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American Institute of Certified Public Accountants. Not-for-Profit Organizations Committee

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AICPA

Audit and Accounting Guide

AUDITS of CERTAIN NONPROFIT ORGANIZATIONS

With Conforming Changes as of May 1, 1994

AICPA

Audit and Accounting Guide

AUDITS of CERTAIN NONPROFIT ORGANIZATIONS

With Conforming Changes as of May 1, 1994

This edition of the audit and accounting guide *Audits of Certain Nonprofit Organizations*, which was originally issued in 1981, has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative pronouncements since the guide was originally issued. The changes made are identified in a schedule in Appendix D of the guide. The changes do *not* include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

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NOTICE TO READERS

This audit and accounting guide presents recommendations of the AICPA Nonprofit Organizations Subcommittee on the application of generally accepted auditing standards to audits of financial statements of certain not-for-profit organizations. Members of the AICPA Auditing Standards Board have found this guide to be consistent with existing standards covered by Rule 202 of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from this guide.

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Preface

This guide has been prepared by the AICPA Nonprofit Organizations Subcommittee to assist the independent auditor in auditing and reporting on the financial statements of certain nonprofit organizations (described in chapter 1) in accordance with generally accepted auditing standards. It also may provide useful guidance to the auditor in auditing the financial statements of other nonprofit organizations that have similar types of transactions.

This guide does not deal with all of the work an independent auditor should undertake in an audit engagement; rather, it discusses the portions of the work that the subcommittee considered particularly pertinent or unique to these nonprofit organizations.

In June 1993, the FASB issued Statements of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117, *Financial Statements of Not-for-Profit Organizations.* FASB Statement No. 116 establishes accounting standards for contributions and applies to all entities that receive or make contributions. FASB Statement No. 116 is effective for financial statements issued for fiscal years beginning after December 15, 1994 and interim periods within those fiscal years, except for not-for-profit organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It is effective for annual financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Some of the guidance in those Statements is inconsistent with guidance in this guide. The AICPA Not-for-Profit Organizations Committee is currently developing a new Audit and Accounting Guide for not-for-profit organizations which is expected to supersede this guide and provide new guidance that is in conformity with the FASB Statements. Guidance in FASB Statements No. 116 and No. 117 that is inconsistent with guidance in this guide supersedes the guidance in this guide, as of the application date of those Statements.

This edition of the guide includes annotations that are intended to make readers aware of differences between the accounting principles prescribed by this guide and those in FASB Statements No. 116 and No. 117. Preparers and auditors of financial statements of organizations that adopt FASB Statements No. 116 and No. 117 may find the annotations useful, but should also read the Statements themselves. In addition, auditors should consider the implications of adopting the Statements on their auditing procedures. Organizations that have not yet adopted FASB Statements No. 116 and No. 117 may find the annotations useful to point out areas in which potential changes may be necessary when the Statements are adopted.

Nonprofit Organizations Subcommittee

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Chapter 1

General

Scope and Application of the Guide

1.01 The American Institute of Certified Public Accountants (AICPA) has issued the following industry audit guides applicable to some nonprofit organizations:

Audits of Providers of Health Care Services

Audits of Colleges and Universities

Audits of Voluntary Health and Welfare Organizations

Audits of State and Local Governmental Units

1.02 This guide does not supersede those guides or their amendments. It provides guidance to the independent auditor in performing an audit in accordance with generally accepted auditing standards of financial statements of all nonprofit organizations not covered by those guides, other than those types of entities that operate essentially as commercial businesses for the direct economic benefit of members or stockholders. Examples of the latter category are employee benefit and pension plans, mutual insurance companies, mutual banks, trusts, and farm cooperatives. The following organizations are among those covered by this guide; however, this list is not all-inclusive:

Cemetery organizations

Civic organizations

Fraternal organizations

Labor unions

Libraries

Museums

Other cultural institutions

Performing arts organizations

Political parties

Private and community foundations

Private elementary and secondary schools

Professional associations

Public broadcasting stations

Religious organizations

Research and scientific organizations

Social and country clubs

Trade associations

Zoological and botanical societies

1.03 Generally accepted auditing standards apply to audits of financial statements of nonprofit organizations. This guide is directed toward those aspects of the audit of nonprofit organizations' financial statements that are unique or are considered particularly significant. Accordingly, this guide does not discuss comprehensively the audit of the financial statements of a nonprofit organization; rather, it provides guidance in applying the existing authoritative pronouncements in such audits.

