2000

Not-for-profit organizations industry developments - 2000; Audit risk alerts

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AUDIT RISK ALERTS

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Not-for-Profit Organizations Industry Developments—2000

Complement to AICPA Audit and Accounting Guide *Not-for-Profit Organizations*

Notice to Readers

This Audit Risk Alert is intended to provide auditors of financial statements of not-for-profit organizations with an overview of recent economic, industry, regulatory, and professional developments that may affect the audits they perform. This document has been prepared by the AICPA staff. It has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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Economic and Industry Developments

What are the industry and economic conditions facing not-for-profit organizations in the current year?

The positive growth in the U.S economy of recent years has continued through 1999 and the first quarter of 2000, fueled by increased productivity and consumer spending. In February 2000, the current period of economic expansion became the longest in history at one hundred and seven months. Inflation remained low, at approximately 2.5 percent, while the U.S. jobless rate remained below 5 percent. The much-anticipated Year 2000 (Y2K) Issue, with its potential for negative economic implications, has so far passed without any major impact, although the potential for problems remains. For example, the effect of the Y2K Issue on year-end processing that has not been completed has yet to be determined.

Both the Dow Jones Industrial Average (DJIA) and the National Association of Securities Dealers Automated Quotation (NASDAQ) composite ended 1999 at record highs, nearly 11,500 for the DJIA and over 4,000 for the NASDAQ. By March 2000, the NASDAQ reached a new milestone, closing over 5,000 for the first time. The equities markets, however, have continued to display periods of volatility throughout 1999 and the first quarter of 2000. Both the DJIA and NASDAQ experienced declines from their record highs of the end of 1999. These fluctuations can have an impact on the giving patterns of contributors to not-for-profit organizations. Also, some not-for-profit organizations have begun to increase the percentage of their investments in equity securities versus debt securities and are therefore more vulnerable to the impact of market fluctuations. See a related discussion titled "Securities Valuation" in the "Audit Issues and Developments" section of this Audit Risk Alert.

Despite the positive economic news, not all sectors of the economy have been equal benefactors of the current prosperity. Similarly, although some not-for-profit organizations have benefited significantly during the current period of economic expansion and the current bull market, others have not been as fortunate. During the past year, the growth in foundation assets as well as foundation giving has been particularly strong, and has included certain large dollar, high profile donations.

Competition among not-for-profit organizations continues to be intense, as the number of not-for-profit organizations, already over one million in number, continues to grow each year. One not-for-profit organization, for example, may have a significant increase in contributions as it benefits from a well-executed media campaign, while negatively affecting other organizations. Also, not-for-profit organizations face increased competition from for-profit businesses. For example, governments that previously focused on not-for-profit organizations as the recipients of social services contracts now outsource a greater part of their social service functions to for-profit businesses in areas such as welfare-to-work programs, foster care programs, juvenile corrections, and special education.

In response to competitive pressures, some not-for-profit organizations have sought greater efficiencies by implementing cost-cutting measures, such as reorganizing established structures by combining departments or eliminating functions, while at the same time continuing to need skilled personnel capable of implementing and maintaining technological improvements and possessing a knowledge of the regulatory, tax, and unique accounting considerations for this industry. Maintaining an appropriate segregation of duties also needs to be considered. Auditors should consider the impact of such changes on the not-for-profit organization's internal control. Statement on Auditing Standards (SAS) No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319) outlines the auditor's responsibilities with regard to considering a client's internal control in planning and performing an audit.

During the past year, more not-for-profit organizations have begun to use the Internet in a number of ways, such as to deliver educational materials and other program services, solicit contributions, including volunteer time, communicate with donors and other not-for-profit organizations, sell products, and disseminate information, including financial information, about the organization. Currently, the overall percentage of contributions received by not-for-profit organizations online is small, as compared with total contributions, and generally is used to supplement traditional fund-raising methods. Nevertheless, the impact of the Internet on not-for-profit organizations is growing as it has for the for-profit sector. For example, philanthropic portals have been developed on the Internet for matching volunteers with charitable organizations. Web sites have been set up to enable the public to view Form 990 filings by exempt organizations, subjecting this information to even greater public scrutiny. See the related discussions titled "The Internet" in the "Regulatory and Legislative Issues and Developments" section of this Audit Risk Alert, and "Auditing in an Online Environment" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.

The financial affairs of not-for-profit organizations continue to be subject to the scrutiny of the media and various "watch dog" groups. Adverse publicity, including adverse publicity resulting from alleged fraudulent financial reporting, can have harmful consequences for a not-for-profit organization, as potential donors looking to place donations seek organizations they believe are trustworthy. So, although any entity can experience the impact of the adverse publicity resulting from alleged fraudulent financial reporting, the effect on a not-for-profit organization can be particularly severe. Auditors should be alert to the impact of negative developments on an organization's ability to continue as a going concern. SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 341), provides guidance for evaluating whether there is substantial doubt about a client's ability to continue as a going concern for a period not to exceed one year from the date of the financial statements being audited. Also, SAS No. 82, *Consideration of Fraud in a Financial Statement*

Audit (AICPA, *Professional Standards*, vol. 1, AU sec. 316), provides guidance to auditors in fulfilling the responsibility to assess the risk of material misstatement due to fraud. See the related discussion titled "COSO Study on Fraud in Financial Reporting" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.

Executive Summary—Economic and Industry Developments

- The growth in the U.S. economy in recent years continued in 1999 and the first quarter of 2000. In February 2000, the current period of economic expansion became the longest in history at one hundred and seven months.
- Some not-for-profit organizations have begun to increase the percentage of their investments in equity securities versus debt securities and are therefore more vulnerable to the impact of market fluctuations.
- During the past year, more not-for-profit organizations have begun to use the Internet in a number of ways, such as to deliver educational materials and other program services, solicit contributions, including volunteer time, communicate with donors and other not-for-profit organizations, sell products, and disseminate information, including financial information, about the organization.
- The financial affairs of not-for-profit organizations continue to be subject to the scrutiny of the media and various "watch dog" groups. Adverse publicity, including adverse publicity resulting from alleged fraudulent financial reporting, can have harmful consequences for a not-for-profit organization, as potential donors looking to place donations seek organizations they believe are trustworthy.

Regulatory and Legislative Developments

Auditors of not-for-profit organizations may need to monitor changes in government regulations for various reasons. For example, they may be required to comply with government auditing standards, as specified in the *Government Auditing Standards* (also referred to as the Yellow Book).[1] In addition, auditors may be required

1. Although *government auditing standards* primarily apply to federal financial assistance, some states have adopted government auditing standards.

to perform a "single audit" and comply with applicable rules. A single audit is an audit of an entity's federal financial assistance, as required by the Single Audit Act Amendments of 1996 (the Act), and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (Circular A-133).[2] Not-for-profit organizations may also be affected by other federal, state, and local laws, such as laws regulating the registration of not-for-profit organizations and tax laws.

Single Audit Guidance Update

What updates to single audit guidance should auditors be aware of?

2000 *Compliance Supplement* Issued

The OMB Circular A-133 *Compliance Supplement* (the Supplement) is based on the requirements of the Act and OMB Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in planning and performing the required audits. The Supplement identifies existing compliance requirements that the federal government expects to be considered as part of an audit in accordance with the Act and OMB Circular A-133.

Keeping its commitment to update the Supplement on a regular basis and to continue to expand the number of programs it includes, the OMB issued a 2000 Supplement in April 2000. For the 141 federal programs in the 2000 Supplement, information is included to help auditors understand the programs' objectives, procedures, and compliance requirements. Part 7 of the Supplement, "Programs Not Included in This Supplement," provides guidance to help auditors determine compliance requirements relevant to the audit, audit objectives, and suggested audit procedures for programs not included in the Supplement. The 2000 Supplement adds twenty-three additional federal programs (some of which result in new or add to existing program clusters) and updates and revises the information on numerous previously included programs. The 2000 Supplement is effective for audits of fiscal years beginning after June 30, 1999.

2. Instead of a single audit, under certain circumstances, program-specific audits may be conducted.

The 2000 Supplement includes Appendix V that lists changes from the 1999 Supplement. Among the more significant changes, the 2000 Supplement—

- Revises references in Part 3, "Compliance Requirements," to clarify that all institutions of higher education and hospitals (including those that are governmental) follow OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations.*
- Substantially revises the program requirements for Catalog of Federal Domestic Assistance (CFDA) programs 84.002, "Adult Education-State Grant Program," 84.048, "Vocational Education—Basic Grants to States," 93.558, "Temporary Assistance for Needy Families (TANF)," and 93.569, "Community Services Block Grant," for program changes resulting from newly effective laws and regulations.
- Adds to Appendix VI an advisory on the impact of Y2K on audits of federal awards under Circular A-133.

Help Desk—A printed copy of the 2000 Supplement can be purchased from the Government Printing Office at telephone (202) 512-1800 (Stock No.041-001-00544-7) A free electronic copy can be obtained on the OMB Web site at http://www.whitehouse.gov/OMB/grants.

Opinion Modifications for Year 2000 Disclosures and Low-Risk Auditees

OMB Circular A-133 permits entities to qualify as low-risk auditees and be eligible for reduced audit coverage if certain conditions are met. One condition is that the auditor's opinion on the entity's financial statements for each of the preceding two years is unqualified, unless the federal cognizant or oversight agency for audit provides a waiver to that criterion.

However, a qualified or adverse opinion relating solely to a government's Y2K note disclosure (as previously required by Governmental Accounting Standards Board (GASB) Technical Bulletin (TB) 98-1, *Disclosures About Year 2000 Issues, as amended*), does not preclude the government from qualifying as a low-risk auditee. The OMB issued an advisory to federal departments and agencies to that effect on August 30, 1999, titled "Impact of Y2K on Audits of Federal Awards Under OMB Circular A-133." There is no need for the government to request or obtain a waiver to qualify for this exception.

Help Desk—The GAO advisory about Y2K is on its Web site at http://www.whitehouse.gov/OMB/grants, in the section on Current Policy Documents of Interest, and in Appendix VI of the 2000 Supplement.

Data Collection Form

The submission of a data collection form is a key part of completing a single audit. This form helps the federal government accumulate information on the thousands of single audits that are performed. The Federal Audit Clearinghouse (FAC) is the entity responsible for receiving data collection forms and report submissions. The FAC also is responsible for maintaining a database of the information from the forms. The database can be accessed on the FAC Web site at http://harvester.census.gov/sac.

In January 2000, the FAC introduced a process to permit online submissions of the data collection form on its Web site. Auditors and auditees can complete portions of the form directly on that Web site, and benefit from online edits on the entered data before submitting the form. In fact, the Web site does not permit the form to be submitted online if there are unresolved edit failures. Although the form is submitted electronically through this process, it still needs to be printed, signed and dated by the auditee and auditor, and mailed to the FAC with the appropriate number of audit reporting packages.[3]

3. The online form only accepts a maximum of forty programs or contracts to be listed in Part III, Items 6 and 7, also known as page 3 of the form. If a data collection form is being submitted in hardcopy form (that is, not using the electronic submission process), the FAC permits those forms to be submitted using a Microsoft Excel spreadsheet attachment for data on page 3 (Part III, Items 6 and 7). For the file layout specifications for that Excel spreadsheet, contact FAC at fac@census.gov.

The data collection form summarizes the information contained in the reporting package, including the auditor's reports and the auditee's schedule of expenditures of federal awards. OMB Circular A-133 requires the auditee to complete and certify sections of the form that state whether the audit was completed in accordance with OMB Circular A-133. Further, information is required to be provided about the auditee, its federal programs, and the results of the audit. The auditor is also required to complete and certify certain sections of the form, including information on the results of the financial statement audit and the audit of the federal programs. It is important for both the auditor and the auditee to carefully follow the detailed instructions that accompany the form.

> **Help Desk**—The data collection form and related instructions are available from the FAC in both Microsoft Word and WordPerfect word processing formats at http://harvester.census.gov/sac. Creating your own electronic version of the form is not permitted. The form and instructions can also be obtained from the OMB's Web site at http://www. whitehouse.gov/OMB/grants. A printed copy can be obtained from the FAC at (888) 222-9907. The form number is SF-SAC. Further, auditors can complete and submit the data collection form on the Internet at the FAC Web site, as discussed in this section of this Audit Risk Alert.

Because of numerous errors in the preparation of the data collection forms when they were first introduced, the FAC issued revised instructions for the form in November 1998. (No changes were made to the form itself.) Because of the changes in the instructions, education, and growing familiarity with the form, the percentage of forms rejected for errors dropped from ninety-five percent when the form was first used to forty percent in 1999. The FAC expects that rejection rate to drop even further as use of the online form, which is described above, increases. The reduced rejection rate also has permitted the FAC to more quickly post the information from the data collection forms into its database. In January 2000, the FAC had posted the information from approximately 50,000 data collection forms into the database, an increase of about 35,000 from the number that had been posted in January 1999.

