles **before** the beginning of the audit.
- The audit organization should have a process for recruiting, hiring, staff development, assignment of work and evaluation of personnel to ensure the knowledge, skills and abilities are present to work on engagements.
- Roles and competencies are discussed.

Role	Example Activities and Level of Complexity, Ambiguity, and Uncertainty	Proficiency Needed
Entry level	Plan or perform procedures. This level is characterized by a low level of complexity, ambiguity, and uncertainty.	Basic
Supervisory level	Perform procedures, direct engagements. This level is characterized by moderate levels of complexity, ambiguity, and uncertainty.	Moderate
Partners and directors	Plan engagements, perform procedures, direct, or report on engagements, review engagement quality prior to issuing a report, sign reports. This level is characterized by advanced levels of complexity, ambiguity, and uncertainty.	Advanced

The various activities that auditors perform are better defined.

- **Planning:** Determining engagement objectives, scope, and methodology, establishing criteria to evaluate matters subject to audit, coordinating the work of other audit organizations (if any). This does not include auditors whose activities are limited to gathering information to be used in planning.
- **Directing:** Supervising the work of team members or others who are involved in performing engagement activities and reviewing engagement work to determine whether the engagement objectives are met.
- **Performing procedures:** Performing tests and other types of procedures necessary to accomplish the engagement objectives.
- **Reporting:** Determining the report content and substance or reviewing reports to determine whether the engagement objectives have been met and the evidence obtained supports the report's technical content and substance prior to report issuance. This includes reviewing engagement quality prior to issuing the report and signing the report.

The competence of specialists is important as are their qualifications. Auditors should assess the competency of specialists by evaluating:

- The professional certification, license, or other recognition of the competence of the specialist in his or her field.
- The reputation and standing of the specialist in the views of peers and others who are able to judge performance.
- The specialist’s experience and previous work in the subject matter.
- The auditor’s prior experience in using the specialist’s work.
- The knowledge of any technical performance standards or other professional or industry requirements in the specialist’s field.
- The competence of the specialist with respect to relevant auditing standards.

There is an additional exemption for continuing professional education. Nonsupervisory auditors who charge less than 40 hours of time annually to GAGAS engagements may be exempt.

GAGAS now defines the measurement for CPE programs and activities, as shown in the following table.

Program or Activity	Measurement
Group Programs	50 minutes for 1st hour and then 25-minute increments
College or university credit	<ul style="list-style-type: none"> ■ Each credit is 15 CPE hours for semester system courses ■ Each credit is 10 CPE hours for the quarter system courses ■ Nondegree credit is based on the number of actual classroom hours
Individual self-study	<ul style="list-style-type: none"> ■ CPE provider recommends credit for a passing score
Speakers, instructors, discussion leaders at CPE programs, authors that develop course material	<ul style="list-style-type: none"> ■ Presentation and preparation time: 1 CPE hour granted for presentation; up to 2 CPE hours may be granted for writing and preparation ■ Maximum number of hours that may be granted to an auditor as a speaker, discussion leader, instructor or auditor may not exceed 40 hours for a 2-year period.
Articles, books and materials on subjects and topics that contribute to professional proficiency	<ul style="list-style-type: none"> ■ 1 CPE hour for each hour writing ■ Maximum hours for 2-year period—20

The audit organization has the ultimate responsibility in determining if the CPE courses employees want to take qualify for GAGAS credit.

Chapter 5—Quality Control and Peer Review

Audit firms need to get annual written affirmation on compliance with policies and procedures on independence from personnel who need to be independent:

- Audit firms have to establish policies and procedures regarding:
 - Taking on engagements that it has the capabilities to perform
 - Review of engagement work performed by more experienced members
 - Assignment of responsibility for each engagement to a partner or director (communicate to management and those charged with governance)
 - Defining the role of the engagement partner and communicating the responsibilities to the individual assigned to fulfill that role
 - Consultation when difficult, contentious issues arise
 - Termination of audit engagements before completion when the audit report is not issued (document the reasons for the termination, as well as the results of the work to date)
 - Documentation of any changes to the scope of the audit objectives and the reasons for the changes
- There are additional requirements added for engagement performance, documentation, and reporting.
- For those audit firms that are not affiliated with a recognized organization like the AICPA, Council of Inspectors General on Integrity and Efficiency, Association of Local Government Auditors, International Organization of Supreme Audit Institutions, and the National State Auditors Association, the peer review scope is significantly expanded.

