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Dear ProSystem *fx*® Customer:

This *Not-for-Profit Entities & Single Audit Knowledge-Based Audits*™ *Fall 2009 Update* is intended to provide you with the latest information as you head into your fall planning season. This update incorporates the most recent regulatory changes and decisions that may impact your not-for-profit audits and should be viewed as a supplement to the KBA Not-for-Profit and Single Audit ProSystem *fx* Knowledge Tools Titles.

The update is organized into sections that describe each of the major changes in the not-for-profit and single audit standards. At the end of each section, we have included a list of the affected KBA documents for your convenience.

It is our goal at CCH to keep our content as updated as possible and to deliver this updated content when it is the most relevant to our customers. Because of the varied schedule of not-for-profit audits, we plan to continue to provide this update in the fall as auditors are preparing for their calendar year-end engagements. All of these changes will be incorporated in our next full release of our Knowledge Tools Knowledge-Based Audit™ content in Summer 2010.

Sincerely,

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Update for Knowledge-Based Not-for-Profit Audits and Single Audits Fall 2009

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FASB Accounting Standards Codification™ Transition

On July 1, 2009, the Financial Accounting Standards Board (FASB) issued the FASB Accounting Standards Codification™ (ASC), which will become the source of authoritative generally accepted accounting principles (GAAP) for nongovernmental entities (in addition to guidance issued by the SEC).

Related to the transition to the ASC, the FASB issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a Replacement of FASB Statement No. 162*. The transition guidance provided by the FASB in ASC 105, *Generally Accepted Accounting Principles* (ASC 105-10-65), includes the following:

- The transition requirements shall be effective for financial statements issued for interim and annual periods ending after September 15, 2009.
- The ASC shall become the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities.
- As of the effective date stated above, all then-existing non-SEC accounting and reporting standards that had been included in levels (a) through (d) GAAP are superseded, except those noted below and certain grandfathered accounting guidance described in ASC 105-10-70. Concurrently, all nongrandfathered, non-SEC accounting literature not included in the ASC is deemed nonauthoritative.
- The following standards remain authoritative until such time that each is integrated into the ASC:
  - FASB Statement of Financial Accounting Standards No. 164, *Not-for-Profit Entities: Mergers and Acquisitions*;
  - FASB Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets*;
  - FASB Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)*; and
  - FASB Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a Replacement of FASB Statement No. 162*.
- Nonpublic, nongovernmental entities that previously have not applied the guidance listed below should account for the adoption of that guidance as a change in accounting principle (including related disclosures) on a prospective basis for revenue arrangements entered into or materially modified in those fiscal years beginning on or after December 15, 2009, and interim periods within those years:
  - ASC 958, *Not-for-Profit-Entities* (ASC 958-605-15-3 and 15-4);
  - ASC 985, *Software* (ASC 985-605-55-4 through 55-118);
  - ASC 985-605-55-186 through 55-203;
  - ASC 985-845-25-1 through 25-7; and
  - ASC 985-845-55-1 through 55-8.

With the exception of ASC 958-605-15-3 and 15-4, the paragraphs (above) provide specific guidance for software vendors. ASC 958-605-15-3 and 15-4 relate to the recognition of contributions.

Note: Implementation of the ASC will have a significant effect on how practitioners: (1) research accounting issues; and (2) stay current on new GAAP requirements. The traditional FASB statements and other authoritative pronouncements will no longer be issued. Rather, the FASB will issue additions/changes to the ASC as a means of promulgating new and revised GAAP requirements. While the ASC includes much of the accounting guidance contained in the AICPA Audit and Accounting Guide (AAG), *Not-for-Profit Organizations*, the AICPA is in the process of revising that AAG to serve as implementation guidance for existing GAAP.

On a practical level, practitioners should work with their clients to remove any references to specific FASB statements and other pronouncements contained in the financial statements. In most cases, there is no need to reference a specific FASB statement or other pronouncement in the financial statements, as the financial statements include an accounting policy note stating that the statements are prepared in accordance with GAAP. In past practice, often a specific pronouncement was appropriately cited in the year of adoption, and then reference to that pronouncement was carried forward to subsequent years by rote. With that in mind, before simply substituting ASC section and paragraph references for FASB statements and other pronouncement references in the financial statements, the practitioner and client should determine whether any reference is required at all.

FASB Statement of Financial Accounting Standards No. 164, Not-for-Profit Entities: Mergers and Acquisitions—Including an Amendment of FASB Statement No. 142

In April 2009, the FASB issued Statement of Financial Accounting Standards No. 164 (FAS-164), *Not-for-Profit Entities: Mergers and Acquisitions—Including an Amendment of FASB Statement No. 142*, which has not yet been included in the ASC. FAS-164 reflects the culmination of extensive deliberation by the FASB regarding how to account for combinations of not-for-profit entities. In many cases, the combination of not-for-profit entities does not readily lend itself to being accounted for under the purchase method of accounting used by commercial enterprises because frequently the transaction does not clearly resemble an “acquisition” of one entity by another.