Following are some common submission errors that occurred in 1999:

- *Submission of Photocopies.* Some organizations have been submitting photocopies of their completed forms, rather than the form with original auditee and auditor signatures. Only the originally signed form can be submitted to the FAC.

- *Dating Signatures (Part I, Items 6g and 7g, of the Form).* Auditees and auditors should date (month, day, and year) their signatures on Part I of the form. Some forms have been rejected because the signatures were not dated

- *Cognizant or Oversight Agency for Audit (Part I, Item 9, of the Form).* Only recipients expending more than $25 million a year in federal awards are assigned a cognizant agency for audit. Because of the size of that threshold, most auditees instead have an oversight agency for audit. OMB Circular A-133 sections .400(a) and .400(b) provide guidance on determining the auditee's cognizant or oversight agency for audit, which most often is the federal awarding agency that provides the predominant amount of direct funding. Cognizant assignments are established every five years.

  For purposes of the data collection form, the cognizant or oversight agency for audit always is a federal agency. A nonfederal, pass-through entity never should be identified as a cognizant or oversight agency for audit. Some auditees have marked "State" in Part I, Item 9, trying to indicate that a state agency is their cognizant or oversight agency for audit, but, instead, inadvertently select the U.S. Department of State. Because most of Part I of the form is completed by the auditee, auditors may wish to remind the auditee of the proper information to include as the cognizant or oversight agency for audit.

- *Federal Agencies Required to Receive the Reporting Package (Part III, Item 5, of the Form).* Only federal agencies whose direct awards are affected by current- or prior-year audit findings should be identified as needing to receive a copy of the reporting package (described in section .320(d) of OMB Circular A-133). If no federal agency is required to receive a copy of the reporting package, the auditor should mark "None." Auditees must send the FAC one reporting package for each federal agency identified in Part III, Item 5, plus one archival copy for the FAC.[4] For example, consider an auditee that has four federal awards that were received directly from four federal agencies. Further, assume that the current-year single audit resulted in audit findings on one of the four federal awards and that the summary schedule of prior audit findings included the status of a prior-year finding related to a second federal award that had no current-year audit findings. In this example, the auditee would be required to submit three reporting packages to the FAC—one for the FAC to retain as an archival copy, one for the federal agency that provided the direct federal award that had current-year findings associated with it, and one for the federal agency that provided the direct federal award where the summary schedule of prior audit findings reported the status of a prior-year finding.

A common error has been for auditors to mark all federal agencies that provided funding, regardless of whether there were audit findings from awards provided directly by the federal agency. Another common error has been to mark "State" because the auditee is obligated to submit copies of the reporting package to a state pass-through entity. "State" should be marked only if there are audit findings relating to U.S. Department of State programs. As a result of those errors, reports were sent to the FAC that were not needed, causing an unnecessary paper flow from the auditee to the FAC and certain federal agencies.

- *Federal Programs (Part III, Items 6 and 7 of the Form).* In Items 6 and 7 of Part III of the form, some auditors are listing multiple CFDA numbers on a single line. Sometimes,

4. Note that OMB Circular A-133, section .320(e), provides guidance on when a subrecipient needs to submit the reporting package or other information to the pass-through entity.

the auditors are grouping program clusters, and sometimes they are grouping all programs received from a single federal agency. Each line item in this section should have a unique CFDA number (or other identifying number). (Consult the revised instructions for the form for guidance on handling non-CFDA numbers.)

The data collection form is an OMB form, and every three years the OMB reviews its forms to determine whether they should be (1) renewed with their current content, (2) not renewed, or (3) renewed with content change. The data collection form is subject to this review process in 2000, and it is likely that auditors and their auditees will see a revised data collection form, along with revised instructions, later this year. Any changes will be posted on the FAC and OMB Web sites.

AICPA Single Audit Information

Various pieces of single audit information can be viewed or downloaded from the AICPA Web site at http://www.aicpa.org/belt/a133main.htm. That site has the illustrative auditor's reports from appendix D of SOP 98-3, *Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards*, updated for the issuance of *Government Auditing Standards: Amendment No. 2, Auditor Communication*. (See the related discussions titled "Revisions to *Government Auditing Standards*" in this section of this Audit Risk Alert and "Revised Yellow Book Reports" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.) The electronic versions of the illustrative schedules of expenditures of federal awards and schedule of findings and questioned costs from appendixes C and E of SOP 98-3 as well as unofficial frequently asked questions and answers regarding OMB Circular A-133 also can be obtained.

Update on President's Council on Integrity and Efficiency Audit Review Guides and Informal Results of Recent Reviews Performed by Inspectors General

It has been several years since the major overhaul to single audit rules. To obtain more information about audit quality under those revised rules, many federal Inspectors General (IGs) are increasing their scrutiny of completed OMB Circular A-133 audits. To assist the IGs in carrying out this objective, the President's Council on Integrity and Efficiency (PCIE) issued updated editions of its two checklists—the *Uniform Guide for Initial Review of A-133 Audit Reports* (Initial Review Guide) and the *Uniform Quality Control Review Guide for A-133 Audits* (QCR Guide)—in late 1999.

The Initial Review Guide is used by federal agencies when performing desk reviews of OMB Circular A-133 audit reports. The objectives of the initial reviews are to: (1) ensure that audit reports meet applicable reporting requirements; (2) identify any follow-up audit work needed; (3) identify audits for potential QCRs; and (4) identify issues that may require management attention. The QCR Guide is used by federal agencies as a tool to ensure that the OMB Circular A-133 audits are conducted in accordance with applicable standards and meet single audit requirements. Before completing OMB Circular A-133 audits, consider reviewing the updated guides to gain an understanding of what the IGs will be looking for in their reviews. Taking this step will help ensure that engagements meet the criteria identified.

> **Help Desk**—Copies of the PCIE's Initial Review and QCR Guides are available on the Internet at http://www.ignet.gov/ignet/single/pcie.html.

Although the IGs have not issued any formal reports on what they are finding in their reviews, IGs have spoken about areas that they believe need improvement. A brief discussion of those items follows. Auditors should review those items to help ensure that similar problems are avoided in OMB Circular A-133 audits.

Risk-Based Audit Approach. In some instances, auditors are not adequately documenting the risk assessment process for type B programs. Often the working papers contain the conclusions about the risk of a program but do not document the basis for the conclusions. For example, the working papers might state that a program is low risk because the program is not complex; however, the working papers do not indicate how that conclusion is supported.

> **Help Desk**—To assist auditors, the AICPA Practice Aid, *Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133,* Audits of States, Local Governments, and Non-Profit Organizations (Product No. 008730kk), includes a checklist and worksheets for type A and type B program risk assessments.

Also, some auditors are not making type B program risk assessments on an individual program basis but, rather, are making the assessments on a global basis. Doing that is not consistent with the OMB Circular A-133 requirements to assess program risk on an individual program basis.

Last, in several cases, auditors based their type A and B program determinations on budgeted or appropriated expenditure amounts instead of actual expenditures as required by OMB Circular A-133.

Internal Control. OMB Circular A-133 requires the auditor to plan the testing of internal control over compliance for major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program. In some cases, the IGs are finding that the basis for the audit procedures that are performed and how they relate to a low assessed level of control risk is not documented in the working papers.

Situations have also been noted in which it appears that internal control testing is performed on internal control over financial reporting, but not internal control over compliance for federal programs. OMB Circular A-133 requires testing of the internal control over compliance for federal programs (unless the auditor finds it is likely to be ineffective in preventing or detecting noncompliance, in which case the auditor would report a reportable condition, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control).

Compliance Supplement. Parts 3 and 4 of the Supplement describe various audit objectives for auditors to consider in carrying out their OMB Circular A-133 audits. The IGs are noting instances in which the tests performed by the auditor do not appear to be related to the applicable audit objectives identified in the Supplement.

Also, the IGs are finding that some auditors are failing to use certain applicable parts of the Supplement. As a refresher, consider reviewing Parts 1, 2, and 3 of the Supplement, which describe how it should be used.

Audit Sampling. In general, the IGs are noting an overall lack of documentation with regard to sampling in the following areas:

- Plan and methodology
- Basis for sample size
- Rationale for item selection
- Analysis of exceptions
- Conclusions

Also, in reviewing working papers, sometimes the IGs are finding that they do not indicate which tests are tests of internal control versus tests of compliance. This is especially noticeable when auditors use dual-purpose testing.

SAS No. 41, *Working Papers* (AICPA, *Professional Standards*, vol. 1, AU Sec. 339), provides guidance on documentation of audit procedures. Auditors may want to consider referring to the AICPA's Auditing Practice Release (APR), *Audit Sampling* (Product No. 021061kk), which provides guidance to help auditors apply audit sampling in accordance with SAS No. 39, *Audit Sampling* (AICPA, *Professional Standards*, vol. 1, AU Sec. 350). While neither SAS No. 39 nor the APR include specific documentation requirements, the APR does include examples of items to consider documenting in tests of controls and substantive tests. (See SOP 98-3, paragraphs 3.18 through 3.22, for a discussion of the internal control documentation requirements and working paper standards from *Government Auditing Standards*.

Reporting Audit Findings. OMB Circular A-133 is very specific about what needs to be reported as an audit finding. The audit finding requirements are described in paragraph 10.63 of

SOP 98-3. In their reviews, the IGs are noting problems in this area. For example, some auditors are not reporting items that meet the definition of a reportable audit finding under OMB Circular A-133 because the auditee either already has corrected the problem or plans to correct it in the next reporting period. Regardless of whether an auditee corrects an audit finding, OMB Circular A-133 requires it to be reported in the schedule of findings and questioned costs. Further, some auditors are including reportable audit findings in their management letter instead of the schedule of findings and questioned costs. Including reportable audit findings only in the management letter is not appropriate.

Also, OMB Circular A-133 requires auditors to follow up on prior-year findings, perform procedures to assess the reasonableness of the summary schedule of prior-year audit findings prepared by the auditee, and report, as a current-year audit finding, when the auditor concludes that the summary schedule of prior-year audit findings materially misrepresents the status of any prior audit finding. The IGs are noting that auditors, in certain cases, are not documenting that follow-up.

State Single Audit Requirements

Some states have their own single audit legislation or regulations addressing the requirements for compliance audits of state financial assistance. Auditors should follow the guidance of SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801). SAS No. 74 AU sec. 801.21 requires the exercise of due professional care in ensuring that the auditor and management understand the type of engagement to be performed. If, during a GAAS audit of the financial statements, the auditor becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement, AU sec. 801.22 requires the auditor to communicate to management and the audit committee, or to others with equivalent authority and responsibility, that an audit in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements.

OMB Cost Circulars

Have there been any recent final or proposed changes to the OMB's grants management and cost Circulars?

Circular A-110

OMB issued a revised Circular A-110 on September 30, 1999 (published in the October 8, 1999, *Federal Register* at 64 F.R. 54926). The Circular states that it is effective for awards issued after November 6, 1999, as well as for continuing awards renewed after that date. However, because most grant agreements do not refer to OMB Circular A-110 itself, but rather to an agency's codification of the Circular, the provisions are effective for awards issued thirty days after the provision is codified by the federal agencies. Fifteen agencies amended their codifications of OMB Circular A-110 on March 16, 2000. Therefore, their revised regulations are effective for awards issued after April 17, 2000, as well as for continuing awards renewed after that date.

The revision requires the entities subject to the Circular, which include governmental (public) colleges and universities and hospitals, to make certain research-related records available to federal agencies for public disclosure under the Freedom of Information Act (FOIA). The revision was required by a provision of OMB's appropriation for fiscal year 1999.

In its notice of the final revision to OMB Circular A-110, OMB addressed the issue of reimbursing a recipient's costs of complying with an FOIA request. Such costs would be charged to the affected federal award unless the award's funding period expires before a request is made. OMB suggests that federal awarding agencies and grantees have a separate agreement to cover the full incremental cost of responding to the request if the award's funding period has expired.

Circular A-21

OMB also proposed a revision to OMB Circular A-21, *Cost Principles for Educational Institutions*, in the summer of 1999 (published in the August 12, 1999, *Federal Register* at 64 F.R. 44062) to change how many colleges and universities submit their proposals for indirect cost rates (also called facilities and administrative [F & A] rates). The revision, which is expected to be finalized during 2000, would require a standard format for submitting F&A rate proposals. OMB believes that a standard format would help institutions to more efficiently complete those proposals, allow federal cognizant agencies to review those proposals on a more consistent basis, and perhaps even allow electronic submissions of those proposals in the future. The proposed standard format, which would become Appendix C of OMB Circular A-21, includes two parts: (1) a summary schedule of the institution's proposed F&A rates, along with the F&A cost pools and their allocations and (2) a listing of supporting documents to be submitted with the proposal. Although the revision to OMB Circular A-21 proposed that the standard format would be required for F&A proposals submitted on or after July 1, 2000, it is likely that the effective date will be extended to proposals submitted on or after July 1, 2001. Also, the standard format would not apply to institutions that use the simplified method for calculating F&A rates as described in Section H of OMB Circular A-21. A cognizant agency would be able to grant individual institutions exceptions from the standard format requirement.