Chapter 6—Standards for Financial Audits

- Qualifications for auditors engaged to conduct financial audits of entities that operate outside of the United States are better explained.
- The determination of waste and abuse is subjective so auditors are not required to perform specific procedures to detect waste or abuse in financial audits. Auditors may consider whether and how to communicate such matters if they become aware of them.
- Auditors may also discover that waste or abuse are indicative of fraud or noncompliance with provisions of laws, regulations, contracts, and grant agreements. Therefore, if auditors become aware of waste and abuse, they should be considered when evaluating internal control deficiencies:

- *Waste* is defined in GAGAS as using or expending resources carelessly, extravagantly or for no purpose. Waste is not abuse or a violation of law but arises due to mismanagement and inadequate oversight.
- *Abuse* is behavior that is deemed improper or deficient when compared to that of a prudent person. Auditors do not need to test for abuse.

Chapter 7—Standards for Attestation Engagements and Reviews of Financial Statements

- For attestation engagements, GAGAS incorporates by reference the AICPA’s Statements on Standards for Attestation Engagements (SSAE).
- For reviews of financial statements, GAGAS incorporates by reference AICPA’s AR-C section 90, *Review of Financial Statements*.
- Elaborates on the qualifications that auditors should have who are engaged to conduct attestation engagements.
- Auditors need to consider potential internal control deficiencies when they evaluate the cause of findings identified in attestation engagements.

Chapters 8 and 9—Fieldwork and Reporting Standards for Performance Audits

- Guidance revised to explain that management assertions are not required when conducting a performance audit.
- Attributes of what is considered suitable criteria and examples were added.
- Internal control guidance was updated to align with the 2013 COSO framework.
- Auditors need to consider potential internal control deficiencies when they evaluate the cause of findings identified in performance audits. The April 2021 technical update requires auditors to plan and perform audit procedures to assess internal control to the extent necessary to address the audit objectives if internal control is determined to be significant to the audit objectives.
- The April 2021 technical update also requires auditors to identify the scope of internal control assessed to the extent necessary for report users to reasonably interpret the findings, conclusions, and recommendations in the audit report when reporting on the scope of their work on internal control.
- Guidance has been expanded related to performance audits since there is little guidance elsewhere. The AICPA does not discuss the requirements for performance audits in its professional literature.

OTHER COMPLIANCE NEWS

Corrective Action Plan

Federal agencies have concerns that auditees are not preparing separate Corrective Action Plans (CAP) and Summary Schedule of Prior Audit Findings (SSPAF). Section 200.511 of the UG requires both documents to be included in the reporting package.

The AICPA reviewed a sample of reporting packages and found the following:

- Several reporting packages did not include a CAP when there were findings reported by the auditor.
- Several reporting packages did not include a CAP but the auditor's Schedule of Findings and Questioned Costs included a subheading in each finding that said "Management's Corrective Action Plan" with a one-sentence statement explaining it.
- Several reporting packages included the CAP as a separate section within the auditor's Schedule of Findings and Questioned Costs.
- In some cases, the reporting package included a separate page titled "Corrective Action Plan" but only referred to the auditor's Schedule of Findings and Questioned Costs for each finding number.

The auditee is required to prepare a CAP and it needs to be in a document that is separate from the auditor's findings. The CAP needs to address each finding in the current year, provide the name of the contact person responsible for the corrective action, the action planned and the anticipated completion date. If the auditee does not agree, they are required to explain why.

Additionally, §200.511 also states that the SSPAF must be prepared by the auditee, and where it is not required to be included in a separate document, the AICPA believes that it is better to do so in order for federal agencies or others to be clear about who prepared it.