FAS-164 divides combinations of not-for-profit entities into the following two categories:

1. ***Acquisitions***. An “acquisition” by a not-for-profit entity is defined as a transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and recognizes their assets and liabilities in the acquirer’s financial statements.
2. ***Mergers***. A “merger” is a transaction or other event in which the governing bodies of two or more not-for-profit entities cede control of those entities to create a new not-for-profit entity. To cede control requires that the merging entities not retain shared control of the new entity. To qualify as a new entity, the combined entity must have a newly formed governing body. A new entity often is, but does need not to be, a new legal entity.

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Accounting for an Acquisition

The accounting for a combination of not-for-profit entities that meets the definition of an acquisition is the same as the acquisition method that is used for acquisitions of business entities under FASB Statement of Financial Accounting Standards No. 141 (Revised 2007) (FAS-141R), *Business Combinations* (ASC 805, *Business Combinations*). FAS-164 provides specific guidance to assist the practitioner in:

- Identifying the acquirer;
- Determining the acquisition date;
- Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; and
- Recognizing and measuring goodwill (or the immediate charge to the statement of activities in certain circumstances) or the contribution received.

The identifiable assets acquired, liabilities assumed, and noncontrolling interest (if any) are measured at their fair values at the acquisition date. Some exceptions to this general rule include the following:

- ***Donor relationships****.* The acquiring entity should not recognize an acquired donor relationship as an identifiable intangible asset separately from goodwill.
- ***Collections.*** If the acquiring entity has a policy of not capitalizing collections (i.e., works of art, historical treasures, or similar assets), it should not recognize as an asset those items that it acquires as part of an acquisition and adds to its collections. Rather, the acquirer shall recognize the cost of purchased items as a decrease in net assets and not recognize the fair value of contributed items.
- ***Conditional promises to give****.* The acquirer should:
  - Recognize a conditional promise only if the conditions on which it depends are substantially met as of the acquisition date; and
  - Recognize a transfer of assets with a conditional promise to contribute them as a refundable advance unless the conditions have been substantially met as of the acquisition date.

FAS-164 also provides specific guidance regarding the recognition and measurement principles related to:

- Assets and liabilities arising from contingencies;
- Income taxes;
- Employee benefits;
- Indemnification assets;
- Reacquired rights; and
- Assets held for sale.

Unless the operations of the acquired entity as part of the combined entity are expected to be predominantly supported by contributions and returns on investments, the acquiring entity should recognize goodwill as of the acquisition date, measured as:

- The excess sum of:
  - Consideration transferred measured at the acquisition date fair value;
  - The fair value of any noncontrolling interest in the acquiree; and
  - In an acquisition achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree.
- Over:
  - The net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed.

FAS-164 provides that if the operations of the acquired entity as part of the combined entity are expected to be predominantly supported by contributions and returns on investments, the acquirer shall recognize the excess amount (as calculated above) as a separate charge in its statement of activities as of the acquisition date rather than as goodwill. "Predominantly supported by" means that contributions and returns on investments are expected to be significantly more than the total of all other sources of revenues.

If the above calculation results in a deficiency rather than an excess, the amount should be treated as a contribution received and recorded as a credit in the statement of activities as of the acquisition date.

FAS-164 also provides guidance for the subsequent accounting of assets and liabilities acquired in a business combination. For goodwill that is recognized in accordance with the requirement described above (and any other intangible assets recognized), not-for-profit entities should apply the guidance of FASB Statement of Financial Accounting Standards No. 142 (FAS-142), *Goodwill and Other Intangible Assets* (ASC 350, *Intangibles—Goodwill and Other*), as subsequently amended.

Accounting for a Merger

For combinations of not-for-profit entities that are considered mergers, the "carryover method" as described in FAS-164 should be applied.

The carryover method requires combining the assets and liabilities recognized in the separate financial statements of the merging entities as of the merger date with certain limited adjustments that may be needed to reflect a consistent method of accounting.

Under FAS-164, the entity resulting from a merger is a new reporting entity with no activities before the merger date. Accordingly, the new entity's initial reporting period begins with the merger date, and the merger itself is not reported as an activity of the new entity's initial reporting period. Instead, the combined assets, liabilities, and net assets of the merging entities are included in the statement of financial position as of the beginning of that initial reporting period, if presented.