Other Cost Circular Activity

OMB has put on hold its project to combine the three cost principles circulars (OMB Circular A-21, for educational institutions; OMB Circular A-87, for state, local, and Indian tribal governments; and OMB Circular A-122 for nonprofit organizations) into a single circular because of concerns expressed by federal agencies regarding the diverse nature of grantees and, accordingly, differing treatments of certain items of cost. OMB will conduct a review to improve the consistency of costs in those three circulars.

OMB and the federal agencies are beginning to review the format and content of all application and reporting forms required by grant programs, and the feasibility of submitting those forms electronically. That review is the first step in implementing Public Law 106-107, the Federal Financial Assistance Management Improvement Act of 1999.

HUD Electronic Submission Requirements for Public Housing Authorities

What are the electronic submission requirements for public housing authorities, and what are the auditor's responsibilities with respect to the requirements?

As noted in the Audit Risk Alert, *Not-for-Profit Organizations Industry Developments—1999*, the U.S. Department of Housing and Urban Development (HUD) published revised Uniform Financial Reporting Standards (UFRS) for HUD Housing Programs (see *Federal Register*, September 1, 1998, at 63 F.R. 46581) to establish uniform annual financial reporting standards for HUD's public housing, section 8 housing, and multifamily insured housing programs. As a result of the revised standards, public housing authority (PHA) project owners of HUD-assisted housing (which already, under long-standing regulatory and contractual requirements, submit financial information on an annual basis to HUD) are required to submit financial information electronically to HUD via a template known as the Financial Data Schedule (FDS).

The Real Estate Assessment Center (REAC) is the HUD national management center created to receive and evaluate electronic submissions and to assess the condition of HUD owned and assisted developments. To ensure accuracy and consistency of the FDS data in the assessment process for PHA assets, REAC requires the following:

- Audited annual basic financial statements prepared in conformity with generally accepted accounting principles (GAAP) for governmental entities, as prescribed by the GASB
- Attestation by auditors on FDS data as to its "fair presentation in relation to audited basic financial statements" in accordance with the audit provisions of SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551)
- A separate attestation agreed-upon procedures engagement under AICPA Statement on Standards for Attestation Engagements (SSAE) No. 4, *Agreed-Upon Procedures Engagements*

(AICPA, *Professional Standards*, vol. 1, AT sec. 600), where the auditor compares the PHA's electronically submitted data in the REAC staging database to the hard copy of the audit report and FDS

PHA electronic FDS submission requirements became effective for fiscal years ending on or after September 30, 1999. A PHA must submit its preliminary FDS electronically within two months after its fiscal year-end based on unaudited information. No auditor involvement is necessary for that unaudited submission. Note, however, that HUD has granted an automatic one-month extension for PHAs with fiscal years ending September 30, 1999, through June 30, 2000. A final FDS based on audited financial statements must be electronically submitted within the earlier of thirty days after receipt of the auditor's report or nine months after a PHA's fiscal year end (pursuant to OMB Circular A-133). It is this final submission on which the auditor performs a separate attestation agreed-upon procedures engagement. The auditor's agreed-upon procedures report is prepared and submitted to HUD electronically.

REAC has issued a document titled *Guidelines for Public Housing Authorities and Independent Auditors* that provides guidance on the detailed requirements for electronic submission and the auditor's involvement in the process.[5]

Revisions to *Government Auditing Standards*

Are there any recent or upcoming revisions to Government Auditing Standards?

Government Auditing Standards Amendments

In 1999, the General Accounting Office (GAO) issued two amendments to the 1994 *Government Auditing Standards* (also

5. The AICPA provided input into the Guidelines as HUD developed it, particularly on the auditor report templates. A copy of the Guidelines can be obtained from the REAC Web site at http://www.hud.gov/reac/pdf/fass_ph_guideufrs.pdf. Additional information regarding the activities of REAC and how they affect HUD programs and audits of HUD programs is available on the REAC Web site at http://www.hud.gov/reac. Further assistance on the electronic submission requirements is available by contacting the REAC Customer Service Center at (888) 245-4860.

known as the Yellow Book), the set of standards for the audits of various entities, that should be followed when required by law, regulation, agreement, contract, or policy. The GAO has codified those two amendments into the body of its Yellow Book. A printed copy of that updated Yellow Book codification is not available yet, but you can download a free electronic version from the GAO Web site at http://www.gao.gov/govaud.ybk01.htm. You also can order printed copies of the two amendments or download free electronic versions. (See the "References for Additional Guidance" section of this Audit Risk Alert.)

Amendment No. 1. The first amendment, titled *Government Auditing Standards: Amendment No. 1, Documentation Requirements When Assessing Control Risk at Maximum for Controls Significantly Dependent Upon Computerized Information Systems,* is effective for financial statement audits of periods ending on or after September 30, 1999. It establishes a new field work standard that requires certain information to be documented when financial data significantly depends upon computerized information systems.

SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit, as amended by SAS No. 78* (AICPA, *Professional Standards,* vol. 1, AU sec. 319), requires auditors to document their basis for conclusions when control risk is assessed below maximum. However, SAS No. 55, as amended, does not impose a similar requirement for assessments of control risk at maximum. Amendment No. 1 adds the following field work standard:

> In planning the audit, auditors should document in the working papers (1) the basis for assessing control risk at the maximum level for assertions related to material account balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent upon computerized information systems, and (2) consideration that the planned audit procedures are designed to achieve audit objectives and to reduce audit risk to an acceptable level.

The Advisory Council on Government Auditing Standards (Advisory Council), the group that advises the GAO on changes to the Yellow Book, believes that requiring the above documentation will help to ensure that auditors do not inadvertently rely on computer-generated evidence in conducting substantive testing. The intent of the standard is not to replace auditors' judgment in planning the audit, but to assist auditors in ensuring the soundness of their planned audit procedures when significant accounting applications are supported by computerized information systems.

The standard also incorporates, where applicable, conforming changes to recognize the effect of SAS No. 78 on the Yellow Book—principally updating terminology to conform with SAS No. 78 and deleting guidance that is addressed in SAS No. 78, which was issued after the 1994 version of *Government Auditing Standards.*

Amendment No. 2. The second amendment, titled *Government Auditing Standards: Amendment No. 2, Auditor Communication*, is effective for financial statement audits of periods ending on or after January 1, 2000. It establishes a field work standard (by amending and expanding what previously had been a reporting standard) and amends a reporting standard to improve auditor communication concerning the auditor's work on compliance with laws and regulations and internal control over financial reporting.

SAS No. 83, *Establishing an Understanding With the Client*, as amended by SAS No. 89, *Audit Adjustments*, (AICPA, *Professional Standards*, vol. 1, AU sec. 310.05–.07), requires auditors to establish an understanding with the client regarding the services to be performed. SAS No. 61, *Communication With Audit Committees*, as amended by SAS No. 89 (AICPA, *Professional Standards*, vol. 1, AU sec. 380), requires auditors to determine that certain matters related to the conduct of the audit are communicated to those who have responsibility for oversight of the financial reporting process. (See the discussion titled "SAS No. 89, *Audit Adjustments*" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.) The new field work standard in Amendment No. 2 broadens the parties with whom the auditor must communicate to include the auditee (which it defines) and the individuals contracting for or requesting the audit services. It also requires the auditor to communicate specific information regarding the nature and extent of planned testing and reporting on compliance with laws and regulations and internal control over financial reporting. This communication must take place during the planning stages of the audit. Written communication is preferred, although not required. The Advisory Council believes this amendment will reduce the risk that the needs or expectations of the parties involved may be misinterpreted.

Amendment No. 2 also requires that when auditors issue separate reports on compliance with laws and regulations and internal control over financial reporting, the report on the financial statements should state that they are issuing those additional reports. The report on the financial statements also should state that the reports on compliance with laws and regulations and internal control over financial reporting are an integral part of a generally accepted government auditing standards audit, and in considering the results of the audit, those reports should be read along with the auditors' report on the financial statements. The Advisory Council believes this amendment will highlight the importance of the auditor's reports on compliance with laws and regulations and internal control over financial reporting required under *Government Auditing Standards*. Because of this Amendment, the AICPA has revised certain illustrative auditor's reports in SOP 98-3. See the related discussion "Single Audit Guidance Update" in this section of this Audit Risk Alert and the discussion "Revised Yellow Book Reports" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.

Other Efforts of the Advisory Council on Government Auditing Standards

Other topics currently on the Advisory Council's agenda that could result in the issuance of exposure documents this year include auditor independence and performance auditing. Check the GAO Web site or future issues of the AICPA's *Journal of Accountancy* and *CPA Letter* for status updates.

State and Local Issues

State and local laws concerning not-for-profit organizations continue to change. Some states have enacted or are revising existing laws concerning not-for-profit organization registration or licensing requirements; annual reporting requirements; charitable solicitation, registration, and disclosure requirements; charitable gift annuity registrations; and limitations on fund-raising expenses. Some states are actively limiting expenditures of the amounts raised within the state for disaster relief so they are used only for the purposes for which the contributions were raised. Some states have increased efforts to have not-for-profit organizations pay property taxes, collect and remit sales and use taxes, or make other payments in lieu of such taxes. Organizations soliciting contributions or selling products on the Internet may be deemed to be doing business in the states from which the sales are initiated, creating a nexus to those states and, perhaps, the responsibility to collect and remit state sales taxes as well as other filing responsibilities.

The American Association of Fund-Raising Counsel, Inc. (AAFRC) publishes its *Annual Survey of State Laws Regulating Charitable Solicitations* (available for $35). Copies of this publication can be obtained by visiting the AAFRC Web site at http://www.aafrc.org.

Uniform Registration Form for Fund-raising and Compliance With Mailing Requirements

Not-for-profit organizations are required to register and file with the appropriate authorities in most states in which they either have a physical presence or solicit contributions. As a result of a project started by the National Association of State Charity Officials, in conjunction with the National Association of Attorneys General and a consortium of not-for-profit groups, thirty-three jurisdictions (thirty-two states and the District of Columbia) to date have adopted a uniform registration statement, with a view toward easing the administrative burden on organizations that are required to register in more than one state. A copy of the unified registration statement can be found on the Internet Nonprofit Center Web site at www.nonprofits.org/library/gov/urs.

Most states have statutes that include compliance requirements for certain mailings, such as charitable solicitations and sweepstakes. Some states have increased efforts to enforce those statutes. (Also, organizations may be required to withhold taxes on and file information about sweepstakes prizes under Internal Revenue Service [IRS] requirements.) Auditors should be aware of the existence of such filing requirements and statutes and their potential impact on not-for-profit organizations and their financial statements.

Adverse publicity resulting from an organization's failure to comply with each state's registration and mailing requirements could adversely affect the amounts some donors are willing to contribute. Also, though it is unlikely, such noncompliance could be an illegal act that may have a direct and material effect on the determination of financial statement amounts. SAS No. 54 discusses the nature and extent of the consideration the auditor should give to the possibility of illegal acts and provides guidance on the auditor's responsibilities if a possible illegal act is detected.

Full Disclosure in Charity Promotions

Some not-for-profit organizations enter into marketing arrangements with commercial enterprises in which the not-for-profit organization receives money when the commercial entity sells its products. For example, a potential customer may be told that for each long-distance phone call made through a particular long-distance phone company, the company will make a contribution to one of a group of not-for-profit organizations. However, in many of these arrangements, the customer is given insufficient information about the benefits to the not-for-profit organizations to make an informed decision about purchasing the product. A number of state laws require explicit disclosure regarding the percentage paid to the not-for-profit organization, and some require the promotion to state the total dollar amount that the not-for-profit organization expects to receive. However, many corporations and not-for-profit organizations fail to provide the required information and include only a vague description of the benefit to the not-for-profit organizations, such as "a portion of the profits." Although these violations have not been enforced much in the past, the possibility exists that states will be more active in enforcing their rules and applying the penalties. This would mean a concern for the auditor and client about both adverse publicity and the effects on the financial statement amounts resulting from an illegal act, pursuant to SAS No. 54.

Internal Revenue Service Activities

What are some of the current tax issues that may affect audits of not-for-profit organizations?