Following is an excerpt from the UG, Frequently Asked Questions document concerning the CAP:

Auditee responsibility for preparing the summary schedule of prior audit findings and corrective action plan (200.511-1)—The auditor must be independent of the auditee, and since the UG states that the auditee must prepare the summary schedule of prior audit findings and the corrective action plan, **the auditor may not prepare this schedule.** The auditee must submit the corrective action plan on **auditee letterhead.** In addition, the corrective action plan must be separate from the auditor's findings. The auditee cannot use the "views of responsible officials" section of the findings to fulfill the requirement to prepare the corrective action plan. The corrective action plan must include the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. The auditee can use this space to state that they disagree with the findings or say that corrective action is not needed. If they do this, the document should include an explanation with specific reasons for their views.

REVISED DATA COLLECTION FORM (DCF)

The Data Collection Form was revised and issued in 2019. The revised DCF is effective for fiscal periods with ending dates in 2019, 2020, and 2021. There are several changes that auditors need to know.

Notes to the SEFA

The footnotes to the Schedule of Expenditures of Federal Awards (SEFA) are required to be uploaded into the DCF. The information is included at Part II Item 2 and will include:

- A description of the accounting policies used in preparing the SEFA
- Whether or not the auditee used the de minimis 10% indirect cost rate
- Any additional footnotes

PART II: FEDERAL AWARDS - Continued	
2. Notes to the Schedule of Expenditures of Federal Awards (SEFA)	
Note 1: Describe the significant accounting policies used in preparing the SEFA. (2 CFR 200.510(b)(6))	
<div style="border: 1px solid black; height: 40px;"></div>	4,000 characters
Note 2: Did the auditee use the de minimis cost rate? (2 CFR 200.414(f))	
<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Both	
Please explain.	
<div style="border: 1px solid black; padding: 5px;">Note 2 will auto-populate based on the answer selected. If "Yes" is chosen, Note 2 will populate with "The auditee used the de minimis cost rate." If "No" is chosen, Note 2 will populate with "The auditee did not use the de minimis cost rate". This auto-populated text is editable. If "Both" is chosen, Note 2 will not auto-populate, and users must enter the text manually.</div>	4,000 characters
Additional Notes <small>All additional notes included in the reporting package must be entered in this section and will be automatically numbered sequentially by the IDES system as they are entered.</small>	
Note 3: <div style="border: 1px solid black; padding: 2px;">Loan/loan guarantee outstanding balances.</div>	75 characters
<div style="border: 1px solid black; padding: 5px;">Note 3 will auto-populate with the outstanding loan balance information entered into Part II, Item 1 (a)-(d) and (j) for awards identified as being a Federal loan or loan guarantee in Part II, Item 1(i). The auto-generated text may be edited as needed to match the loan information from the Notes in the reporting package.</div>	4,000 characters

Written Communications to the Auditee

The full text of any audit findings will be collected in Part III Item 5 in addition to the text of the auditee's corrective action plan.

FORM SF-SAC		Report ID:	Version:
PART III: INFORMATION FROM THE SCHEDULE OF FINDINGS AND QUESTIONED COSTS - Continued			
5. Text of the Audit Findings			
a. Audit Finding Reference Number	b. Audit Finding Text		
YYYY-###	Enter the text of the finding exactly as it appears in the Schedule of Findings and Questioned Costs, excluding charts or tables. You may copy and paste this text directly from the reporting package.		
	30,000 characters		
This column is populated automatically from Part III, Item 4(e). One row is created for each unique reference number. This page cannot be used if no audit findings are reported on Part III, Item 1(c) (if "0" is entered in Part III, Item 1(c) for each award).	This column will display the text of the audit finding. If there are any charts or tables within the text of the audit finding, "See Schedule of Findings and Questioned Costs for chart/table" will be displayed in place of the chart or table. If there are any footnotes within the text, "See Schedule of Findings and Questioned Costs for footnote" will be displayed at the end of the text in place of any footnotes. If the auditee qualifies as an Indian Tribe and opts not to authorize the FAC to make the reporting package publicly available, "Exemption for Indian Tribes" will be displayed in this column in place of the finding text for each Audit Finding Reference Number.		