Need for an Audit

1.04 In many jurisdictions, nonprofit organizations that solicit contributions from the public are subject to governmental regulation and must furnish, to a regulatory agency, reports on their activities. Such reports frequently include financial statements and independent auditors' reports on the statements. Also, many nonprofit organizations receive grants for conducting activities, are compensated for costs incurred in programs, or share with other nonprofit organizations in fund-raising activities. Specific reporting requirements are often imposed in connection with these activities, and in many cases an audit is required. SOP 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards* (see appendix C), provides auditors of not-for-profit organizations with a basic understanding of the work they should do and the reports they should issue for audits under the 1988 revision of *Government Auditing Standards* issued by the Comptroller General of the United States and Office of Management and Budget Circular A-133. In addition, even when an audit is not required by a regulatory or fund-raising agency or by a grantor, nonprofit organizations often engage independent auditors to audit and report on their financial statements in order to provide additional assurance to the users of the financial statements. Nonprofit organizations also may engage accountants to compile or review their financial statements; guidance on performing such services is provided by AICPA Statements on Standards for Accounting and Review Services.

Application of Generally Accepted Accounting Principles

1.05 This guide does not prescribe accounting principles applicable to nonprofit organizations. While there is no single source for all established accounting principles, Statement on Auditing Standards (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report,* enumerates the sources so designated by AICPA Council and provides guidance for the use of other sources.

1.06 On December 31, 1978, the AICPA issued Statement of Position (SOP) 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations.* At that time, the Financial Accounting Standards Board (FASB) was studying the objectives of financial reporting by nonbusiness organizations. Thus, no effective date was established for adoption of the accounting principles recommended in SOP 78-10. In September 1979 the FASB issued Statement of Financial Accounting Standards No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters,* which specified that the specialized accounting and reporting principles and practices in the SOP are preferable accounting principles for purposes of justifying a change in accounting principles as required by APB Opinion No. 20, *Accounting Changes.* In November 1992, the FASB issued Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections,* which rescinds FASB Statement No. 32. The guidance in FASB Statement No. 32 is no longer necessary with the issuance of SAS No. 69. SAS No. 69 requires an entity initially applying an accounting principle after March 15, 1992 (including those making an accounting change) to follow the hierarchy of generally accepted accounting principles that it sets forth. In December 1980 the FASB issued Statement of Financial Accounting Concepts No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations,* which establishes the objectives of general-purpose external financial reporting by nonprofit ("nonbusiness") organizations. However, the FASB is continuing to study accounting standards for nonprofit organizations, and no effective date has been established for SOP 78-10.

1.07 In June 1993, the FASB issued Statements of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made,* and No. 117, *Financial Statements of Not-for-Profit Organizations.* FASB Statement No. 116 establishes accounting standards for contributions and applies to all entities that receive or make contributions. FASB Statement No. 116 is effective for financial statements issued for fiscal years beginning after December 15, 1994 and interim periods within those fiscal years, except for not-for-profit organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It is effective for annual financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Some of the guidance in those Statements is inconsistent with guidance in this guide. The AICPA Not-for-Profit Organizations Committee is currently developing a new Audit and Accounting Guide for not-for-profit organizations which is expected to supersede this guide and provide new guidance that is in conformity with the FASB Statements. Guidance in FASB Statements No. 116 and No. 117 that is inconsistent with guidance in this guide supersedes the guidance in this guide, as of the application date of those Statements.

1.08 Some nonprofit organizations may find that financial statements prepared on the cash basis or the modified cash basis of accounting are adequate for their governing boards and other users. SAS No. 62, *Special Reports,* describes the independent auditor's reporting requirements when the financial statements are prepared on a comprehensive basis of accounting other than generally accepted accounting principles, including a cash or modified cash basis. An illustrative form of an auditor's report on financial statements prepared on a modified cash basis is included in chapter 8 of this guide.