Auditors should be aware of relevant tax laws and regulations and their potential effect on not-for-profit organizations and their financial statements.[6] A not-for-profit organization's failure to maintain its tax-exempt status could have serious tax consequences and affect both its financial statements and related disclosures, and such failure could possibly require modification of the auditor's report. Failure by a not-for-profit organization to comply with tax laws and regulations could be an illegal act and have either a direct effect on the determination of financial statement amounts or an indirect effect on the financial statements that would require appropriate disclosures. SAS No. 54 discusses the nature and extent of the consideration that the auditor should give to the possibility of illegal acts in an audit of financial statements in accordance with GAAS, and provides guidance on the auditor's responsibilities when a possible illegal act is detected.

Charitable Split-Dollar Life Insurance

The IRS has been reviewing the use of a controversial method of making contributions to not-for-profit organizations—charitable split-dollar life insurance arrangements, and, in Notice 99-36, has warned that deductions connected with charitable split-dollar insurance plans would be challenged. In one common form of this arrangement, the donor seeks to minimize federal income and estate taxes by making an annual contribution to the not-for-profit, which in turn uses the money, or most of the money, to

6. Auditors should be alert for updates to the topics discussed in this section of the Audit Risk Alert and other recent developments related to IRS activities. The appendix to this Audit Risk Alert provides a list of Internet resources, including some Web sites that can provide information on tax issues that may impact not-for-profit organizations.

pay all or most of the premium on a policy insuring the donor's life. Along with the donation, the donor provides the not-for-profit organization with a letter stating the not-for-profit organization can use the donated funds any way it wishes, and the donor takes a tax deduction. The policy is held by a separate life insurance trust, the beneficiaries of which are the donor's heirs. Upon the donor's death, a portion of the death benefit is paid to the not-for-profit. However, the heirs may receive the bulk of the policy proceeds in addition to the cash value.

In addition to the IRS looking at these arrangements, Congress has enacted changes to the tax code in 1999 that specifically disallow deductions for charitable split-dollar arrangements, and impose excise taxes on participating not-for-profit organizations.

Travel Tours

The IRS has issued final regulations 1.513-7 on the tax consequences of travel and tour operations of exempt organizations, effective for tax years beginning after February 7, 2000. The regulations provide seven examples illustrating which tour activities might be exempt and which might give rise to unrelated business taxable income (UBTI). The examples involve cultural and educational organizations as well as tours sponsored by social welfare and scientific organizations. According to the regulations, the determination of whether revenues from a tour are subject to tax as UBTI will be determined by an analysis of all the relevant facts and circumstances.

IRS CPE Text

The IRS has published its annual *Exempt Organizations Continuing Professional Education Technical Instruction Program* for the year 2000 (CPE Text). It is published by the IRS Exempt Organization division for its employees.

The material in the CPE Text is designed specifically for training purposes only. Although not to be used or cited as authority for setting or sustaining a technical position, the CPE Text can provide auditors with insight into the IRS's views on current issues that may affect not-for-profit organizations. The CPE Text includes twenty-one chapters on specific issues, as well as a current developments section, covering areas such as health clubs, auto donation schemes, and health care concerns, and is available on the IRS Web site at http://www.irs.ustreas.gov/prod/bus_info/eo/cpe.html.

IRS Regulations on Disclosure

Final regulations were released April 9, 1999, relating to tax-exempt organization disclosure requirements under Internal Revenue Code (IRC) section 6104(e), which require exempt organizations to provide copies of their exemption applications and three most recent information returns upon request. The new public disclosure rules which took effect on June 8, 1999, provide that—

1. Requests made in person generally must be responded to immediately.
2. Written requests must be responded to within thirty days.

Reasonable fees to cover administrative costs for postage and reproduction are permissible. Exceptions to this rule are provided if—

1. The documents are requested to harass an organization; however, the IRS has indicated that harassment campaigns probably will be "narrowly construed."
2. The documents are made "widely available" (that is, making materials available via electronic means, such as the Internet).

Failure to comply with the public inspection rules could result in a $20-per-day penalty (subject to a $10,000 maximum), with a $5,000 penalty for willful failure.

The National Center for Charitable Statistics and Philanthropic Research, Inc., undertook a project to receive and scan Form 990s from the IRS and make them available to the public on the Web sites http://www.guidestar.org and http://nccs.urban.org. The IRS also plans to have Form 990s filed available in a CD-ROM format.

The Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1998 extended the new disclosure rules to private foundations. Final regulations covering these disclosures by private foundations were issued in January 2000.

Corporate Sponsorship Regulations

In March 2000, the IRS issued proposed regulations that would affect the classification of income received under corporate sponsorship arrangements. Depending on the nature of the agreement, there could be revenues subject to unrelated business income tax. In one example of a corporate sponsorship arrangement, a university receives payment from a soft-drink company, and agrees that the soft-drink company will be the exclusive provider of this type of beverage at the university. The proposed regulations require that certain payments that are received by not-for-profit organizations under such exclusive sponsorship deals with corporate sponsors would be subject to taxation as unrelated business income.

The Internet

As more and more not-for-profit organizations begin to utilize the Internet for fundraising, research, communications with donors, volunteers, and other organizations, as well as other uses, these not-for-profit organizations will need to assess the potential for tax implications. The treatment of income received from commercial advertising on a not-for-profit organization's Web site is an example of a potential tax issue. Also, can electronic communications be used to satisfy quid pro quo rules? Quid pro quo rules require not-for-profit organizations that solicit donations in excess of seventy-five dollars, and provide something to the donor in return, provide a written statement of acknowledgment to the donor advising of the contribution limitation to the excess of the donation over the value of the goods or services provided in exchange. The IRS has looked at the impact of the Internet on not-for-profit organizations and included a chapter "Tax Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet" in its CPE Text for not-for-profit organizations. Among the discussions included are the tax rules for contributions that are received via the Internet, and the use of email responses for acknowledging donor contributions. See the discussion of the CPE Text in this section of the Audit Risk Alert.

In addition, online activities by a not-for-profit organization can subject a not-for-profit organization to greater scrutiny by the IRS for prohibitions against political activity on the organization's Web site that may jeopardize the organization's exempt status.

Tax Exempt and Governmental Entities Division

As part of its modernization plan, the IRS has created the Tax Exempt and Government Entities (TE/GE) Division, comprised of three segments working separately with exempt groups, employee plans, and governmental entities. The TE/GE Division's mission is "to provide Tax Exempt and Governmental Entities customers top quality service by helping them understand and comply with applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all." With the focus on customer service in the TE/GE Division's mission, its tax compliance strategy will mix educational outreach activities with traditional enforcement activities. That is, when the TE/GE Division identifies significant tax compliance issues, it not only will undertake efforts to identify and correct individual instances of noncompliance, it also will educate the tax-exempt community about the nature of the requirements and ways to improve individual compliance.

Audit and Attestation Issues and Developments

SAS No. 88, *Service Organizations and Reporting on Consistency*

What are the requirements of the new SAS No. 88?

In December 1999, the AICPA Auditing Standards Board (ASB) issued SAS No. 88, *Service Organizations and Reporting on Consistency* (AICPA, *Professional Standards*, vol. 1, AU sec. 324 and 420). Part 1, "Service Organizations," amends SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324.03 and 324.06–.10) to—

- Clarify the applicability of SAS No. 70 by stating that the SAS is applicable if an entity obtains services from another organization that are part of the entity's information system. It also provides guidance on the types of services that would be considered part of an entity's information system.
- Revise and clarify the factors a user auditor should consider in determining the significance of a service organization's controls to a user organization's controls.
- Clarify the guidance on determining whether information about a service organization's controls is necessary to plan the audit.
- Clarify that information about a service organization's controls may be obtained from a variety of sources.
- Change the title of SAS No. 70 from *Reports on the Processing of Transactions by Service Organizations to Service Organizations.*

Part 2, "Reporting on Consistency," amends SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 420, "Consistency of Application of Generally Accepted Accounting Principles") to—

- Conform the list of changes that constitute a change in the reporting entity (AU sec. 420.07) to the guidance in paragraph 12 of Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes.*
- Clarify that the auditor need not add a consistency explanatory paragraph to the auditor's report when a change in the reporting entity results from a transaction or event.
- Eliminate the requirement for a consistency explanatory paragraph in the auditor's report if a pooling of interests is not accounted for retroactively in comparative financial statements.

- Eliminate the requirement to qualify the auditor's report and consider adding a consistency explanatory paragraph to the report if single-year financial statements that report a pooling of interests do not disclose combined information for the prior year.

All of the amendments contained in SAS No. 88 were effective upon issuance. Readers should refer to the full text of this Standard.

SAS No. 89, *Audit Adjustments*

What are the requirements of the new SAS No. 89?

In December 1999, the ASB issued SAS No. 89, *Audit Adjustments*, to establish audit requirements intended to encourage audit clients to record financial statement adjustments proposed by the auditor. To accomplish this objective, three SASs are amended.

First, SAS No. 89 amends SAS No. 1, *Codification of Auditing Standards and Procedures*, as amended by *Appointment of the Independent Auditor*, SAS No. 83, *Establishing an Understanding With the Client* (AICPA, *Professional Standards*, vol. 1, AU sec. 310). SAS No. 89 adds the following to the list in AU section 310.06 of matters that generally are included in the understanding with the client:

> Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Second, SAS No. 89 amends SAS No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333.06 and 333.16), by requiring that the representation letter include an acknowledgment by management that the effects of any uncorrected financial statement misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. SAS No. 89 also requires that a summary of the uncorrected misstatements be included in or attached to the representation letter.

Third, SAS No. 89 amends SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380) to require the auditor to inform the audit committee about adjustments arising from the audit, whether or not recorded by the entity, that could, in the auditor's judgment, have a significant effect on the entity's financial reporting process.

These amendments are effective for audits of financial statements for periods beginning on or after December 15, 1999. Early adoption is permitted. Readers should refer to the full text of this Standard.

> **Help Desk**—Information about other recently issued SASs can be found on the AICPA Web site at http://www/aicpa.org. Also, see the "Listing of Recent Auditing, Attestation, and Accounting Pronouncements" section in this Audit Risk Alert.

2000 Audit and Accounting Guide Revisions

The AICPA Audit and Accounting Guide *Not-for-Profit Organizations* is available through the AICPA's looseleaf subscription service (Product No. G0100kk). In the looseleaf service, conforming changes (those necessitated by the issuance of new authoritative pronouncements) and other minor changes that do not require due process are incorporated periodically. Paperback editions of Audit and Accounting Guides as they appear in the service are printed annually (Product No. 013392kk). Copies may be obtained by calling the AICPA Order Department (Member Satisfaction) at (888) 777-7077 or faxing a request to (800) 362-5066.

Revisions that will be included in the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* with conforming changes as of May 1, 2000, will include those made to reflect the issuance of the following standards:

- SAS No. 88, *Service Organizations and Reporting on Consistency*

- SAS No. 89, *Audit Adjustments*
- FASB Statement No. 135, *Rescission of FASB Statement No. 75 and Technical Corrections*
- FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*
- FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133*

Revised Yellow Book Reports

The illustrative auditor's reports in the financial statements included in SOP 98-3 (an appendix to the *Not-for-Profit Organizations Audit and Accounting Guide*) have been revised for changes required by *Government Auditing Standards: Amendment No. 2, Auditor Communication*. (See the discussion titled "Revisions to *Government Auditing Standards*" in the "Regulatory and Legislative Developments" section of this Audit Risk Alert.) Specifically, in the paragraph that refers to the *Government Auditing Standards* report on the consideration of internal control over financial reporting and tests of compliance with the provisions of laws, regulations, contracts and grants, the following sentence was added:

> That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The updated illustrative auditor's reports on the financial statements have also been posted on the AICPA Web site at http://www.aicpa.org/belt/a133main.htm.

Gifts in Kind

What issues should be considered when auditing gifts in kind?

Some not-for-profit organizations receive in-kind contributions, such as donations of food and clothing. Chapter 5 in the AICPA

Audit and Accounting Guide *Not-for-Profit Organizations* includes guidance on the accounting for such in-kind contributions. The Guide states that receipts of noncash assets, such as property, equipment, and inventory, sometimes referred to as gifts in kind that can be used or sold, should be measured at fair value, and discusses factors that should be considered in determining fair value. Paragraph 5.08 in the Guide states that organizations should consider the quality and quantity of the gifts, as well as any applicable discounts that would have been received by the organization, including discounts based on that quantity if the assets had been acquired in exchange transactions. If the gifts have no value, as might be the case for certain clothing and furniture that cannot be (a) used internally by the organization or for program purposes or (b) sold by the organization, the item received should not be recognized. Also, information about in-kind transactions may be required to be disclosed under FASB Statement No. 57, *Related Party Disclosures.*

An auditor at a not-for-profit organization may need to use a specialist's work in order to obtain competent evidential matter about the valuation of gifts in kind. SAS No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, AU sec. 336), provides guidance when an auditor uses the work of a specialist.