FORM SF-SAC		Report ID:	Version:
PART IV: CORRECTIVE ACTION PLAN			
1. Audit Finding Reference Number	2. Text of the Corrective Action Plan		
YYYY-###	Enter the text of the Corrective Action Plan exactly as it appears in the reporting package, excluding charts or tables. You may copy and paste this text directly from the reporting package.		
	10,000 characters		
This column is populated automatically from Part III, Item 4(e). One row is created for each unique reference number. This page cannot be used if no audit findings are reported on Part III, Item 1(c) (if "0" is entered in Part III, Item 1(c) for each award).	This column will display the text of the corrective action plan. If there are any charts or tables within the text of the CAP, "See Corrective Action Plan for chart/table" will be displayed in place of the chart or table. If the auditee qualifies as an Indian Tribe and opts not to authorize the FAC to make the reporting package publicly available, "Exemption for Indian Tribes" will be displayed in this column in place of the CAP text for each Audit Finding Reference Number.		

The certifications of the auditor and auditee have updated references.

Other Improvements and Internet Data Entry System (IDEAS) Changes

Several additional changes, in addition to those discussed above, were made to the revised DCF and IDEAS. These changes include:

- A system edit check for the auditee EIN
- A system edit check revision for multiple DUNS numbers
- A cluster drop-down box revision
- Revision of the format of auditor statement
- A new requirement to identify items changed when a previously submitted single audit is resubmitted
- A new option to prepare a system-generated SEFA and notes export

SINGLE AUDIT ISSUES

Section 200.513 of the Uniform Guidance states that a federal agency designated by OMB will lead a government-wide project 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.” The agency will then make recommendations to address any audit quality issues, which could include changes to applicable audit requirements, standards and procedures. This government-wide audit quality project will be conducted every six years beginning in 2018, and the results must be public.

The purpose is to see if quality has improved in single audits especially where there were single audit deficiencies identified in the President’s Council on Integrity and Efficiency (PCIE’s 2017 study). Many expect that the results will be better. The AICPA performed its own audit quality project in 2016. During that project, 87 engagements were selected for review by subject matter experts. Of them, 41 were single audits. Of those 41 engagements, 17 were deemed nonconforming. Recent announcements by the AICPA indicate that the number of nonconforming audits is closer to 50%. Furthermore, the AICPA found that as the number of single audits performed by a lead partner decreased, the nonconformity percentage increased substantially as indicated in the table below.

No. of single audits performed by partner annually	Nonconformity percentage
1	68%
2 to 10	44%
11 or more	25%

The results also showed that among AICPA’s Government Audit Quality Center (GAQC) members, the nonconformity rate was 32% versus 58% for those that were not members. The AICPA has instituted additional training for peer reviewers since some peer reviewers were found to lack knowledge in the requirements of a single audit. State peer review acceptance bodies are being more critical of peer reviewers. In addition, findings by federal agencies are referred to the AICPA ethics division. When deficiencies are noted, the firm may be subject to suspension from performing single audits, additional oversight in the form of pre-issuance reviews of single audit engagements, and additional continuing professional education.

The AICPA has also provided practitioners with additional tools and templates for practitioners that belong to the GAQC to help them in making improvements to their audits. These can be accessed by GAQC members on the AICPA’s website.

Supplemental checklists are available to AICPA members and do not require GAQC membership. They can be found at:

<https://us.aicpa.org/interestareas/governmentalauditquality/resources/auditpracticetoolsaids>

Part A of the AICPA’s UG Supplemental Checklist for Review of OMB Single Audit Engagements focuses on the audit areas noted to be deficient by the Council of Inspectors General on Integrity and Efficiency (CIGIE) report. It uses strong language when instructing peer reviewers on the conduct of peer reviews, stating that peer reviewers should be aware that failures to conform to professional standards in these areas are seen by the Inspector General as resulting in substandard audits. In the Peer Review Board’s (PRB’s) instructions to Part A, it says:

[T]he PRB has concluded that a failure to properly perform audit procedures in one or more of the areas covered in Part A will result in an engagement that has not been performed in accordance with professional standards in all material respects.

The CIGIE identified documentation as a major weakness in audits, and Part A reminds reviewers that a firm's verbal description of work performed is not adequate. Lack of documentation will cause the reviewer to conclude that the engagement was not performed in accordance with GAAS and GAS in all material respects.

Part B of the two-part checklist includes other areas specific to the compliance audit, and, although important, failure to properly perform one of those procedures would not generally result in an audit failure.