Materiality

1.09 Matters presented in this guide apply only to material items. The concept of materiality involves both qualitative and quantitative judgments and does not depend solely on relative dollar amounts. The significance of an item to an entity, the pervasiveness of a misstatement, and the effect of a misstatement on the financial statements taken as a whole are all factors to be considered in making a judgment regarding materiality. However, it is usually not meaningful to emphasize net results of financial activities of nonprofit organizations in making materiality judgments because such organizations are not profit oriented. Otherwise, matters that would be considered material for a profit-oriented entity generally would be considered material for a nonprofit organization. SAS No. 47, *Audit Risk and Materiality in Conducting an Audit,* provides guidance on the auditor's consideration of audit risk and materiality when planning and performing an audit of financial statements in accordance with generally accepted auditing standards.

Financial Statements of Nonprofit Organizations

1.10 The basic financial statements of a nonprofit organization are a balance sheet and a statement of activity, also referred to as a statement of support, revenue, expenses, capital additions, and changes in fund balances, or similar titles. If a reconciliation between beginning and ending fund balances is not included in the statement of activity, a separate statement of changes in fund balances ordinarily would be presented. Additionally, the basic financial statements may include a statement of changes in financial position.[1] The basic financial statements of the current period often are presented on a comparative basis with those of one or more prior periods. [FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It requires that all not-for-profit organizations provide a statement of financial position, a statement of activities, and a statement of cash flows. It requires reporting amounts for the organization's total assets, liabilities, and net assets in a statement of financial position; reporting the change in an organization's net assets in a statement of activities; and reporting the change in its cash and cash equivalents in a statement of cash flows. FASB Statement No. 117 requires classification of an organization's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. It requires that the amounts for each of three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities. See paragraph 1.07.]

1.11 Nonprofit organizations present their expenses classified either on a functional basis (according to the purpose for which costs are incurred, such as specific programs and supporting services) or on an object basis (according to their natural classification, such as salaries, employee benefits, and purchased services). In some cases, the organization may present an analysis that sets forth expenses on both bases in a matrix or grid format. Such an analysis is illustrated in paragraph 8.02 of the AICPA industry audit guide, *Audits of Voluntary Health and Welfare Organizations,* and in exhibit 6F of SOP 78-10.

General Considerations Concerning Internal Control Structure

1.12 The objectives of the internal control structure relevant to an audit of a nonprofit organization's financial statements generally are the same as the objectives relevant to an audit of a profit-oriented organization's financial statements. Some characteristics of nonprofit organizations that influence internal control structure include—

- A volunteer governing board, many of whose members serve for limited terms.

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[1] Nonprofit organizations are not covered by APB Opinion No. 19, *Statement of Changes in Financial Position.* According to that opinion, a profit-oriented business entity whose financial statements purport to present both financial position and results of operations must present, as a basic financial statement, a statement summarizing changes in financial position for each period for which an income statement is presented. SOP 78-10 states that the nonprofit organizations covered by the SOP also should present statements of changes in financial position in such circumstances. [Note: APB Opinion No. 19 has been superseded by FASB Statement No. 95, *Statement of Cash Flows.* Not-for-profit entities are excluded from the scope of FASB Statement No. 95.]

- A limited number of staff personnel, sometimes too few to provide the appropriate segregation of duties.
- A mixture of volunteers and employees participating in operations. Depending on the size and other features of the organization, day-to-day operations sometimes are conducted by volunteers instead of employees. The manner in which responsibility and authority are delegated varies among organizations. This may affect control over financial transactions, particularly with respect to authorization.
- A budget approved by the governing board. The budget may serve as authorization for the activities to be carried out by management in attaining the organizations' program objectives. Many nonprofit organizations prepare budgets for both operating and capital expenditures.

Consideration of the Internal Control Structure in a Financial Statement Audit

1.13 The second standard of field work (see SAS No. 1, paragraph 150.02), which applies to all audit engagements, including audits of nonprofit organizations, states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed."

