

THE PPC GOVERNMENTAL UPDATE

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Planning Your June 30 Audits



Many firms are beginning to plan their June 30 audits and need to be aware of things that have changed from last year, such as the issuance of a new auditing standard and recently issued GASB Standards.

Auditing Standard

The Auditing Standard Board issued Statement on Auditing Standards (SAS) No. 133, *Auditor Involvement with Exempt Offering Documents*, which is effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018. This SAS amends and codifies auditor involvement guidance that was previously found only in the AICPA state and local government audit guide. It also amends AU-C 560, *Subsequent Events and Subsequently Discovered Facts*.

In planning an audit in which the auditor's report is included in an exempt offering document, it is important to ensure that your engagement letter contains the appropriate language. For example, some auditors include a sentence in the engagement letter notifying clients that they must get the auditor's permission before using

the auditor's report in an exempt offering document.

Additionally, some auditors include a sentence in the engagement letter notifying clients that any exempt offering document issued by the entity with which the auditor is not involved will clearly indicate that the auditor is not involved with the contents of such offering document.

Practical Consideration:

To facilitate the preparation of your engagement letters, *PPC's Guide to Audits of State and Local Governments* includes illustrative engagement letters updated for SAS No. 133.

GASB Standards and Implementation Guidance

The GASB has issued new standards and implementation guides that will be effective for June 30 audits or are encouraged for earlier application (denoted below with an asterisk after the number). Those include:

- GASBS No. 83, *Certain Asset Retirement Obligations*, which establishes the

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criteria for determining the timing and the pattern of recognition of a liability and a corresponding deferred outflow of resources for asset retirement obligations.

- GASBS No. 84*, *Fiduciary Activities*, effective for reporting periods beginning after December 15, 2018, with earlier application encouraged, establishes criteria for identifying fiduciary activities and describes four types that should be reported.
- GASBS No. 87*, *Leases*, effective for reporting periods beginning after December 15, 2019, with earlier application encouraged, establishes standards of accounting and financial reporting for leases by lessees and lessors.
- GASBS No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, provides enhanced disclosures for debt, including direct borrowings and placements, and provides additional essential information for financial statement users.
- GASBS No. 89*, *Accounting for Interest Cost Incurred before the End of a Construction Period*, effective for reporting periods beginning after December 15, 2019, with earlier application encouraged, establishes accounting requirements for interest cost incurred before the end of a construction period.
- GASBS No. 90*, *Majority Equity Interests*, effective for reporting periods beginning after December 15, 2018, with earlier application encouraged, defines a majority equity interest and establishes reporting and accounting requirements.
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*, contains questions and answers relating to pensions, postemployment benefits other than pensions, and other topics. The guide also includes amendments to previously issued implementation guidance on issues pertaining to deposits with financial institutions, cash flows, management's discussion and analysis, and others.
- Implementation Guide No. 2019-1*, *Implementation Guidance Update—2019*, effective for reporting periods beginning after June 15, 2019, with earlier application encouraged, contains new questions and answers relating to multiple topics such as derivative instruments, irrevocable split-interest agreements, postemployment benefits, and several others.

Practical Consideration:

To quickly identify standards that are effective for periods covered by your audits, use the Standards Tracker – Charts Results tool on Checkpoint, available at checkpoint.riag.com for users that subscribe to that service. The tool allows you to filter by date and authoritative body and view a summary of the standard.



Efficiency Gains with Dual-purpose Tests

Auditors all want to be more efficient on engagements... especially single audit engagements. Dual-purpose tests can help with this; however, dual-purpose testing is often cited as an area of deficiency during peer reviews. The AICPA's audit risk alert, *Government Auditing Standards and Single Audit Developments—2018/19*, published information from a recent single audit analysis performed as part of the Enhancing Audit Quality initiative. This analysis named the auditor's lack of understanding of the meaning and purpose of dual-purpose testing as one of the most common misconceptions. So, let's talk about dual-purpose testing and how you can ensure you're benefitting from its efficiencies without jeopardizing audit quality.

Practical Consideration:

You can access the *Government Auditing Standards and Single Audit Developments—2018/19* risk alert on Checkpoint at checkpoint.riag.com if you subscribe to AICPA materials. You can also purchase the risk alert from the AICPA at www.aicpastore.com.

What is Dual-purpose Testing?

A dual-purpose test is the simultaneous performance of tests of controls that involve sampling and tests of compliance with laws and regulations. In plain English, it's a test that allows you to test both internal controls *and* compliance with laws and regulations using the same sample.

Why Should I Perform Dual-purpose Tests?

In a single audit, auditors are required to obtain an understanding of internal control over federal programs sufficient to plan the audit to support a low assessed level of control risk of noncompliance for major programs. This means you must test internal controls over compliance because you can't get a low assessed level of control risk without control testing. If it must be done, do it as efficiently as possible by testing controls and compliance with the same sample (i.e., dual purpose).

How Do I Meet the Requirements for Both Tests?