Materiality

In August 1999, the Securities and Exchange Commission (SEC) issued a new Staff Accounting Bulletin (SAB) No. 99, *Materiality.* SAB No. 99 addresses the application of materiality thresholds to the preparation and audit of financial statements filed with the SEC. The SAB does not create new standards or definitions for materiality, but reaffirms the concepts of materiality as expressed in the accounting and auditing literature as well as in long-standing case law.

Although SEC reporting requirements do not apply to audits of not-for-profit organizations, these requirements nonetheless affect the direction that independent auditors will be taking with respect to the evaluation of the materiality of misstatements that are identified during a financial statement audit. For a more detailed discussion of SAB No. 99, see the AICPA general *Audit Risk Alert—1999/2000.* Also, the full text of the SAB can be viewed at the SEC Web site at http://www.sec.gov/rules/acctreps/sab99.htm.

Securities Valuation

The percentage of investments held in equity securities versus bonds has increased in recent years at many not-for-profit organizations. Chapter 8 in the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* discusses the accounting and auditing considerations for investments, including investments in equity securities. Specifically, paragraph 8.09 states that FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* provides that investments in equity securities with readily determinable fair value and all debt securities should be reported at fair value.

Auditors considering documentation of a securities valuation that is based on quotations from securities exchanges may wish to consider recent technological developments that have brought changes to the securities markets. Traditional stock exchanges such as the NYSE and NASDAQ are proceeding with preparations to extend trading hours. Also, a growing number of alternative trading systems, including electronic communication networks, have been developed where buyers and sellers in securities are matched for a commission. These developments have resulted in increased opportunities for extended trading hours beyond the trading hours of traditional stock exchanges. The after-hours trading brings additional considerations regarding liquidity and price volatility that distinguish this trading period from the regular trading day. Auditors should monitor these developments to gain an understanding of their impact on valuation policy.

Impact of New Accounting Pronouncements

Many not-for-profit organizations will be implementing new financial accounting standards that can have a significant impact on their accounting procedures and financial statements. SOP

98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, became effective for financial statements for years beginning on or after December 15, 1998. Also, some organizations may elect early adoption of new FASB Accounting Standards Nos. 133, *Accounting for Derivative Instruments and Hedging Activities* and 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.* (See related discussions in the "Accounting Issues and Developments" section of this Audit Risk Alert). SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit*, as amended (AICPA, *Professional Standards*, vol. 1, AU sec. 319), provides guidance on the independent auditor's consideration of internal control in planning the audit of financial statements in accordance with GAAS, including a discussion of the entity's risk assessment for financial reporting purposes. Among the examples of the circumstances that can adversely affect an entity's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements is the adoption of new accounting pronouncements or changing accounting principles. Auditors should obtain a sufficient knowledge of the client's risk assessment process to understand how management considers risks relevant to financial reporting objectives and decides how to address those risks, and be alert to the implications on the internal control of the client.

Auditing in an Online Environment

What issues should an auditor consider when auditing transactions in an online environment?

Some not-for-profit organizations are using the Internet to raise contributions or sell products online. Conducting transactions in an electronic environment such as the Internet can appeal to an organization for a variety of reasons, including the ability to reach a wider donor base and lower transaction costs, particularly if the costs of nonautomated methods, such as postage rates, are rising.

In an online transaction, traditional source documents are replaced with electronic communications. Auditors should carefully consider the internal controls related to these communications as well as the nature and sufficiency of available evidential matter underlying the transactions.

SAS No. 31, *Evidential Matter*, as amended by SAS No. 80, (AICPA, *Professional Standards*, vol. 1, AU sec. 326), provides guidance to auditors who have been engaged to audit the financial statements of an entity that transmits, processes, maintains, or accesses significant information electronically.

SAS No. 31, as amended by SAS No. 80, states that the auditor's specific objectives do not change whether information is processed manually or electronically. However, the methods of applying audit procedures to gather evidence may be influenced by the method of processing. In entities in which significant information is transmitted, processed, maintained, or accessed electronically, the auditor may determine that it is not practical or possible to reduce detection risk to an acceptable level by performing only substantive tests for one or more financial statement assertions. For example, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is produced, maintained, or accessed only in electronic form. In such circumstances, the auditor should perform tests of controls to gather evidential matter to use in assessing control risk or consider the effect on the auditor's report.

The SAS further states that in certain entities, some of the accounting data and corroborating evidential matter are available only in electronic form. Certain electronic evidence may exist at a certain point in time. Such evidence may not be retrievable after a specified period of time if files are changed and if backup files do not exist. Therefore, the auditor should consider the time during which information exists or is available in determining the nature, timing, and extent of the auditor's substantive tests, and if applicable, tests of controls.

COSO Study on Fraud in Financial Reporting

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) recently released a study on fraud in financial reporting. *Fraudulent Financial Reporting: 1987-1997, An Analysis of U.S. Public Companies* analyzes two hundred randomly selected cases of alleged financial fraud investigated by the SEC to provide a current profile of the frauds committed, the companies and individuals affected by fraudulent activity, and the consequences of fraud. Although this study relates to fraudulent financial reporting in public companies, it may provide some useful insights to auditors of not-for-profit organizations as well. Additional information on this report is provided in the AICPA general *Audit Risk Alert—1999/2000* (Product No. 022250kk).

Executive Summary—Audit and Attestation Issues and Developments

- In December 1999, the AICPA's Auditing Standards Board (ASB) issued SAS No. 88, *Service Organizations and Reporting on Consistency* (AICPA, *Professional Standards*, vol. 1, AU sec. 324 and 420).
- In December 1999, the ASB issued SAS No. 89, *Audit Adjustments*, to establish audit requirements intended to encourage audit clients to record financial statement adjustments proposed by the auditor. To accomplish this objective, three existing SASs are amended.
- The illustrative auditor's reports in the financial statements included in SOP 98-3 have been revised for changes required by *Government Auditing Standards: Amendment No. 2, Auditor Communication.*
- Some not-for-profit organizations have begun to use the Internet to sell products or raise contributions online. SAS No. 31, *Evidential Matter*, as amended by SAS No. 80 (AICPA, *Professional Standards*, vol. 1, AU sec. 326), provides guidance to auditors who have been engaged to audit the financial statements of an entity that transmits, processes, maintains, or accesses significant information electronically.

Accounting Issues and Developments

Transfers of Assets

What are the requirements of the new FASB Statement No. 136, Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others?

FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for*

Others, establishes standards for transactions in which an entity—the *donor*—makes a contribution by transferring assets to a not-for-profit organization or charitable trust—the *recipient organization*—that accepts the assets from the donor and agrees to use those assets on behalf of or transfer those assets, the return on investment of those assets, or both to another entity—the *beneficiary*—that is specified by the donor. It also establishes standards for transactions that take place in a similar manner but are not contributions because the transfers are revocable, repayable, or reciprocal.

This Statement requires a recipient organization that accepts cash or other financial assets from a donor and agrees to use those assets on behalf of or transfer those assets, the return on investment of those assets, or both to a specified unaffiliated beneficiary to recognize the fair value of those assets as a liability to the specified beneficiary concurrent with recognition of the assets received from the donor. However, if the donor explicitly grants the recipient organization variance power or if the recipient organization and the specified beneficiary are financially interrelated organizations, the recipient organization is required to recognize the fair value of any assets it receives as a contribution received. Not-for-profit organizations are financially interrelated if (1) one organization has the ability to influence the operating and financial decisions of the other and (2) one organization has an ongoing economic interest in the net assets of the other. This Statement does not establish standards for a trustee's reporting of assets held on behalf of specified beneficiaries, but it does establish standards for a beneficiary's reporting of its rights to assets held in a charitable trust.

This Statement requires that a specified beneficiary recognize its rights to the assets held by a recipient organization as an asset unless the donor has explicitly granted the recipient organization variance power. Those rights are either an interest in the net assets of the recipient organization, a beneficial interest, or a receivable. If the beneficiary and the recipient organization are financially interrelated organizations, the beneficiary is required to recognize its interest in the net assets of the recipient organization and adjust that interest for its share of the change in net assets of the recipient organization. If the beneficiary has an unconditional right to receive all or a portion of the specified cash flows from a charitable trust or other identifiable pool of assets, the beneficiary is required to recognize that beneficial interest, measuring and subsequently remeasuring it at fair value, using a valuation technique such as the present value of the estimated expected future cash flows. If the recipient organization is explicitly granted variance power, the specified beneficiary does not recognize its potential for future distributions from the assets held by the recipient organization. In all other cases, a beneficiary recognizes its rights as a receivable.

This Statement describes four circumstances in which a transfer of assets to a recipient organization is accounted for as a liability by the recipient organization and as an asset by the resource provider because the transfer is revocable or reciprocal. Those four circumstances are if (1) the transfer is subject to the resource provider's unilateral right to redirect the use of the assets to another beneficiary, (2) the transfer is accompanied by the resource provider's conditional promise to give or is otherwise revocable or repayable, (3) the resource provider controls the recipient organization and specifies an unaffiliated beneficiary, or (4) the resource provider specifies itself or its affiliate as the beneficiary and the transfer is not an equity transaction. If the transfer is an equity transaction and the resource provider specifies itself as beneficiary, it records an interest in the net assets of the recipient organization (or an increase in a previously recognized interest). If the resource provider specifies an affiliate as beneficiary, the resource provider records an equity transaction as a separate line item in its statement of activities, and the affiliate named as beneficiary records an interest in the net assets of the recipient organization. The recipient organization records an equity transaction as a separate line item in its statement of activities.

This Statement requires certain disclosures if a not-for-profit organization transfers assets to a recipient organization and specifies itself or its affiliate as the beneficiary or if it includes in its financial statements a ratio of fundraising expenses to amounts raised.

This Statement incorporates without reconsideration the guidance in FASB Interpretation No. 42, *Accounting for Transfers of*

Assets in Which a Not-for-Profit Organization Is Granted Variance Power, and supersedes that Interpretation. This Statement is effective for financial statements issued for fiscal periods beginning after December 15, 1999, except for the provisions incorporated from Interpretation No. 42, which continue to be effective for fiscal years ending after September 15, 1996. Earlier application is encouraged. This Statement may be applied either by restating the financial statements of all years presented or by recognizing the cumulative effect of the change in accounting principle in the year of the change. Readers should refer to the full text of FASB Statement No. 136.

New AICPA Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations*

What information is provided in the new AICPA Practice Aid Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations?

The AICPA has published a nonauthoritative Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations*, that provides illustrative financial statements and related disclosures for nongovernmental not-for-profit organizations other than health care providers.

Chapters 1 through 4 of this Practice Aid provide illustrative examples of the financial statements for a not-for-profit organization—the statement of financial position, showing both columnar and layered formats; the statement of activity, including changes in net assets; the statement of cash flows, showing both the direct method and indirect method; and the statement of functional expenses.

Chapters 5 through 7 present illustrations of a variety of illustrative financial statement note disclosures as follows:

- Chapter 5: Sample Disclosures—General
  - Description of Organization and General Accounting Policies

- Contingencies and Other Uncertainties, Including Going Concern Questions
- Related Parties
- Use of Estimates
- Comparative Prior-Period Information
- Foreign Operations
- Accounting Changes
- Sample Management Statement of Responsibility

- Chapter 6: Sample Disclosures Primarily Related to the Statement of Financial Position
  - Investments
  - Contributions Receivable
  - Other Receivables
  - Inventory and Prepaid Expenses
  - Collections
  - Fixed Assets
  - Liabilities
  - Net Assets

- Chapter 7: Sample Disclosures Primarily Related to the Statement of Activity and Related Statements
  - Measure of Operations
  - Contributions Received, Including Government Grants
  - Earned Income and Deferred Revenue
  - Expenses

This reference tool also provides additional information regarding financial statements prepared on a basis other than GAAP, as well as about information outside the financial statements. In the appendices to this Practice Aid, you will find excerpts from current accounting guidance that is relevant to not-for-profit organizations.

Copies of this new Practice Aid (Product No.006605kk) may be obtained by calling the AICPA Order Department (Member Satisfaction) at (888) 777-7077, faxing a request to (800) 362-5066, or visiting the AICPA Web site at http://www.aicpa.org.

New AICPA Technical Practice Aids

What new technical practice aids have been published since the last Audit Risk Alert?

The AICPA staff publishes nonauthoritative guidance regarding not-for-profit organizations, commonly referred to as technical practice aids, in the section titled "Accounting and Auditing Publications Technical Questions and Answers (Nonauthoritative)" in the AICPA publication *Technical Practice Aids*, Section 6140.[7] Also, recently published technical practice aids and additional nonauthoritative guidance can be found on the AICPA Web site at http://www.aicpa.org/members/div/acctstd/general/nfptpa.htm. Since the publication of last year's Audit Risk Alert, one new technical practice aid specifically applicable to not-for-profit organizations, 6140.11 *Costs of Soliciting Contributed Services and Time That Do Not Meet The Recognition Criteria in FASB Statement No. 116*, was published in Section 6140, and posted to the AICPA Web site. In summary, this technical practice aid provides that the costs of soliciting contributed services including services that do not meet the recognition criteria in paragraph 9 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, should be reported as fundraising. Similarly, costs of soliciting management and general services should be reported as fundraising, even if the management and general services do not meet the recognition criteria.