1.14 SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit,* describes the application of the second standard of field work, and SAS No. 48, *The Effects of Computer Processing on the Audit of Financial Statements,* discusses the effects of computer processing on the audit of financial statements. Guidance concerning the independent auditor's communication of matters relating to the internal control structure appears in SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit.*

Chapter 2

Expenses

2.01 Some nonprofit organizations present their expenses classified on a functional basis; others present their expenses classified on an object basis. When expenses are classified on a functional basis, each significant program and supporting service usually is reported separately in the statement of activity. Program services are those directly related to the purposes of the organization; supporting services are those not directly related to program services (such as fund-raising, membership development, and management and general expenses). In some cases, certain expenses (such as payroll and pension costs) pertain to more than one program or supporting service; generally, such expenses are allocated among the pertinent services. Because of the importance of fund-raising expenses to users of financial statements of a nonprofit organization, such costs may be disclosed in the financial statements even though the organization presents its expenses classified on an object basis. [FASB Statement No. 117 requires that information about expenses be presented on a functional basis. It also requires that all expenses be presented as decreases in unrestricted net assets. See paragraph 1.07.]

2.02 When performing auditing procedures with respect to expenses, the auditor's objectives should be to obtain reasonable assurance that expenses are authorized or approved by management, are supported, are properly classified, are recognized in the appropriate period, and (when presented on a functional basis) are properly allocated to the appropriate functions. The most significant expenses incurred by many nonprofit organizations are payroll costs, and, therefore, the methods of allocating such costs are of particular interest to the auditor.

2.03 Internal control structure policies and procedures pertaining to a nonprofit organization's expenses are generally the same as the controls applicable to expenses of profit-oriented organizations. Examples of internal control structure policies and procedures that may apply to expenses include—

- Existence of a well defined organizational chart that clearly defines the organization's activities by function and a detailed chart of accounts that defines the expenses chargeable to them.
- Controls over expenses, including comparison with approved budget estimates, and investigation of significant variations. (Budget estimates are generally approved and monitored by the organization's governing board.)
- Controls over disbursements, which include approval of disbursements and review of the distribution of expenses to accounts and the allocation among functions, if applicable.

2.04 The auditing procedures for expenses in nonprofit organizations are in most respects the same as those for expenses in profit-oriented organizations. When expenses are reported on a functional cost basis, examples of additional auditing procedures that the auditor should consider include—

- Obtaining reasonable assurance that expenses have been approved. If the budget serves as authorization for expenses, the auditor would compare the expenses with the budget.
- Obtaining reasonable assurance that the functional classifications used adequately present the activities of the organization.

- Reviewing and testing the allocations of expenses that apply to more than one function and considering whether the methods and the underlying bases for allocation are reasonable and consistent. For example, a review of salary and wage allocations might include an examination of program reports, job descriptions, and employee time or activity reports.
- Obtaining reasonable assurance that the classifications used are consistent with those of the preceding year or, if not, that the changes are adequately disclosed.

Expenditures of Restricted Resources

2.05 Internal control structure policies and procedures and auditing procedures relating to expenditures of resources restricted by donors, grantors, or other outside parties to specific purposes are discussed in chapter 6.

Grants Awarded

2.06 Grants may be awarded by nonprofit organizations to other organizations. Generally, the audit objectives, the internal control structure policies and procedures, and the auditing procedures that the auditor should consider for grants that have been awarded are similar to those for other expenses. Examples of additional procedures that the auditor should consider include—

- Examining grant authorizations and related agreements.
- When appropriate, examining documentation relating to the tax status of the grantee organizations.
- Reviewing the organization's grant-monitoring procedures, including accountability, if any, by the grantee for use of the funds.
- Reviewing procedures for cancelling grants and for obtaining refunds of grants made, if appropriate.
- Obtaining reasonable assurance that grants have been recorded in the proper accounting period.

Taxation of Nonprofit Organizations

2.07 Although nonprofit organizations generally are exempt from income taxes, tax regulations usually are important considerations in the audits of nonprofit organizations. Certain nonprofit organizations may be subject to taxes on unrelated trade or business income and on excess lobbying expenses, as well as to excise, payroll, real estate, and personal property taxes. Also, they may be required to collect sales taxes on sales of publications or products and to withhold payroll taxes.