If the peer reviewer determines that the auditor has not complied with the elements in Part A, they should consider expanding the peer review scope. This would apply to the element that was not appropriately addressed by the auditor. The reason for the expansion of scope would be to determine whether the auditor had a pattern of noncompliance with a requirement and, if that is true, whether it is a deficiency or significant deficiency in the design or operation of the audit firm's system of quality control.

The auditor can help ensure a quality audit by obtaining the necessary training and also by completing Part A (and even Part B) of the checklist and cross-referencing to where the work was performed. If the audit required is only a financial statement audit under *Government Auditing Standards* (GAS), the Supplemental Checklist for Review of Audit Engagements Performed in Accordance with *Government Auditing Standards* (Yellow Book) December 2011 Revision is the only one that would be relevant at this time because the 2018 Yellow Book cannot be implemented early. The checklist can be accessed at the same web address:

<https://www.aicpa.org/content/dam/aicpa/interestareas/peerreview/resources/peerreviewprogrammanual/downloadabledocuments/22110-gas-supp-check.pdf?contentType=secured>

The CIGIE produced desk review and quality control review (QCR) checklists. There are two checklists that are very helpful that were issued by the OIG:

1. Desk review guide:

[https://www.ignet.gov/sites/default/files/files/Desk%20Review%20guide%20for%20Single%20Audits%20-%20final%20\(Dec%202016\).pdf](https://www.ignet.gov/sites/default/files/files/Desk%20Review%20guide%20for%20Single%20Audits%20-%20final%20(Dec%202016).pdf)

2. Quality control review (QCR) guide:

[https://www.ignet.gov/sites/default/files/files/Quality%20Control%20Review%20guide%20for%20Single%20Audits%20-%20final%20\(Dec%202016\).pdf](https://www.ignet.gov/sites/default/files/files/Quality%20Control%20Review%20guide%20for%20Single%20Audits%20-%20final%20(Dec%202016).pdf)

Now is a good time to ensure that audits are deficiency free.

A list of frequent deficiencies follows.

Risk Assessments

Risk assessments were not performed for every major program. The AICPA is placing priority on ensuring that risk assessments are properly performed not only for financial statement audits, as

discussed earlier, but also for compliance audits. The guidance provides considerations for the reviewer to use when evaluating the firm's compliance with risk assessment standards and instructs the state *Peer Review* Program Report Acceptance Bodies to require implementation plans and corrective action when Findings for Further Consideration are identified.

The main issues identified here are the fact that risk assessments must be performed at the major program and compliance requirement level. Reviewers are seeing far too many instances where there are no risks identified. If this is truly the case, the auditor should ensure the documentation is in the workpapers to support it. Linkage is also an issue that has been identified. When a risk is identified, there should be an action step that is designed to bring the risk down to a sufficiently low level. This could include altering the nature, timing and extent of procedures or increasing the level of supervisory review.

Direct and Material Compliance Requirements

Auditors are not properly documenting why they consider certain compliance requirements not to be direct and material. This is a significant concern because when a compliance requirement is not considered direct and material, it is not tested. The auditor should document **why** the requirement is not considered direct and material.

EXAMPLES

- Procurement is not considered to be a direct and material compliance requirement for major program XYZ because materiality is \$50,000 for the program and 95% of program expenditures is payroll related.
- Eligibility is not considered to be a direct and material compliance requirement. The state (passthrough entity) selects the beneficiaries to receive service and the NFP has no discretion.
- Program income is not considered to be a direct and material compliance requirement. The amount of program income was \$6,000 and materiality for this program is \$75,000.

Internal Control over Compliance

Auditors are not testing internal controls at the entity level. Frequently, auditors will make affirmative statements such as the “board reviews the financial statements before they are released” or “management sets the tone about the necessity to follow all compliance requirements and takes corrective action when issues are noted.” Although these are good controls, just the affirmative statement does not serve as a test of controls. Documentation should include what the auditor observed, who he/she spoke with about the control, and other evidence such as review of documents.