Disclosure Requirements

FAS-164 provides specific disclosure requirements for acquisitions and mergers. These disclosures should be used to update those contained in the KBA-901 series disclosure checklists when the requirements of FAS-164 are adopted for an acquisition or merger.

Acquisition Disclosure Requirements

FAS-164 requires the acquirer to disclose information that enables users of its financial statements to evaluate the nature and financial effect of an acquisition that occurs either:

- During the current reporting period; or
- After the reporting date but before the financial statements are issued or are available to be issued.

The required disclosures are extensive and described in detail in paragraphs 86 through 88 of FAS-164.

FAS-164 also requires the acquirer to disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to acquisitions that occurred in the current or previous reporting periods. Paragraphs 90 and 91 of FAS-164 provide detailed descriptions of these required disclosures.

Merger Disclosure Requirements

Disclosures required for a combination accounted for as a merger are detailed in paragraph 18 of FAS-164. The required disclosures will enable users of its financial statements to evaluate the nature and financial effect of the merger that resulted in its formation.

FAS-164 also provides that if the specific disclosures required by paragraph 18 and other GAAP do not meet the objective stated above, the entity shall disclose whatever additional information is necessary to meet that objective.

Effective Date

FAS-164 is required to be applied prospectively to:

- Mergers for which the merger date is on or after the beginning of an initial reporting period beginning on or after December 15, 2009; and
- Acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2009.

Earlier application is prohibited. FAS-164 should be applied in both annual and interim periods after its effective date. FAS-164 also provides transitional guidance, including that for previously recognized goodwill.

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KBA Documents Affected (Not-for-Profit Module):

KBA-901D	Financial Statement Presentation and Disclosure Checklist: Part IV—Other Financial Statement Topics and Disclosures (Part I)

FASB Statement of Financial Accounting Standards No. 165, Subsequent Events (ASC 855, Subsequent Events)

The FASB issued Statement of Financial Accounting Standards No. 165 (FAS-165), *Subsequent Events* (ASC 855, *Subsequent Events*), to move into the accounting hierarchy guidance that had previously been contained in the auditing standards. The former terminology (i.e., type 1 and type 2 subsequent events) has been replaced with "recognized" and "nonrecognized" subsequent events. In addition, as part of the convergence with international standards, there is a new requirement to disclose the date through which subsequent events have been evaluated:

- ***For recognized subsequent events***. The entity recognizes (i.e., records) the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.
- ***For nonrecognized events***. The entity does not recognize subsequent events that provide evidence about conditions that did not exist at the balance sheet date but arose after the balance sheet date but before the financial statements are issued or are available to be issued. FAS-165 (ASC 855) provides that some nonrecognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading. For such events, an entity should disclose:
  - The nature of the event; and
  - An estimate of its financial effect or a statement that such an estimate cannot be made.

FAS-165 (ASC 855) requires that an entity disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. These dates are defined as follows:

- ***Date the financial statements are issued.*** Financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with GAAP.
- ***Date the financial statements are available to be issued.*** Financial statements are considered available to be issued when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance have been obtained (e.g., from management, the board of directors, and/or significant shareholders).

The process involved in creating and distributing the financial statements will vary depending on an entity's management and corporate governance structure, as well as statutory and regulatory requirements. FAS-165 (ASC 855) provides that an entity that has a current expectation of widely distributing its financial statements to its shareholders and other financial statement users (including a public entity) shall evaluate subsequent events through the date that the financial statements are issued. All other entities shall evaluate subsequent events through the date that the financial statements are available to be issued.

As a practical matter, for a typical, non-public not-for-profit entity, the date through which subsequent events will be evaluated (and which is disclosed in the financial statements) will be the same as the date of the auditor's report.

FAS-165 (ASC 855) is effective for interim and annual financial periods ending after June 15, 2009, and should be applied prospectively.

KBA Documents Affected (Not-for-Profit Module):

KBA-901E	Financial Statement Presentation and Disclosure Checklist: Part V—Other Financial Statement Topics and Disclosures (Part II)
AUD-901	Audit Program: Subsequent Events

FASB Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets—*an Amendment of FASB Statement No. 140*

Although it is not expected to have wide-spread effects on not-for-profit entities, auditors should be aware of the issuance of FASB Statement of Financial Accounting Standards No. 166 (FAS-166), *Accounting for Transfers of Financial Assets—an Amendment of FASB Statement No. 140*. FAS-166 eliminates the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures.

FAS-166 must be applied as of the beginning of the reporting entity's first annual reporting period that begins after November 15, 2009. Earlier application is prohibited.