Documentation for dual-purpose tests needs to clearly distinguish how the tests performed accomplish the testing of compliance, the testing of the operating effectiveness of internal control over compliance, and the results of those

tests. To do so auditors should:

- *Select an appropriate sample size.* The AICPA's Audit Guide, *Government Auditing Standards and Single Audits*, Paragraph 11.54, indicates the sample size for a dual-purpose test of internal controls and compliance will usually be the larger of the two samples that would be used if the internal control and the compliance samples were tested separately. Therefore, you should determine sample size for both internal control testing and compliance testing and select the larger sample size.

Practical Consideration:

PPC's Guide to Single Audits and PPC's SMART Practice Aids—Single Audits provide practice aids to assist you in determining appropriate sample sizes for both tests of controls and tests of compliance.

- *Document the tests of controls and tests of compliance separately.* While using the same selection to test both internal controls and compliance, there should be separate documentation indicating the specific internal control attributes and compliance attributes tested. Documentation could be in various forms, such as narratives, tick marks, attribute descriptions, or similar notations. For example, a test of allowable costs might document (1) the control test performed (e.g., tick mark noting Jane Doe, Program Director, approval on supporting documentation prior to payment) and (2) the compliance test performed (e.g., tick mark for reviewing documentation supporting expenditure and verifying allowability per regulatory guidance).
- *Document the conclusions of the tests of controls and tests of compliance separately.* Again, the same sample is being used, but two separate tests are being performed. As a result, there should be separate conclusions documenting the results of the procedures performed. It's possible that your conclusion regarding internal controls over compliance and compliance will differ. For example, you could report a significant deficiency or material weakness in internal control over compliance for allowable costs because the appropriate personnel didn't review and approve the expenditure for allowability in a timely manner. However, you might not report any unallowable costs (as all costs may have been allowable despite the lack of internal controls).

Practical Consideration:

The AICPA's Governmental Audit Quality Center provides an illustrative dual-purpose testing workpaper on their website at www.aicpa.org/interestareas/governmentalauditquality/resources/auditpracticetoolsaids/single-audit-practice-aids.html.

Get Those Gains

Hopefully this article provides you with some valuable information to assist you in performing effective and efficient dual-purpose testing in your single audits. Now, get out there, and get those efficiency gains on your single audits this summer!



GASB Issues Proposed Implementation Guide for Leases

On February 19, 2019, the GASB issued an Exposure Draft on lease implementation guidance. The proposed guidance is intended to clarify the requirements of GASBS No. 87, *Leases*.

Background

In June 2017, the GASB issued new standards for leases which become effective for reporting periods beginning after December 15, 2019. Not long after issuance of the new standards, GASB began developing implementation questions utilizing issues raised by stakeholders through various due process channels. In addition, suggestions for questions were provided by a consultative group representative of GASB's stakeholders.

GASB implementation guides fall into category B on the governmental GAAP hierarchy.

Organization of the Implementation Guide

After a brief introduction and two explanatory paragraphs, the questions begin in section 4. There are 80 questions and answers on a variety of issues, followed by three appendixes. Appendix B will be of interest to many since it contains three comprehensive illustrations on lease implementation. After laying out the facts and assumptions, the illustrations provide a discussion of accounting and reporting and illustrate quantitative information using tables.

A Sampling of the Questions

Let's take a high-level look at some of the questions covered in the implementation guide.

Scope and Applicability of GASBS No. 87:

- Question 4.1 addresses leases that are not considered exchange transactions, such as a lease with a rate that

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is significantly below fair market value. In this case, the guidance in GASBS No. 87 would not apply.

- Question 4.2 addresses the issues of control and the period of the lease in a case where a government has the right to use a facility for only part of a week during its lease. In this case GASBS No. 87 would apply.
- Question 4.3 addresses easements; if they are a permanent conveyance or conveyed at less than fair market value, they would not meet the criteria for lease accounting.

Some of the other topics in this group of questions include cellphone towers, land engaged in oil and gas exploration and production, biological assets, hunting grounds, solar farms, ranches, and others.

Lease Term:

- Question 4.14 addresses leases on buildings under construction, explaining that paragraph 5 of GASBS No. 87 states that the right to use the underlying asset of a lease is the right to obtain the present service capacity from its use and the right to determine the nature and manner of its use. In the example given, lease commencement would occur when a certificate of occupancy is issued for the building.
- Question 4.16 addresses bargain renewal options in leases. The example given is a 20-year lease with a \$1 option to renew for an additional five years. The answer explains that all factors relevant to the likelihood of exercise should be considered, including significant economic incentives. In this case, the lease term would be 25 years.

Other Topics Covered

The following is a partial list of other topics included in the questions and answers section:

- Short-term leases
- Contracts that transfer ownership
- Lease assets
- Notes to financial statements for lessees
- Leases of assets that are investments
- Certain regulated leases
- Lease receivables
- Deferred inflow of resources
- Lease incentives
- Contracts with multiple components
- Lease modifications

Proposed Effective Date

The proposed effective date for the implementation guide is for periods beginning after December 15, 2019, which coincides with the effective date of GASBS No. 87. Therefore, for June year-end governments, the first fiscal year of implementation would be the year ending on or after June 30, 2021.

Practical Consideration:

The full text of the Exposure Draft is available on Checkpoint at checkpoint.riag.com for users that subscribe to GASB content, and at www.gasb.org.