EXAMPLE

An auditor identified the control “management sets the tone about the necessity to follow all compliance requirements and takes corrective action when issues are noted” and documented the following:

I spoke with both the Executive Director and the CFO concerning proper adherence to compliance requirements by client personnel involved in working with federal programs. I was provided with an agenda to the monthly grant staff meetings where concerns were raised and discussed, and corrective action planned. I noted that when there was a concern raised, the next month the

minutes of the meeting showed a report on corrective action. I spoke with two of the grant accounting staff and they corroborated this information. I believe that the control is appropriately designed, implemented and effective.

Control activities were identified and tested but it was hard to distinguish between them and the compliance tests in dual purpose testing. There appear to be two main causes of this deficiency. First, the auditor is identifying what they believe is a control but it is really a substantive or compliance test, and second, the attributes are worded in such a way that it is not possible to tell one from the other.

EXAMPLE

An auditor identified the following controls over allowable cost:

- Cost is allowable under the terms of the Uniform Guidance (Section 200.403).
- Cost was approved by a member of the grant accounting staff who has knowledge of the grant and allowable cost.
- Traced and agreed the amount per the invoice to the federal report requesting reimbursement.
- Noted two signatures on the check.
- Traced and agreed the amount of the expenditure to the general ledger.

Of the attributes identified above, the only one that is clearly an internal control attribute is item b. That is because it identifies a client action designed to prevent, detect, or correct misstatement on a timely basis.

Attribute a. is a compliance test because it involves the auditor's conclusion as to the allowability of a cost based on the Uniform Guidance criteria.

Attribute c. and e. are substantive tests that illustrate that two numbers agree. If the step was performed by client personnel and there was documentation to support it, then this could be a test of controls. As it is, it appears the auditor is doing the test.

Attribute d. is a substantive test that illustrates that there are two signatures on a check. These signatures are evident, but if it was a properly-designed internal control, client personnel would be performing an action to ensure that the support is present for the expenditure before the check is signed.

Other internal control issues identified were that controls tested did not link back to controls identified in earlier steps and control weaknesses identified during the internal control assessment were not identified as significant deficiencies or material weaknesses. Note that control deficiencies are not always significant deficiencies or material weaknesses but they need to be evaluated to determine whether individually or in the aggregate they rise to that level.

Audit Sampling

The following deficiencies that were noted relate to audit sampling.

Samples for internal control and compliance are not calculated using the same thought processes. When calculating a sample for internal control, the auditor looks at the significance of the control and the inherent risk in the compliance requirement.

Sampling Table from the GAS/Single Audit Guide

Control Testing Sample Size Table - Population 250 or More Items	
Significance of Control and Inherent Risk of Compliance Requirements	Minimum Sample Size with 0 Deviations Expected
Very significant and higher inherent risk	60
Very significant and limited inherent risk or moderately significant and higher inherent risk	40
Moderately significant and limited inherent risk	25

A rule of thumb noted in the Audit Guide for populations where the element is performed more often and the sample is between 52 and 250 is to take 10% of the population. The auditor would also determine whether, for qualitative reasons, that was sufficient.

When controls are performed 52 or fewer times or on a quarterly, monthly, semi-monthly or weekly basis, the following table is appropriate.

Small Population Sample Size Table	
Frequency and Population Size	Sample Size
Quarterly (4)	2
Monthly (12)	2-4
Semi-Monthly (24)	3-8
Weekly (52)	5-9

When the auditor finds deficiencies in internal control, this will alter the extent of compliance testing as noted below.

EXAMPLE

An auditor was computing a sample size for test of eligibility. He was going to evaluate the items in the sample to determine if client personnel completed a checklist designed to guide them in collecting the appropriate information from the potential beneficiary and completing the eligibility calculation. He also wanted to determine if the work was approved by the supervisor. The evidence supporting these two attributes was 1) a completed form with the employee's signature and 2) the supervisor's signature. The auditor chose a sample of 40 based on the inherent risk (lower) and the significance of the control (very significant).

The AICPA sampling table (90% confidence interval) below illustrates the sample sizes. The AICPA Audit Guide permits sample sizes based on a 90% to 95% confidence level. However, this chart is helpful when determining the impact of finding deviations.