KBA Documents Affected (Not-for-Profit Module):

KBA-901E	Financial Statement Presentation and Disclosure Checklist: Part V—Other Financial Statement Topics and Disclosures (Part II)

Proposed FASB Staff Position FAS 157-g, *Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, "Investment Companies"*

Many not-for-profit entities, particularly those with significant endowment funds, have moved to diversify their investment portfolios by investing in alternative investments, including investment companies that have calculated net asset value per share in accordance with the AICPA AAG, *Investment Companies*.

Many of these investments do not have readily determinable fair values, but do provide investors with a net asset value per share (or its equivalent). Because there is no readily determinable fair value, it is common for investors to estimate the fair value using the net asset value per share, without adjustment. In some cases, the investee stands ready to redeem these investments for their net asset value per share, which provides a good indication of the price the investor would receive to sell the investment (i.e., its fair value).

Due to recent economic difficulties, many of these funds have imposed restrictions on the redemption of shares of the fund by investors. Accordingly, two questions arise:

1. Should the net asset value per share in these cases be a good indicator of fair value; or
2. Should fair value be estimated at some reduced amount of the reported net asset value per share to reflect the fact that there are redemption restrictions?

The proposed FASB Staff Position (FSP) would take the position that a reporting entity should be permitted to estimate the fair value of the net asset value per share without further adjustment, if the net asset value per share is determined in accordance with the AICPA AAG, *Investment Companies*, as of the reporting entity's measurement date. Certain restrictions and disclosures would apply. Readers can track the progress of the proposed FSP at the FASB's Web site (www.fasb.org) under the project pages for FASB Statement of Financial Accounting Standards No. 157 (FAS-157), *Fair Value Measurements*.

KBA Documents Affected (Not-for-Profit Module):

AUD-802	Audit Program: Investments in Securities, Derivative Instruments, and Hedging Activities
AUD-818	Audit Program: Fair Value Measurements and Disclosures

New Audit Requirements for 403(b) Employee Benefit Plans

Employee benefit plans sponsored by not-for-profit entities under Internal Revenue Code Section 403(b) and covered under the Employee Retirement Income Security Act (ERISA) will be subject to the same reporting and audit requirements in effect for Section 401(k) plans. Accordingly, ERISA-covered 403(b) plans with 100 or more participants generally will be required to file audited financial statements beginning with their 2009 Form 5500 filing. These plans with fewer than 100 participants can use abbreviated reporting forms without audited financial statements.

The U.S. Department of Labor estimates that approximately 7,000 403(b) plans will be subject to the new audit requirements. Auditors of not-for-profit entities should determine whether their clients sponsor such plans and whether the audit requirements will apply, depending on the level of eligible participants.

KBA Documents Affected (Not-for-Profit Module):

N/A	N/A

Implementation of SAS-115, *Communicating Internal Control Related Matters Identified in an Audit*

In October 2008, the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) issued Statement on Auditing Standards No. 115 (SAS-115) (AU 325), *Communicating Internal Control Related Matters Identified in an Audit*, which supersedes SAS-112 of the same name. SAS-115 revises the SAS-112 definitions of the terms “material weakness” and “significant deficiency” to be consistent with the definitions used in Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5 (AS-5), *An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements*, and AICPA Statement on Standards for Attestation Engagements No. 15 (SSAE-15) (AT 501), *An Examination of an Entity’s Internal Control over Financial Reporting That Is Integrated with an Audit of Its Financial Statements*. SAS-115 is effective for audits of financial statements for periods ending on or after December 15, 2009, with earlier implementation permitted.

SAS-115 provides the following new definitions:

- A “deficiency in internal control” exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.
- A “material weakness” is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.
- A “significant deficiency” is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

SAS-115 in Reporting on Internal Control over Financial Reporting and Compliance and Other Matters in Audits of Financial Statements Performed in Accordance with *Government Auditing Standards*

Generally accepted government auditing standards (GAGAS) require that in addition to providing an opinion or a disclaimer of opinion on the financial statements, auditors should: (1) report on the scope and results of testing of the entity’s internal control over financial reporting, compliance with laws, regulations, and provisions of contracts or grant agreements; and (2) report certain fraud or abuse. The Government Accountability Office (GAO) issued interim guidance that indicates the following regarding the implementation of the SAS-115 definitions in the GAGAS report:

> Auditors may satisfy the internal control reporting requirements in GAGAS paragraph 5.11 by including in the GAGAS report on internal control all identified “material weaknesses” and “significant deficiencies” following the new definitions and requirements from SAS 115

and SSAE 15, as applicable, providing those definitions, and describing the scope of testing performed on the entity's internal control over financial reporting.

In addition, the AICPA Government Audit Quality Center (GAQC) has released guidance and illustrative auditor's reports that implement the provisions of SAS-115. The GAQC guidance and illustrative reports can be viewed and downloaded at AICPA Web site (http://gaqc.aicpa.org).