7. This material has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA. These answers are not sources of established accounting principles as described in SAS No. 69, *The Meaning of* Presents Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 411), nor are they sources of authoritative GAAS.

Reporting of Related Entities

What new developments have occurred with respect to accounting for related entities of not-for-profit organizations?

An ongoing issue for not-for-profit organizations involves accounting for related entities. This becomes a concern as the complexity of the organizational structures of some not-for-profit organizations increases. For example, some not-for-profit organizations have set-up for-profit subsidiaries. This is not only an accounting issue, but also an issue of public attention. Some organizations have had negative publicity arising from situations in which the organization has a for-profit arm that is portrayed as being subsidized by the tax benefits available to the not-for-profit organization.

Current accounting guidance with respect to related entities includes, among other pronouncements, FASB Statement No. 57, and SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*. However, additional guidance in this area is expected as a result of the FASB's consolidations project.

As a part of this project, in February 1999, the FASB issued an exposure draft of a proposed FASB Statement, *Consolidated Financial Statements: Purpose and Policy (Revision of Exposure Draft issued October 16, 1995)*. The proposed Statement would establish standards that specify when entities should be included in consolidated financial statements. It would apply to business enterprises and not-for-profit organizations that control other entities regardless of the legal form of the controlling and controlled entities. This proposed Statement, if issued and required to be applied by not-for-profit organizations, would supersede SOP 94-3 to the extent that it is inconsistent with the FASB Statement resulting from the exposure draft. For additional discussion of this exposure draft, see the discussion titled "FASB Exposure Drafts" in the "On the Horizon" section of this Audit Risk Alert.

Derivatives and Hedging Activities

Not-for-profit organizations that make significant use of derivative instruments as part of their financial strategies may be particularly affected by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. For example, a not-for-profit organization may use derivatives as part of its investment strategy or as part of a strategy to reduce risk on foreign-currency transactions. Additionally, many not-for-profit organizations do not realize they have derivatives, but they may have embedded derivatives in such items as lease agreements, insurance policies, bonds, and financial guarantees.

FASB Statement No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available-for-sale security, or a foreign-currency-denominated forecasted transaction. The accounting for changes in the fair value of a derivative (that is, gains and losses) depends on the intended use of the derivative and the resulting designation.

FASB Statement No. 133 (paragraph 43) includes certain provisions regarding accounting by not-for-profit organizations and other entities that do not report earnings:

> An entity that does not report earnings as a separate caption in a statement of financial performance (for example, a not-for-profit organization or a defined benefit pension plan) shall recognize the gain or loss on a hedging instrument and a nonhedging derivative instrument as a change in net assets in the period of change unless the hedging instrument is designated

as a hedge of the foreign currency exposure of a net investment in a foreign operation. In that case, the provisions of paragraph 42 of this Statement shall be applied. Entities that do not report earnings shall recognize the changes in the carrying amount of the hedged item pursuant to paragraph 22 in a fair value hedge as a change in net assets in the period of change. Those entities are not permitted to use cash flow hedge accounting because they do not report earnings separately. Consistent with the provisions of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, this Statement does not prescribe how a not-for-profit organization should determine the components of an operating measure, if one is presented.

FASB Statement No. 133 (paragraphs 44 through 47) also contains extensive disclosure requirements.

FASB Statement No. 133 was amended as a result of the issuance of FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133*. Among other matters, FASB Statement No. 137, which became effective upon issuance in June 1999, defers the effective date of FASB Statement No. 133 to all fiscal quarters of fiscal years beginning after June 15, 2000.

Readers should refer to the full text of FASB Statement Nos. 133 and 137 when considering accounting and reporting issues related to derivative instruments and hedging activities.

The FASB has established the Derivatives Implementation Group (DIG), a task force that assists the FASB in answering questions that companies will face when they begin implementing FASB Statement No. 133. Issues addressed by the DIG can be found on the FASB Web site at http://www.fasb.org. Also, in March 2000, the FASB issued an exposure draft of a proposed FASB Statement that would amend FASB Statement No. 133. For additional discussion of this exposure draft see the discussion titled "FASB Exposure Drafts" in the "On the Horizon" section of this Audit Risk Alert.

Joint Activities

SOP 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, became effective for financial statements for years beginning on or after December 15, 1998. If comparative financial statements are presented, retroactive application is permitted but not required.

Additionally, in 1998, the Audit Issues Task Force (AITF) of the ASB issued the following AITF Advisory on Reporting the Adoption of SOP 98-2:

> In March 1998, the Accounting Standards Executive Committee issued SOP 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, which is effective for financial statements for years beginning on or after December 15, 1998. The adoption of the SOP may change amounts reported as program expense, management and general expense, and fundraising expense, but will not change total expenses or changes in net assets. In discussing the import of the classifications covered by the SOP, paragraph C-6 notes that external financial statement users of not-for-profit organization's financial statements focus on and have perceptions about amounts reported as program, management and general, and fund raising. The Audit Issues Task Force of the Auditing Standards Board is advising auditors that the adoption of the SOP, whether or not retroactively applied, is an accounting change for which the consistency standard is applicable. If the change has a material effect on the comparability of the entity's financial statements, the auditor should refer to the change in an explanatory paragraph of his or her report in accordance with SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508.16).

Start-Up Activities

As a reminder, SOP 98-5, *Reporting on the Costs of Start-Up Activities*, became effective for financial statements for fiscal years beginning after December 15, 1998. SOP 98-5 provides guidance on the financial reporting of start-up costs and organization costs, requiring these costs be expensed as incurred. SOP 98-5 applies to all nongovernmental entities, including not-for-profit organizations. Initial application of this SOP generally should be reported as the cumulative effect of a change in accounting principle, as described in APB Opinion No. 20, *Accounting Changes*. When adopting this SOP, entities are not required to report the pro forma effects of retroactive application.

Illustration 3 provided in the appendix to SOP 98-5 refers to not-for-profit organizations and provides the following example.

> A not-for-profit organization that has provided meals to the homeless is opening a shelter to house the homeless. The organization will rent the facility. This will be the organization's first shelter and it will conduct a fund-raising campaign to raise money to start up the shelter. The organization will lease space for the shelter and will incur capital expenditures for leasehold improvements and furniture. The organization expects that it will require three months to set up the space for the shelter. The organization will hire a security firm to secure the premises during the three-month period in which the shelter is built. Following are some of the costs that might be incurred in conjunction with start-up activities that are subject to the provisions of [SOP 98-5]:
>
> - Employee salary-related costs related to needs and feasibility studies
> - Staff recruiting and training
> - Rent, security, insurance, and utilities
> - Consultant fees for developing policies and procedures for operating the shelter
> - Amortization and depreciation, if any, of leasehold improvements and furniture
> - Costs of social workers
>
> The following costs incurred in conjunction with start-up activities are outside the scope of [SOP 98-5] (as noted in paragraphs .07 and .08):

- Costs of fund-raising
- Costs of leasehold improvements and furniture
- Architect fees for the leasehold improvements
- Advertising costs to publicize the shelter

Auditors should review SOP 98-5 and its illustrations to assess whether management has properly accounted for start-up activities pursuant to the provisions of the SOP, and that the applicable guidance in other authoritative literature has been followed for those costs that are outside of the scope of the SOP.

Executive Summary—Accounting Issues and Developments

- The FASB issued FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.*
- The AICPA has published a new, nonauthoritative Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations,* that provides illustrative financial statements and related disclosures for nongovernmental not-for-profit organizations other than health care providers.
- A new nonauthoritative technical practice aid for not-for-profit organizations, *Costs of Soliciting Contributed Services and Time That Do Not Meet The Recognition Criteria in FASB Statement No. 116,* has been published and posted to the AICPA Web site at http://www. aicpa.org.
- The FASB issued FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133,* that defers the effective date of FASB Statement No. 133 to all fiscal quarters of fiscal years beginning after June 15, 2000.
- SOP 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising,* became effective for financial statements for years beginning on or after December 15, 1998. SOP 98-5, *Reporting on the Costs of Start-Up Activities,* became effective for financial statements for fiscal years beginning after December 15, 1998.

Listing of Recent Auditing, Attestation, and Accounting Pronouncements[8]

New Auditing Standards

- SAS No. 88, *Service Organizations and Reporting on Consistency*. See the discussion titled "SAS No. 88, *Service Organizations and Reporting on Consistency*" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.
- SAS No. 89, *Audit Adjustments*. See the discussion titled "SAS No. 89, *Audit Adjustments*" in the "Audit and Attestation Issues and Developments" section of this Audit Risk Alert.
- SAS No. 90, *Audit Committee Communications*, amends SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), and SAS No. 71, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722) to establish requirements for auditors of SEC engagements. A summary of this SAS can be found on the AICPA Web site at http://www.aicpa.org.
- SAS No. 91, *Federal GAAP Hierarchy*, amends SAS No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 411), to establish a hierarchy of accounting principles for federal governmental entities. A summary of this SAS can be found on the AICPA Web site at http://www.aicpa.org.

For a discussion of the outstanding exposure drafts for proposed SASs, see the discussion titled "ASB Exposure Drafts" in the "On the Horizon" section of this Audit Risk Alert.

Help Desk—AICPA reSOURCE provides electronic access to AICPA Professional Standards, Technical Practice Aids, and Audit and Accounting Guides. AICPA reSOURCE CD-ROM

8. Any specific exemptions related to not-for-profit organizations have been noted here. Readers should refer to the complete text of pronouncements to determine whether they are applicable in a particular situation.

provides access to this AICPA audit and accounting literature on CD-ROM. AICPA reSOURCE Online provides online access to AICPA audit and accounting literature. AICPA reSOURCE CD-ROM and AICPA reSOURCE Online are available by subscription. Subscription to AICPA reSOURCE Online is available through the AICPA Web site at http://www.aicpa.org. AICPA reSOURCE CD-ROM may be obtained by calling the AICPA Order Department (Member Satisfaction) at (888) 777-7077.

New Attestation Standards and Attestation Interpretations

As of the writing of this Audit Risk Alert, no new attestation standards or attestation interpretations have been issued since the last Audit Risk Alert.

New Auditing Interpretations

Auditing Interpretations are issued by the AITF of the ASB to provide timely guidance on the application of ASB pronouncements. Interpretations are reviewed by the ASB but are not as authoritative as ASB pronouncements. Nevertheless, a departure from an Interpretation may have to be justified if the quality of a member's work is questioned. Interpretations become effective upon their publication in the *Journal of Accountancy.*

The three new Interpretations listed below are available on the AICPA Web site at http://www.aicpa.org/members/div/auditstd/announce/index.htm

- AU Section 324, *Reports on the Processing of Transactions by Service Organizations*, addition to Interpretation 3, "Responsibilities of Service Organizations and Service Auditors With Respect to Information About the Year 2000 Issue in a Service Organization's Description of Controls" (AICPA, *Professional Standards*, vol. 1. AU sec. 9324)
- AU Section 508, *Reports on Audited Financial Statements*, Interpretation 13, "Reference to Country of Origin in the Auditor's Standard Report" (AICPA, *Professional Standards*, vol. 1. AU sec. 9508)

- AU Section 334, *Related Parties,* Interpretation 7, "Management's and Auditor's Responsibilities for Related Party Disclosures Prefaced by Terminology Such As 'Management Believes That'" (AICPA, *Professional Standards,* vol. 1. AU sec. 9334)

New Audit Issues Task Force Advisories

From time to time, the AITF issues AITF Advisories to provide nonauthoritative guidance on current developments or recently issued authoritative literature. As of the writing of this Audit Risk Alert, no new AITF Advisories have been issued since the last Audit Risk Alert.

New FASB Pronouncements

- FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.* See the discussion titled "Transfers of Assets" in the "Accounting Issues and Developments" section of this Audit Risk Alert.
- FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133*—an amendment of FASB Statement No. 133. See the discussion titled "Derivatives and Hedging Activities" in the "Accounting Issues and Developments" section of this Audit Risk Alert.
- FASB Interpretation No. 43, *Real Estate Sales.* A summary is included in the AICPA general *Audit Risk Alert—1999/2000.*
- FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation,* an interpretation of APB Opinion No. 25. A summary will be included in the AICPA general *Audit Risk Alert—2000/2001* available in November 2000.

- The status of issues considered recently by the Emerging Issues Task Force (EITF) of the FASB can be found in the AICPA general *Audit Risk Alert—1999/2000* (EITF issues discussed through the September 1999 meetings) and the general *Audit Risk Alert—2000/2001*, available in November 2000.