Acceptable Errors	Low					Moderate			High		
	2%	3%	4%	5%	6%	7%	8%	9%	10%	15%	20%
0	114	76	57	45	38	32	28	25	22	15	11
1	194	129	96	77	64	55	48	42	38	25	18
2	265	176	132	105	88	75	65	58	52	34	25
3	331	221	166	132	110	94	82	73	65	43	32

If the auditor selected a sample of 40 and had zero deviations, then he/she could be 90% confident that the deviation from controls in that population was no more than 5.5% (interpolated). Control reliance would be assessed as low for that control.

The auditor performed the test and noted that out of 40, there were 2 deviations on test 2. The supervisor failed to sign off on the form as having reviewed the form. The auditor concluded that this was a key control since the employee was new at their job. Therefore, there were not mitigating controls. The auditor concluded that a test of 88 would only identify more deviations, so control risk was assessed at high. A larger sample than originally planned was selected for testing compliance.

Other deficiencies noted by reviewers related to sampling was that the documentation was incomplete. Items generally missing were the identification of how the auditor determined that the population used to sample was complete, the identification of the sampling unit and sampling methodology, the control to be tested, and what constitutes a deviation.

In addition, samples had attributes with N/A and no replacement items were tested. If a sample of 40 is required, then the auditor needs a sample of 40 to be an appropriate test.

Material Noncompliance

There are still issues regarding when compliance is considered material noncompliance. The following example helps to illustrate the parameters.

EXAMPLE

An auditor, testing eligibility, tested a sample of 40 items for compliance. She noted that out of the sample, there were 2 deviations. She calculated a mathematical deviation rate of 5%. Materiality was set at 5% for the audit of the major program; however, she didn't really think that 2 out of 40 was so bad. After all, 38 were correct.

Sample Size = 25		Sample Size = 40		Sample Size = 60	
Deviation	Deviation Rate	Deviations	Deviation Rate	Deviations	Deviation Rate
0	0%	0	0%	0	0%
1	4.0%	1	2.5%	1	1.6%
2	8.0%	2	5.0%	2	3.3%
3	12.0%	3	7.5%	3	5.0%
4	16.0%	4	10.0%	4	6.6%

The senior on the engagement showed her another chart which she obtained from the AICPA's Sampling Audit Guide which was a statistically based chart.

Sample Size = 25		Sample Size = 40		Sample Size = 60	
Deviation	Deviation Rate	Deviations	Deviation Rate	Deviations	Deviation Rate
0	8.8%	0	5.6%	0	3.8%
1	14.7%	1	9.4%	1	6.4%
2	20.2%	2	12.8%	2	8.7%
3	24.9%	3	16.0%	3	10.8%
4	29.9%	4	19.0%	4	12.9%

The senior explained that because the auditor does not audit 100%, there is the possibility of error in the sample so that 2 deviations in a sample of 40 could really be a deviation rate of 12.8%. With this perspective, the staff person agreed that the test had identified material noncompliance.

When material noncompliance is identified, it is highly likely that there is a control deficiency behind the finding of noncompliance. Auditors should take care to evaluate this even if controls were tested and no deviations were noted in the control test.

- Material noncompliance found during compliance tests not included as findings.
- Changes in state/federal eligibility requirements made during the year were not incorporated in the auditor's tests.

Schedule of Expenditures of Federal Awards

Auditors are failing to provide a reconciliation of the Schedule of Expenditures of Federal Awards to the general ledger. This is a required step so that the auditor will have sufficient evidence to provide an in-relation-to opinion. Many auditors are signing off on a step indicating they have performed the reconciliation, but more documentation is needed. There are usually more than just federal awards in an account which supports the expenditure number. In addition, there may be fixed assets capitalized in the general ledger that are included as federal expenditures on the schedule, amounts passed down to subrecipient, and noncash items, such as commodities or guarantees, that make this process less than straightforward.

Single Audits Conducted below the Threshold

It has come to the attention of reviewers that auditors are performing single audits at the request of management or their boards for entities that do not meet the \$750,000 threshold to have a single audit. Where there is no guidance preventing the audit, auditors should be aware of these important facts.

- The Federal Audit Clearinghouse does not want the report.
- The auditee cannot get reimbursed for the audit with federal dollars.
- Parts of the compliance supplement will not apply.

- The entity will not be able to use this audit in the determination of whether it is a low-risk auditee at a future time.
- The report issued will need to be altered because the audit is not conducted as required by the Uniform Guidance.

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