2.08 Generally, the audit objectives, the internal control structure policies and procedures, and the auditing procedures that the auditor should consider for taxes of a nonprofit organization are similar to those for a profit-oriented organization. Examples of additional procedures that the auditor should consider include—

- Identifying those taxes from which the organization is exempt and those for which it is liable.
- Examining exemption letters from tax authorities.
- Obtaining reasonable assurance that the conditions for tax-exempt status are met and that necessary information returns have been filed on a timely basis.

- Identifying any unrelated business income and applicable expenses and evaluating the provision for the related taxes.
- Making inquiries of management concerning the organization's lobbying activities (if any) and evaluating the provision for any related taxes.
- Reviewing the results of the latest examination by the Internal Revenue Service or other taxing authorities.
- Making inquiries concerning whether the organization is a private foundation as that term is defined in section 509 of the Internal Revenue Code. If the organization is a private foundation, the auditor should obtain reasonable assurance that the provision for any applicable taxes is adequate and that the organization has complied with the provisions of the code and regulations relating to such matters as required distribution of income and prohibited activities.

Chapter 3

Revenue

3.01 Increases in the aggregate net assets of nonprofit organizations arise from revenue (discussed in this chapter) or from support and capital additions (discussed in chapter 4). Deferral of revenue and support is discussed in chapter 6.

The Audit Objective

3.02 When performing auditing procedures with respect to revenue, the auditor's objective should be to obtain reasonable assurance that revenues have been recorded properly in regard to amount, account, and period and that they are presented in conformity with generally accepted accounting principles.

Types of Revenue

3.03 Revenue generally is classified as follows:

- Fees for performance of services (service fees)
- Sales of publications and other items
- Income and gains and losses from investments
- Third-party reimbursements

Service Fees

3.04 The categories of service fees are numerous and depend on the nature of the organization's activities. Some examples are—

- Membership dues and initiation fees of associations, clubs, and unions.
- Admission fees for performances and exhibitions of performing arts organizations and museums.
- School tuition.
- Client fees of voluntary service organizations.
- Annual care fees of cemetery organizations.
- Life membership and other fees of homes for the aged.

3.05 Internal control structure policies and procedures pertaining to service fees of a nonprofit organization generally are the same as those over similar fees of profit-oriented organizations. Examples of internal control structure policies and procedures that may apply to service fees include—

- Controls over revenue, including comparison with approved budget estimates and investigation of significant variations.
- Independent accountability over admissions, such as control of all available tickets, both used and unused, to theatrical performances, exhibitions, conferences, seminars, or benefits.
- Segregation of accountability functions relating to membership, enrollment, and similar activities that give rise to dues, tuition, and other revenue.
- Appropriate control procedures over the processing and recording of one-time membership fees.

3.06 The auditor should consider performing analytical procedures (see SAS No. 56, *Analytical Procedures*), including comparison of recorded revenue with related, independently prepared statistical reports. For example, comparisons such as the following might be made:

- Tuition with enrollment statistics
- Admissions revenue with turnstile counts or ticket usage reports
- Dues with membership listings

3.07 If there is significant risk that revenue may be unrecorded or underrecorded, the auditor should consider additional procedures to obtain reasonable assurance that recorded revenues are complete. For example, if there are significant deficiencies in the design or operation of the internal control structure relevant to cash receipts from service fees, the auditor may select, from a source independent of the accounting function, a sample of members, students, ticket subscribers, or other patrons and request confirmation from them of amounts paid, if any. If the auditor is unable to obtain reasonable assurance concerning such revenues, he should consider the effect this may have on his report. (See paragraphs 8.06 and 8.07.)

Sales of Publications and Other Items

3.08 Some nonprofit organizations sell items that have been purchased, produced, or donated, such as

- Publications, subscriptions to periodicals, and advertising space.
- Souvenirs, reproductions, and records.

Other revenue may be raised by auctions, concession sales, or other events.

3.09 Generally, the internal control structure policies and procedures and auditing procedures that the independent auditor should consider for sales of publications and other items are the same as those for sales by profit-oriented organizations. Accordingly, it is important for the entity to control the number of publications printed, issued, and on hand and to control the number of items of merchandise available, sold, and on hand.