Example reports are included in the Not-for-Profit Knowledge-Based Audit tools, which implement the requirements of SAS-115 and the proposed wording changes included in the AICPA GAQC illustrations. These example reports include:

- RPT-980: Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (*No Reportable Instances of Noncompliance and No Material Weaknesses with No Significant Deficiencies Identified*); and
- RPT-981: Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (*Significant Deficiencies and Instances of Noncompliance Identified*).

At the present time, the U.S. Office of Management and Budget (OMB) has not issued any guidance that indicates that the provisions of SAS-115 can be implemented in the reporting of internal control deficiencies in the report on compliance and internal control over compliance for major programs in conjunction with audits performed in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, practitioners are advised not to implement the SAS-115 revised definitions of material weakness and significant deficiency in the reporting of internal control over compliance in the audit of federal awards, until such OMB guidance is provided and published in the Federal Register.

KBA Documents Affected (Not-for-Profit Module):

COR-904A	Communication to Client with Significant Deficiencies or Material Weaknesses (SAS-115)
COR-905A	Communication to Client with *No* Material Weaknesses (SAS-115)
RPT-980	Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* (No *Reportable Instances of Noncompliance and* No *Material Weaknesses with* No *Significant Deficiencies Identified*)
RPT-981	Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* (*Significant Deficiencies and Instances of Noncompliance Identified*)

Issuance of 2009 OMB Circular A-133 *Compliance Supplement*

In May 2009, the OMB released the 2009 OMB Circular A-133 *Compliance Supplement* (2009 Compliance Supplement). The 2009 Compliance Supplement is effective for audits of fiscal years beginning after June 30, 2008, and supersedes the 2008 Compliance Supplement dated March 2008. Circular A-133 provides for the issuance of the Compliance Supplement to assist auditors in planning and performing the required federal award compliance audits, including: (1) identifying material compliance requirements; (2) determining compliance audit objectives; and (3) providing suggested compliance audit procedures that the federal government expects to be considered as part of a Circular A-133 audit. The 2009 Compliance Supplement can be obtained at the OMB Web site (http://www.whitehouse.gov/omb/circulars_a133_compliance_09toc/).

Each year, the OMB updates the Compliance Supplement for new programs, deleted programs, and modified program requirements. However, this year additional changes have been made that resulted from an enhanced federal agency review process to identify areas of the Compliance Supplement that could be improved in response to the results of the federal study on single audit quality. Additionally, the 2009 Compliance Supplement introduces a new appendix that includes information and guidance for auditors on the American Recovery and Reinvestment Act of 2009 (ARRA) and its implications on Circular A-133 audits, as well as a discussion of the common audit deficiencies noted in such audits.

Appendix V of the 2009 Compliance Supplement, *List of Changes for the 2009 Compliance Supplement*, is a key piece of guidance to help practitioners identify all of the changes that the OMB has made. Some of the more significant changes in the 2009 Compliance Supplement include the following:

- Added 5 new programs:
  - Catalog of Federal Domestic Assistance (CFDA) 10.582, Fresh Fruit and Vegetable Program;
  - CFDA 15.623, North American Wetlands Conservation Fund;
  - CFDA 15.635, Neotropical Migratory Bird Conservation;
  - CFDA 20.000, Transit Cross-Cutting Section; and
  - CFDA 20.219, Recreational Trails Program, as part of the Highway Planning and Construction Cluster.
- Deleted 6 programs:
  - CFDA 14.219, Community Development Block Grants/Small Cities Program;
  - CFDA 17.263, Youth Opportunity Grants;
  - CFDA 84.288, Bilingual Education—Program Development and Implementation Grants;
  - CFDA 84.290, Bilingual Education—Comprehensive School Grants;
  - CFDA 84.291, Bilingual Education—Systemwide Improvement Grants; and
  - CFDA 97.008, Urban Areas Security Initiative.
- Modified the applicability of compliance requirements to certain programs in Part 2, *Matrix of Compliance Requirements*:
  - CFDA 15.042, Indian School Equalization Program (added applicability of "Reporting");
  - CFDA 15.426, Coastal Impact Assistance Program (added applicability of "Matching, Level of Effort, Earmarking");
  - CFDA 15.614, Coastal Wetlands Planning, Protection and Restoration Act (added applicability of "Real Property Acquisition/Relocation Assistance");
  - CFDA 93.210, Tribal Self-Governance Program: IHS Compacts/Funding Agreements (added applicability of "Cash Management");
  - CFDA 93.268, Immunization Grants (deleted applicability of "Eligibility"); and
  - Student Financial Aid (deleted applicability of "Subrecipient Monitoring").
- Revised the "Purpose and Applicability—Applicability—Safe Harbor Status" section of Part 1, *Background, Purpose, and Applicability*, and the "Overview of This Supplement" section of Part 3, *Compliance Requirements*, to clarify that the auditor is responsible for achieving the stated

audit objectives for the applicable compliance requirements and the suggested audit procedures are, as the name implies, only suggested.