Also, in February 2000, the FASB issued FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements.* Unlike a Statement of Financial Accounting Standards, FASB Concepts Statements do not establish GAAP. The purpose of the series of FASB Concepts Statements is to set forth fundamentals on which financial accounting and reporting standards will be based, and more specifically, to establish the objectives and concepts that the FASB will use in developing standards of financial accounting and reporting.

New AICPA Accounting and Auditing Statements of Position

- SOP 99-1, *Guidance to Practitioners in Conducting and Reporting on an Agreed-Upon Procedures Engagement to Assist Management in Evaluating the Effectiveness of Its Corporate Compliance Program.* For a summary, see the AICPA general *Audit Risk Alert—1999/2000.*

- SOP 99-2, *Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans.* For a summary see the AICPA general *Audit Risk Alert—1999/2000.*

- SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters.* For a summary, see the AICPA general *Audit Risk Alert—1999/2000.*

- SOP 00-1, *Auditing Health Care Third-Party Revenues and Related Receivables.* A summary will be included in the AICPA general *Audit Risk Alert 2000/2001*, available later in 2000.

PITF Practice Alerts

The Professional Issues Task Force (PITF), established by the SEC Practice Section (SECPS) Executive committee, formulates guidance based on issues arising in litigation, peer reviews, and firm inspections to facilitate the resolution of emerging audit practice issues. This guidance takes the form of Practice Alerts. These Practice Alerts—which are based on existing audit literature, the professional experience of the members of the PITF, and information provided by SECPS member firms—provide auditors with information that may help them improve the efficiency and effectiveness of their audits. The information contained the Practice Alerts is nonauthoritative. It represents the views of the members of the PITF and does not represent official positions of the AICPA. For additional discussions and a listing of recently and previously issued Practice Alerts, visit the AICPA Web site at http://www.aicpa.org.

On the Horizon[9]

FASB Exposure Drafts

What are some of the exposure drafts that have been issued by the FASB for comment?

Proposed Statement of Financial Accounting Standards on Consolidated Financial Statements

In February 1999, the FASB issued an exposure draft of a proposed FASB Statement, *Consolidated Financial Statements: Purpose and Policy*, a revision to an exposure draft issued in October 1995. This proposed Statement would establish standards for

9. This section briefly summarizes some of the exposure drafts that have been released by the FASB and the ASB for comment that may affect not-for-profit organizations and which were outstanding at the time this Audit Risk Alert went to press. Auditors should be alert for the issuance of a final statement or interpretation or other developments related to these FASB and ASB projects. Further information related to the FASB projects can be obtained from the FASB Web site at http://www.fasb.org. Further information related to the ASB projects can be obtained from the AICPA Web site at http://www.aicpa.org.

determining when entities should be included in consolidated financial statements. It would apply to business enterprises and not-for-profit organizations that control other entities regardless of the legal form of the controlling and controlled entities. The proposed statement would—

- Require that a controlling entity (parent) consolidate all entities that it controls (subsidiaries) unless control is temporary at the time the entity becomes a subsidiary.
- Preclude consolidation of a new subsidiary if a parent's control is temporary at the date that control is obtained.

The proposed Statement would supersede the provisions of paragraphs 1 through 3 and 5 of Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, as amended, and would amend ARB No. 51 to extend its provisions to not-for-profit organizations. The proposed statement would also supersede or amend other accounting pronouncements.

The FASB continues to redeliberate issues and concerns raised by respondents to this exposure draft and has decided not to retain the effective date that was proposed in the exposure draft, which was for years beginning after December 1999. See the discussion titled "Reporting of Related Entities" in the "Accounting Issues and Developments" section of this Audit Risk Alert.

Proposed Statement of Financial Accounting Standards on Accounting for Transfers of Financial Assets

In June 1999, the FASB issued an exposure draft of a proposed FASB Statement, *Accounting for Transfers of Financial Assets, (an amendment of FASB Statement No. 125)*. This proposed Statement is a response to requests to reconsider certain provisions of FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The proposed Statement would—

- Clarify the criteria and expand the guidance for determining when the transferor has extinguished control and the transfer is therefore accounted for as a sale.

- Adopt new accounting requirements for pledged collateral.
- Require new disclosures about securitizations and pledged collateral.

The proposed Statement would apply to all transfers of financial assets occurring after December 31, 2000, applied prospectively. The securitization disclosure provisions would be effective for fiscal years ending after December 15, 2000. The collateral disclosure provisions would be effective for fiscal years ending after December 15, 2001.

Proposed Statement of Financial Accounting Standards on Business Combinations and Intangible Assets

In September 1999, the FASB issued an exposure draft of a proposed FASB Statement, *Business Combinations and Intangible Assets*. This proposed Statement is divided into two parts. Part I addresses the method of accounting for business combinations and amends APB Opinion No. 16, *Business Combinations*. Part II addresses the accounting for intangible assets (including goodwill) whether acquired singly, in a group, or as part of a business combination and supersedes APB Opinion No. 17, *Intangible Assets*. Part II of this proposed Statement would apply to both not-for-profit and for-profit organizations, and to intangible assets (including goodwill) acquired in transactions initiated after the issuance date of the final statement. The proposed Statement would amend or supersede other existing accounting pronouncements.

The FASB has decided to address issues specific to combinations of not-for-profit organization as a separate project, conducted concurrently with the main business combinations project. In addition, the FASB clarified the scope of Part I of the proposed Statement, so that all organizations that fall outside the definition of "not-for-profit organization" in FASB Statement No. 116 are within the scope of this Exposure Draft, as is the acquisition of a not-for-profit organization by a business enterprise.

Proposed Statement of Financial Accounting Standards on Accounting for Obligations Associated With the Retirement of Long-Lived Assets

In February 2000, the FASB issued an exposure draft of a proposed FASB Statement, *Accounting for Obligations Associated with the Retirement of Long-Lived Assets,* a revision to an exposure draft issued in February 1996. This proposed Statement would apply to all entities that incur obligations associated with the retirement of tangible long-lived assets. The proposed statement would require—

- An asset retirement obligation be recognized as a liability, initially measured at fair value, when incurred.
- An offsetting amount, referred to as an asset retirement cost, be recognized as an increase in the carrying amount of the associated long-lived asset.
- Recognition of interest expense on the liability and depreciation expense on the capitalized asset retirement cost after initial recognition and measurement.

The proposed Statement would be effective for fiscal years beginning after June 15, 2001.

Proposed Statement of Financial Accounting Standards Amending FASB Statement No. 133

In March 2000, the FASB issued an exposure draft of a proposed FASB Statement, *Accounting for Certain Derivative Instruments and Certain Hedging Activities.* This proposed Statement would amend FASB Statement No. 133 and address a limited number of issues causing implementation difficulties for a large number of entities getting ready to implement FASB Statement No. 133.

ASB Exposure Drafts

What are some of the exposure drafts that have been issued for comment by the Auditing Standards Board?

Proposed Statement on Auditing Standards—Auditing Financial Instruments

The ASB issued an exposure draft of a proposed SAS, *Auditing Financial Instruments.* The proposed SAS would supersede SAS No. 81, *Auditing Investments* (AICPA, *Professional Standards,* vol. 1, AU sec. 332), and provide updated guidance on planning and performing auditing procedures for financial statement assertions about financial instruments.

The AICPA is developing an audit guide to be issued with the new SAS and to provide guidance for implementing the SAS on all types of engagements. This guide will also summarize selected accounting guidance on derivatives.

Proposed Statement on Auditing Standards—Omnibus Statement on Auditing Standards—2000

The ASB issued an exposure draft of a proposed SAS titled *Omnibus Statement on Auditing Standards—2000.* The proposed SAS—

- Withdraws SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards,* vol. 1, AU sec. 622) and its Interpretation in order to consolidate the guidance applicable to agreed-upon procedures engagements in professional standards. The guidance currently in SAS No. 75 will be incorporated in SSAE No. 4, *Agreed-Upon Procedures Engagements* (AICPA, *Professional Standards,* vol. 1, AT sec. 600).

- Amends AU section 543 to clarify the position of an auditor of an investee accounted for under the equity method.

- Amends SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards,* vol. 1, AU sec. 508.08) to include a reference in the auditor's report to the country of origin of the accounting principles used to prepare the financial statements and of the auditing standards the auditor followed in performing the audit. It also withdraws Auditing Interpretation No. 13, *Reference to Country of Origin in the Auditor's Standard Report* of SAS No. 58 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508.53–.55).

- Amends SAS No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315.02) to clarify the definition of predecessor auditor.

Proposed Statement on Standards for Attestation Engagements

The ASB has issued an exposure draft of a proposed SSAE, *Attestation Standards: Revision and Recodification* that would supersede SSAE Nos. 1 through 9 and reorganize and renumber the AT sections in the AICPA *Professional Standards* where the body of the attestation standards are codified and organized. The proposed revisions include extensive changes to the existing AT section 100, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100).

Nonauthoritative AICPA Audit and Accounting Products and Services

What other AICPA publications and products can be of value to auditors of not-for-profit organizations?

Industry Conference

The AICPA will hold its Eighth Annual Not-for-Profit Organizations Industry Conference on June 5 to June 6, 2000 (with post-conference workshops on June 7), in Washington, DC. The conference is designed for both practitioners and not-for-profit organization financial executives, and will provide technical information for those decision makers. For further information, call the AICPA CPE Conference Hotline at (888) 777-7077 or visit the AICPA Web site at http://www.aicpa.org.

Accounting and Auditing Technical Hotline

The AICPA Technical Hotline answers members' inquiries about accounting, auditing, attestation, compilation, and review services. Call (888) 777-7077.

Ethics Hotline

The AICPA Professional Ethics Team answers inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. Call (888) 777-7077.

Continuing Professional Education Courses

The AICPA offers many continuing professional education (CPE) courses related to not-for-profit organizations, many of them available for both group study and self-study. Among the available titles are the following:

- Accounting and Reporting Practices of Nonprofit Organizations—Choices and Applications
- AICPA Form 990 Nonprofits Workshop
- Compensation Issues in Not-for-Profit Organizations
- Compliance Auditing
- Fraud in Governmental and Not-for-Profit Audits: The Auditor's Responsibilities Under SAS No. 82
- Getting Started With Not-for-Profit Organization Tax Issues
- HUD Audits: A Comprehensive Guide (available in text and video)
- Joint and Indirect Cost Allocations for Governmental and Nonprofit Organizations: How to Prepare and Audit Them
- Managing Not-for-Profits in the New Accounting and Auditing Environment
- Nonprofit Accounting and Auditing Update (1999-2000 Edition) (available in text and video)

- Single Audit Requirements for Nonprofit and Governmental Organizations
- Solving Complex Single Audit Issues for Government and Nonprofit Organizations (available in text and video)
- Subrecipient Monitoring
- Tackling Tough Tax Topics in Nonprofit Organizations
- Using the AICPA Not-for-Profit Organizations Audit and Accounting Guide
- Workpaper Preparation Techniques for Government and Nonprofit Organizations (available in text and video)
- Yellow Book: Government Auditing Standards (available in text and video)

For more information about AICPA CPE courses, call the AICPA (Member Satisfaction) at (888) 777-7077 or visit the AICPA Web site at http://www.aicpa.org.

Not-for-Profit Organizations Checklists

The AICPA Accounting and Auditing Publications Team has published a revised edition of *Checklists and Illustrative Financial Statements for Not-for-Profit Organizations* (Product No. 008762kk), a nonauthoritative Practice Aid designed to help those preparing reports and financial statements of not-for-profit organizations.

Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations*

This comprehensive, nonauthoritative Practice Aid (Product No. 006605kk) will illustrate a wide variety of not-for-profit organizations financial statement formats and disclosures to assist auditors of not-for-profit organizations. See the discussion titled "New AICPA Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations*," in the "Accounting Issues and Developments" section of this Audit Risk Alert.

Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

This two-volume set (Product No. 008730kk) contains comprehensive analyses of the OMB's revisions to its Circulars for performing Single Audits, numerous checklists, and illustrative examples, and an illustrative case study of the single audit process.

Technical Practice Aids

AICPA Technical Practice Aids includes questions received by the AICPA Technical Hotline on various subjects and the responses to those questions. Sections 6140 and 6960 of *Technical Practice Aids* include questions and answers specifically pertaining to not-for-profit organizations. *Technical Practice Aids* is available both as a subscription service (Product No. G01013kk) and in paperback form (Product No. 005059kk). See the discussion titled "New AICPA Technical Practice Aids" in the "Accounting Issues and Developments" section of this Audit Risk Alert.

> **Help Desk**—AICPA publications can be obtained by calling the AICPA Order Department (Member Satisfaction) at (888) 777-7077, faxing a request to (800) 362-5066 or visiting the AICPA Web site at http://www.aicpa.org.