- Revised Part 3, *Compliance Requirements*, to incorporate the following:
  - Added to each section (i.e., A through M) a new subsection, "Source of Governing Requirements," which includes references to 2 CFR Part 215, the OMB Circular A-102 Common Rule, and other potentially applicable requirements;
  - Updated or corrected citations in Section B, "Allowable Costs/Cost Principles," and Section C, "Cash Management";
  - Updated Section H, "Period of Availability of Federal Funds," and Section L, "Reporting," to clarify or revise testing under the suggested audit procedures; and
  - Updated Section I, "Procurement and Suspension and Debarment," and Section M, "Subrecipient Monitoring," to clarify the requirements under Circular A-133.
- Revised Part 4, *Agency Program Requirements*, to address over 75 programs with major and minor changes, including the addition of new guidance, the removal of outdated guidance, and clarifications. Appendix V of the 2009 Compliance Supplement will help identify the relevant program changes made.
- Revised Part 5, *Cluster of Programs*, for multiple changes to the Student Financial Aid Cluster, including the addition of CFDA 84.379, Teacher Education Assistance for College and Higher Education Grants, and corrected the title of CFDA 93.342, Health Professions Student Loans, Including Primary Care Loans for Disadvantaged Students, where applicable.
- Added new Appendix VII, "Other OMB Circular A-133 Advisories," to include coverage of the effect of the ARRA (discussed in more detail below) based on currently available information and to describe the common audit deficiencies noted in the federal study on single audit quality.

Note: In August 2009, the OMB issued OMB Circular A-133 Compliance Supplement Addendum #1 (Addendum #1) to amend and supplement the 2009 Compliance Supplement for updated guidance on ARRA award expenditures. This addendum is discussed in detail in the section below.

It is important for the practitioner to remember that the Compliance Supplement is not considered an audit program "safe harbor." The Compliance Supplement includes only "suggested" audit procedures. The suggested audit procedures should be considered in conjunction with any other alternative or additional audit procedures when applying professional judgment to determine the most appropriate compliance audit procedures under the circumstances that are needed to achieve the stated audit objectives.

KBA Documents Affected (Single Audit Module):

KBA-400S	Identification of Material Compliance Requirements
KBA-402S through KBA-414S	Understanding Compliance Requirement-Level Controls
AUD-801S through AUD-816S	Audit Programs: Types of Compliance Requirements

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Effect of the American Recovery and Reinvestment Act of 2009 on Circular A-133 Audits

In February 2009, the U.S. Congress approved and the President signed into law the ARRA, one of the most significant and far-reaching economic stimulus initiatives of recent times that will result in approximately $300 billion in additional federal funds being passed down from federal agencies to entities that are generally subject to single audits (e.g., state and local governments and not-for-profit entities, including institutions of higher education). Because of the magnitude of this funding and its high public profile, the ARRA mandates that there be an unprecedented amount of oversight and transparency around the spending of all ARRA funds.

The OMB expects the effects of the ARRA on Circular A-133 single audits to increase significantly during calendar year 2009 and on into 2010. Therefore, practitioners should be alert to determine whether audit clients (both recipients and subrecipients) have properly identified and segregated ARRA awards.

With the release of the 2009 Compliance Supplement, the OMB provided some guidance in new Appendix VII, "Other OMB Circular A-133 Advisories," which is intended to highlight certain areas of the ARRA that will affect single audits. However, because of the short time period between the enactment of the ARRA and the issuance of the 2009 Compliance Supplement, the OMB was unable to completely revise or update the 2009 Compliance Supplement for the full effect of the ARRA. Therefore, Appendix VII should be considered a "first step" in understanding the effect of the ARRA on Circular A-133 single audits. The OMB has indicated that it expects to develop addenda to the Compliance Supplement and other guidance as time progresses to add new programs or modify certain sections (e.g., Part 3, *Compliance Requirements*) to address compliance requirement considerations of the ARRA. Therefore, when ARRA funds awards are identified, practitioners should first review Appendix VII and then follow up through a review of the OMB Web site for additional supplemental ARRA or Compliance Supplement information and guidance.