References for Additional Guidance

Federal Agencies—Administrative Regulations

Most federal agencies issue general administrative regulations that apply to their programs. Those regulations provide general rules on how to apply for grants and contracts, how grants are made, the general conditions that apply to and the administrative responsibilities of grantees and contractors, and the compliance procedures used by the various agencies. Those regulations are included in the *Code of Federal Regulations*.

General Accounting Office

GAO publications include those listed in this section. Unless otherwise noted, requests for copies of these publications should be sent to the U.S. General Accounting Office, P.O. Box 37050, Washington, DC 20013. The telephone number is (202) 512-6000. Orders may also be placed by using the fax number (202) 512-6061. The GAO issues hundreds of reports and testimony to the Congress each year on a variety of subjects, including accounting, budgeting, and financial management. Now the full text of GAO products can be retrieved via the Internet. The GAO's Web site is http://www.gao.gov. For information on how to access GAO reports or other documents on the Internet, send an email message with information in the body to info@www.gao.gov.

Government Auditing Standards, 1994 Revision as Amended

These standards, also referred to as the Yellow Book, relate to audits—both financial and performance—of governmental organizations, programs, activities, and functions, and of governmental funds received by contractors, nonprofit organizations, and other nongovernmental organizations. The standards incorporate the AICPA Statements on Auditing Standards for field work and reporting, and prescribe additional standards to meet the more varied interests of governmental audit report users. The 1994 revision and its amendments are for sale by the Superintendent of Documents, U.S. Government Printing Office (GPO), Washington, DC 20401; telephone (202) 512-1800; fax (202) 512-2250; Stock No. 020-000-00-265-4. The current codification of the standards that includes Amendment Nos. 1 and 2 also is available on the Yellow Book section of the GAO Web site at http://www.gao.gov/govaud/ybk01.htm.

Government Auditing Standards: Amendment No. 1, Documentation Requirements When Assessing Control Risk at Maximum for Controls Significantly Dependent Upon Computerized Information Systems (GAO/A-GAGAS-1)

In May 1999, GAO issued its first amendment to the 1994 version of *Government Auditing Standards.* The new amendment establishes a new field work standard requiring documentation in the planning of financial statement audits in certain circumstances. An electronic version of the standard can be accessed through the Yellow Book section of the GAO Web site. See the discussion titled "Revisions to *Government Auditing Standards*" in the "Regulatory and Legislative Developments" section of this Audit Risk Alert.

Government Auditing Standards: Amendment No. 2, Auditor Communication (GAO/A-GAGAS-2)

Issued in July 1999, this second amendment to *Government Auditing Standards* requires specific communication concerning the auditor's work on compliance with laws and regulations and internal control over financial reporting. The new amendment also requires the auditor to emphasize in the auditor's report on the financial statements the importance of the reports on compliance with laws and regulations and internal control over financial reporting when these reports are issued separately from the report on the financial statements. See the discussion titled "Revisions to *Government Auditing Standards*" in the "Regulatory and Legislative Developments" section of this Audit Risk Alert.

Interpretation of Continuing Education and Training Requirements—Government Auditing Standards

This establishes specific CPE requirements for auditors working on audits made in accordance with those standards. This Interpretation guides audit organizations and individual auditors on implementing the CPE requirements by answering the most frequently asked questions from the audit community. This Interpretation is effective for CPE reporting periods beginning on or after January 1, 1991. This Interpretation is available on the Yellow Book section of the GAO Web site at http://www.gao.gov.

Office of Management and Budget

Circulars

The OMB issues grants management circulars to establish uniform policies and rules to be observed by federal agencies for the administration of federal grants. Federal agencies then adopt these circulars in their regulations. The process for issuing grants management circulars includes due process with a notice of any proposed changes in the *Federal Register*, a comment period, and careful consideration of all responses before issuance of final circulars. Circulars and other documents relevant to audits of not-for-profit organizations are as follows:

- OMB Circular A-21 (Revised), *Cost Principles for Educational Institutions*
- OMB Circular A-110 (Revised), *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*
- OMB Circular A-122 (Revised), *Cost Principles for Non-Profit Organizations*
- OMB Circular A-133 (Revised), *Audits of States, Local Governments, and Non-Profit Organizations*

For copies of circulars and bulletins, write or call the Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503; telephone (202) 395-7332, or check the OMB home page at http://www.whitehouse.gov/OMB/grants.

OMB Circular A-133, *Compliance Supplement*

The OMB *Compliance Supplement* sets forth the major federal compliance requirements that should be considered in a single audit of states, local governments, and non-profit organizations that receive federal assistance. It is Appendix B to OMB Circular A-133, "*Audits of States, Local Governments, and Non-Profit Organizations.*" The 2000 *Compliance Supplement* (and the preceding 1999 *Compliance Supplement*) can be found on the OMB's Web site at the grants management address http://www.whitehouse.gov/ OMB/grants. The 2000 *Compliance Supplement* also is available for sale from the Government Printing Office at telephone (202) 512-1800. The stock number is 041-001-00544-7.

Other Guidance

The *Catalog of Federal Domestic Assistance* (CFDA) is a government-wide compendium of federal programs, projects, services, and activities that provide assistance or benefits to the American public. The General Services Administration (GSA) is responsible for the dissemination of federal domestic assistance information through the catalog and maintains the information database from which program information is obtained. A searchable version of the CFDA is located at http://www.cfda.gov.

Program information provided by the catalog includes authorizing legislation and audit requirements. The GSA makes copies available to certain specified national, state, and local government offices. Catalog staff may be contacted at (202) 708-5126. The catalog may be purchased from the GPO by calling (202) 512-1800.

Program information also is available on machine-readable magnetic tape, high-density floppy diskettes, and CD-ROM. These may be purchased by contacting the Federal Domestic Assistance Catalog Staff (MVS), General Services Administration, 300 7th Street, S.W., Suite 101, Washington, DC 20407; telephone (202) 708-5126.

Auditors should also be aware of the economic, regulatory, and professional developments that may affect the audits they perform, as described in the AICPA general *Audit Risk Alert—1999/2000* (Product No. 022250kk), and AICPA *Compilation and Review Alert—1999/2000* (Product No. 022240kk). These Alerts may be obtained by calling the AICPA Order Department (Member Satisfaction) at (888) 777-7077 or faxing a request to (800) 362-5066. Obtaining product information and placing online orders can be done at the AICPA's Web site, http://www.aicpa.org. (The 2000/2001 version of these publications will be issued later in 2000).

Copies of FASB publications referred to in this document may be obtained directly from the FASB by calling the FASB Order Department at (800) 748-0659.

This Audit Risk Alert replaces *Not-for-Profit Organizations Industry Developments—1999*. The *Not-for-Profit Organizations Industry Developments* Audit Risk Alert is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Alert, please feel free to share them with us. Any other comments that you have about the Alert would be appreciated. You may email these comments to mkasica@aicpa.org or write to:

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APPENDIX
The Internet—An Auditor's Research Tool

Can auditors use the Internet to perform more efficient audits?

If used properly, the Internet can be a valuable tool for auditors. Through the Internet, auditors can access a wide variety of global business information. For example, information is available relating to industry statistics, resources for not-for-profit organizations and their finance professionals, professional news, state CPA society information, Internal Revenue Service information, software downloads, university research materials, currency exchange rates, stock prices, annual reports, and legislative and regulatory initiatives. Not only are such materials accessible from the computer, but they are available at any time, often free of charge.

A number of resources provide direct information, whereas others may simply point to information inside and outside of the Internet. Auditors can use the Internet to—

- Obtain audit and accounting research information.
- Obtain texts, such as audit programs.
- Discuss audit issues with peers.
- Communicate with audit clients.
- Obtain information from a client's Web site.
- Obtain information on professional associations.

There are caveats to keep in mind when using the Internet. Reliability varies considerably. Some information on the Internet has not been reviewed or checked for accuracy; caution is advised when accessing data from unknown or questionable sources. Although a vast amount of information is available on the Internet, much of it may be of little or no value to auditors. Accordingly, auditors should learn to use search engines effectively to minimize the amount of time browsing through useless information. The Internet is best used in tandem with other research tools, because it is unlikely that all desired research can be conducted solely from Internet sources.

Name of Site	*Content*	*Internet Address*
American Institute of CPAs	Information for CPAs on accounting, auditing, industry activities, the activities of the AICPA, and other matters	http://www.aicpa.org
Accountant's Home Page	Resources for accountants and financial and business professionals	http://www.computercpa.com/
Action Without Borders	Includes a directory of not-for-profit organizations and volunteering resources, a newsletter on not-for-profit organization issues, and job postings	http://www.idealist.org
American Society of Association Executives	Provides resources to assist association executives and individuals from for-profit companies that provide products and services to the association community	http://www.asaenet.org
The Chronicle of Philanthropy	Articles from the *Chronicle of Philanthropy* newspaper and links to other sites	http://www.philanthropy.com
Council on Foundations	Includes research, publications, and other information of interest to foundations and corporate donors	http://www.cof.org
CPAnet	Links to other Web sites of interest to CPAs	http://www.cpalinks.com/
Cybersolve	Online financial calculators, such as ratio and breakeven analysis	http://www.cybersolve.com/tools1.html
The Electronic Accountant	World Wide Web magazine that features up-to-the minute news for accountants	http://www.electronicaccountant.com
Financial Accounting Standards Board	Information on the activities of this standard-setting body	http://www.fasb.org

Name of Site	*Content*	*Internet Address*
FedWorld.Gov	U.S. Department of Commerce sponsored site providing access to government publications	http://www.fedworld.gov
Financial Systems Forum	Topics involving the improvement of financial systems by providing information on methodologies, service organizations, and vendors with a focus on applications concerning accounts payable, accounts receivable, asset management, general ledger, and inventory	http://www.fsforum.com
The Foundation Center	Information for not-for-profit organizations, donors, and researchers	http://www.fdncenter.org
Giving USA	American Association of Fund-Raising Counsel sponsored site providing information trends in giving and sources of support	http://www.aafrc.org
General Accounting Office	Policy and guidance materials, reports on federal agency major rules	http://www.gao.gov
Guidestar	Information on not-for-profit organizations and new resources for not-for-profit organizations and donors	http://www.guidestar.org
Guide to WWW for Research and Auditing	Basic instructions on how to use the Web as an auditing research tool	http://www.tetranet.net/users/gaostl/guide.htm
Hoovers Online	Online information on various companies and industries	http://www.hoovers.com
Independent Sector	A forum to encourage giving, volunteering, not-for-profit initiative and citizen action	http://www.indepsec.org
Information for Tax-Exempt Organizations (an IRS site)	A Treasury Department site providing information and answers to frequently asked questions regarding tax-exempt organizations	http://www.irs.ustreas.gov/prod/bus_info/eo
Internet Bulletin for CPAs	CPA tool for Internet sites, discussion groups, and other resources for CPAs	http://www.kentis.com/ib.html

(continued)

Name of Site	*Content*	*Internet Address*
Internet Nonprofit Center	Includes the nonprofit locator, frequently asked questions, and other information	http://www.nonprofits.org
Management Assistance Program for Nonprofits	Includes the Nonprofit Manager's Library and other resources	http://www.mapnp.org
National Association of College and University Business Officers	Provides information geared to colleges and universities, including accounting tutorials on specific situations encountered in higher education accounting	http://www.nacubo.org
The National Center for Nonprofit Boards	Resources to help strengthen not-for-profit organization boards of directors	http://www.ncnb.org
The National Center for Charitable Statistics	Provides statistics on revenue and expenses of not-for-profit organizations	http://urban.org
National Charities Information Bureau	Promotes giving and helps contributors obtain accurate information about charitable organizations	http://www.give.org
The Nonprofit Genie	Advice, links to other sites, publications, and other information on not-for-profit organization management	http://www.genie.org
The Nonprofit Resource Center	Information and links to other sites covering financial management, governance, legal, and other matters	http://www.not-for-profit.org
The Nonprofit Risk Management Center	Provides information to help not-for-profit organizations control their risks	http://www.nonprofitrisk.org
The Nonprofit Times Online	Articles from the *Nonprofit Times* newspaper and links to other sites	http://www.nptimes.com
CompassPoint Nonprofit Services	Workshops, consulting, publications, and other information and resources of interest to managers of not-for-profit organizations	http://www.supportcenter.org
Tax Analysts Online	Provides information on current tax developments	http://www.tax.org

Name of Site	*Content*	*Internet Address*
U.S. Department of Education	Information on programs, resources, and other matters	http://www.ed.gov
U.S. Tax Code Online	A complete text of the U.S. Tax Code	http://www.fourmilab.ch/ustax/ustax.html
U.S. Office of Management and Budget	OMB information and literature	http://www.whitehouse.gov/OMB/
Vision Project	Information on the profession's Vision Project	http://www.cpavision.org/horizon