To date, the OMB has issued the following supplemental guidance:

- A memorandum dated June 22, 2009, *Implementing Guidance for the Reports on Use of Funds Pursuant to the ARRA*, which can be accessed at the OMB Web site (http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-21.pdf). This memorandum provides guidance on ARRA reporting requirements.
- Addendum #1 dated June 30, 2009, which can be accessed at the OMB Web site (http://www.whitehouse.gov/omb/assets/a133_compliance/arra_addendum_1.pdf). This addendum supplements the 2009 Compliance Supplement and provides additional guidance for programs, including clusters of programs, with expenditures of ARRA awards. Addendum #1 is effective for single audits of fiscal years beginning after June 30, 2008 (i.e., for June 30, 2009 single audits and periods ending thereafter) and should be used in conjunction with the other parts and appendixes of the 2009 Compliance Supplement.

Based on the guidance available at the present time, including Addendum #1, some of the most significant considerations for practitioners in the conduct of Circular A-133 single audits related to the effect of ARRA awards include the following:

- ***Effect on CFDA numbers.*** Appendix VII of the 2009 Compliance Supplement indicates that federal agencies are required to specifically identify ARRA awards, regardless of whether the funding is provided under a new or existing CFDA number. Addendum #1 supplements and amends Part 2 of the 2009 Compliance Supplement, *Matrix of Compliance Requirements*, and Part 4, *Agency Program Requirements*, by identifying ARRA-funded programs by **bolding** the program number and name. These bolded items include new CFDA numbers for new ARRA programs or clusters and existing CFDA numbers for programs or clusters that are ARRA funded and for which ARRA compliance requirements have been added.
- ***Effect on federal award clusters.*** In Addendum #1, the OMB has indicated that it will need to update the clustering guidance in Part 5 of the 2009 Compliance Supplement, *Clusters of Programs*, because many of the ARRA awards will have new CFDA numbers even though they may be additions to and share common compliance requirements with an existing program. Addendum #1 updated Part 5 by showing all new or revised clusters with ARRA funded programs displayed in **bold**, as well as providing specific ARRA cluster considerations or revisions for Student Financial Assistance, Research and Development, and Child Nutrition clusters.
- ***Effect on major program determination.*** Appendix VII describes the effect of ARRA award expenditures on major program determination. Generally, two scenarios could arise: (1) one CFDA number could be used for combined non-ARRA and ARRA funds; or (2) a new CFDA number could be used for the ARRA funds. In the first case, Appendix VII states that the auditor should consider all federal programs with expenditures of ARRA funds to be programs of higher risk in accordance with Sections .525(c)(2) and .525(d) of Circular A-133. Also, when performing the risk-based approach under Section .520(c)(1), Type A programs with expenditures of ARRA funds should "not" be considered low risk except when the auditor determines, and clearly documents the reasons, that the expenditure of ARRA funds is low risk for the program. In the second case, Appendix VII states that for situations in which an ARRA CFDA number has been added to a cluster, the ARRA CFDA number should be considered a new program and the cluster would not qualify as a low-risk Type A program. Therefore, the cluster will not meet the requirement of having been audited in one of the last two audit periods and will have to be audited as a major program (assuming it is a Type A program).
- ***Effect on determining applicable compliance requirements.*** Appendix VII emphasizes that compliance requirements unique to the ARRA are not included in the 2009 Compliance Supplement. Therefore, auditors should: (1) review the award documents, including the terms and conditions; (2) check the OMB Web site for any addenda to the 2009 Compliance Supplement; and (3) use the framework provided by the 2009 Compliance Supplement (e.g., in Parts 3, 4, 5, and 7) as guidance to identify ARRA compliance requirements material to the federal program and to determine the appropriate audit procedures. With the issuance of Addendum #1, the OMB has provided additional guidance and modifications to the 2009 Compliance Supplement compliance requirements that:
  - Add new cross-cutting provisions (with new language shown in bold) to the following types of compliance requirements: (1) Activities Allowed or Unallowed; (2) Davis-Bacon Act; (3) Procurement and Suspension and Debarment; (4) Subrecipient Monitoring; and (5) Special Tests and Provisions.
  - List three new ARRA compliance requirements (i.e., R1, R2, and R3) to Special Tests and Provisions that apply to all programs expending ARRA awards (and should be added to Part

4 or Part 7 guidance) in addition to providing related audit objectives and suggested audit procedures for these new requirements.
  - Indicate that the new reporting requirements imposed by the ARRA are not applicable for audit periods with ending dates in June, July, and August of 2009, but that an additional addendum would be issued later addressing the reporting requirements and related audit objectives and suggested procedures. For preliminary reporting guidance, refer to the June 22, 2009, OMB document, *Implementing Guidance for the Reports on Use of Funds Pursuant to the ARRA*.
- ***Effect on the SEFA and DCF***. Appendix VII states that federal agencies (and recipients passing ARRA funds to subrecipients) are required to include specific ARRA requirements in their terms and conditions for ARRA awards to ensure separate identification in both the schedule of expenditures of federal awards (SEFA) and the data collection form (DCF). Generally, ARRA award terms and conditions require recipients to accomplish this by: (1) identifying ARRA expenditures separately on the SEFA; (2) identifying ARRA expenditures as separate rows under Item 9 of Part III of the DCF by CFDA number; and (3) including the prefix "ARRA-" in identifying the name of the federal program on the SEFA and as the first characters in Item 9d of Part III on the DCF. Addendum #1 also provides the added requirements for ARRA presentation matters in the SEFA and DCF, in addition to the requirements for recipients to separately identify (and document) to each subrecipient at the time of a subaward the federal award and CFDA numbers, and the amount of ARRA funds, as well as requiring subrecipients to meet the SEFA and DCF presentation requirements.
- ***Effect on internal control guidance***. Addendum #1 also provides added emphasis related to internal control testing over compliance in regards to major programs funded with ARRA awards. This guidance to auditors includes the following:
  - Encouragement of interim communication to promptly notify auditee management (i.e., during the audit rather than merely at the engagement end in the auditor's report) of any internal control significant deficiencies or material weaknesses identified that are related to ARRA funded programs.
  - Guidance to consider the entity's control environment and other control activities in addressing the risks related to noncompliance with the requirements related to Activities Allowed or Unallowed, Allowable Costs and Cost Principles, and Eligibility that may exist because of: (1) the newness of the ARRA program; (2) the rapid growth in program funding; (3) changes in regulatory environment; and (4) similar risks.
  - Guidance to consider not only the volume of ARRA funding in the current audit period, but also the future anticipated volume, when evaluating the likelihood and magnitude of control deficiencies.

An ARRA page is available at the GAQC Web site (http://gaqc.aicpa.org/Resources/Recovery+Act+Resource+Center.htm), which is dedicated to helping its members locate auditor resources and information related to the ARRA and its effect on single audits.

KBA Documents Affected (Single Audit Module):

KBA-104S	Circular A-133 Compliance Audit Significant Matters
KBA-302S	Understanding the Entity and Its Program Environment
KBA-400S	Identification of Material Compliance Requirements
AID-301S	Determining Single Audit Applicability
AID-303S	Determining Major Programs

Update on Single Audit Electronic Data Collection Form

Practitioners should remember that beginning with 2008 fiscal year-ends and forward, paper submissions of the single audit DCF required under Circular A-133 are no longer accepted by the Federal Audit Clearinghouse (FAC). Only electronic submissions of the DCF and the required reporting package through the (FAC) Internet Data Entry System (IDES) are accepted.

For audit periods ending in 2004, 2005, 2006, and 2007, the previous version of the DCF should be used, which can be accessed at the FAC Web site (http://harvester.census.gov/fac/) by clicking on the Data Collection Form Options link. Further, reporting packages for previous fiscal periods ending prior to 2008 must be mailed in hard copy. However, for 2008 fiscal year-end submissions and beyond, all submissions must be in electronic form and there will no longer be any paper copy submissions of the DCF and reporting package to the FAC.

The new IDES instructions for DFC submissions for 2008 and beyond are available at http://harvester.census.gov/fac/collect08/main_instruct.pdf and include the following:

- Chapter 1: Important Notes for Using the Internet Data Entry System;
- Chapter 2: Create a Report ID and New Form;
- Chapter 3: Update a Form From a Previous Session;
- Chapter 4: Enter Data in the Form SF-SAC;
- Chapter 5: How to Upload Page 3 (Optional);
- Chapter 6: How to Upload Page 4 Multiple EINs (Optional);
- Chapter 7: How to Upload Page 4 Multiple DUNS (Optional);
- Chapter 8: Check Data, Correct Errors & Print Draft Pages;
- Chapter 9: Upload the PDF File of the Audit Report;
- Chapter 10: Certify Form SF-SAC;
- Chapter 11: File a Revised Submission;
- Appendix I-A & I-B: Federal Agency Two-Digit Prefix Listing;
- Appendix II: Contact Information;
- Glossary; and
- Index.

To use the IDES, auditees and auditors must have Internet access and valid e-mail accounts. They must also have the ability to upload a PDF file to the IDES. Cookies must be enabled in the Internet browser to allow proper data transfers between the sending computer and the IDES. Instructions on how to enable cookies are provided in the IDES instructions. Before final submission of the DCF and reporting package (i.e., once both the auditee and auditor are ready to begin the certification process), the IDES will send an e-mail to the auditee and auditor certifying officials with a unique number that will be used to serve as a signature code.

KBA Document Affected (Single Audit Module):

KBA-901S	Circular A-133 Compliance Audit Review and Approval Checklist