Income and Gains and Losses From Investments

3.10 Nonprofit organizations may receive income from investments and may have gains and losses from their investments, including—

- Dividends and interest
- Rents and royalties
- Gains and losses realized on dispositions of investments
- Unrealized gains and losses resulting from changes in the fair value of investments

In some instances, these items may be restricted by donors or others and, therefore, may be accounted for as deferred revenue or capital additions.

3.11 Although the accounting for investments by nonprofit organizations may differ in some respects from that of profit-oriented organizations (see the related discussion in SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations,* paragraphs 77 through 83), the internal control structure policies and procedures and auditing procedures that the auditor should consider for investment income and for gains and losses from investments are generally the same for both profit-oriented and nonprofit organizations. In addition, important considerations for nonprofit organizations are the internal control structure policies and procedures pertaining to restricted revenue and the auditing procedures relating to it. These matters are discussed in chapter 6.

3.12 In some cases, the investments of nonprofit organizations' unrestricted and restricted funds are pooled. As indicated in chapter 5, in such cases the auditor should make tests to obtain reasonable assurance that the investment income and the gains or losses from investments are appropriately allocated to the funds participating in the investment pool.

3.13 Recently, some nonprofit organizations have adopted the so-called total-return approach to the management of investments of endowment and quasi-endowment funds (see SOP 78-10, paragraphs 75 and 76 for a discussion of this approach and related accounting considerations). Not all states permit the use of the total-return approach. Thus, the auditor should consider whether the approach is permitted under applicable state law and whether the accounting for the available net gains from endowment funds is appropriate.

Third-Party Reimbursements

3.14 Some nonprofit organizations provide services to others, the cost of which is reimbursed by a third party.

3.15 The audit objective in the examination of third-party reimbursements should be to obtain reasonable assurance that revenue has been appropriately accrued for all reimbursable costs (and only for those that are reimbursable).

3.16 Examples of internal control structure policies and procedures that apply to third-party reimbursements include—

- Review of third-party payor contractual agreements at regular intervals to ascertain that the services rendered are in accordance with the terms of the agreements.
- Preparation of cost reimbursement reports on a timely basis and review of the reports by appropriate management personnel.
- Establishment of procedures to ensure that properly reimbursable direct and indirect costs are billed to, and collected from, third-party payors.

3.17 Examples of procedures that the auditor should consider include—

- Reading pertinent sections of significant third-party payor contracts to determine the basis for reimbursement.
- Reviewing cost reimbursement reports and testing underlying support to obtain satisfaction that they were prepared on the basis of the principles of reimbursement in the contract with the third-party payor.
- Testing allocations of indirect costs among the organization's programs, including the bases used for the allocation of indirect costs.
- Reviewing the status of audits by third-party payors and considering the potential effect, if any, on the financial statements.

3.18 If the organization depends significantly on third-party reimbursement arrangements to carry out its program activities, the auditor also should evaluate whether the financial statements adequately disclose information related to these arrangements.

Chapter 4

Support and Capital Additions

4.01 Gifts, grants, and bequests to nonprofit organizations normally are accounted for as either support or capital additions. [FASB Statement No. 116 establishes accounting standards for contributions and applies to all entities that receive or make contributions. See paragraph 1.07.]

Support

4.02 Nonreciprocal giving in support of the activities of nonprofit organizations often is the principal resource of such organizations. This guide refers to such gifts, grants, and bequests as *support.*

4.03 Support may be unrestricted or may be subject to donor- or grantor-imposed restrictions that limit the manner or time period in which it may be used. Restrictions may be explicit in the gift instrument or implicit because of the manner in which the gift was obtained. [FASB Statement No. 116 requires not-for-profit organizations to distinguish between contributions received that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets. See paragraph 1.07.]

4.04 If the amount of the grant is based on a specific measure of service (such as grants based on research personnel hours or dedication of facilities for specified periods of time), the amounts received normally would be accounted for as service fees (see chapter 3) rather than as support. [Grants based on a specific measure of service may meet the definition of conditional promises to give set forth in FASB Statement No. 116. See paragraph 1.07.]

Capital Additions

4.05 Nonexpendable gifts, grants, and bequests restricted by the donor or grantor for endowment, plant, or loan purposes, either permanently or for a period of time, are referred to in this guide as *capital additions.* Donor or grantor restrictions may include requirements such as the following:

- A specified or indefinite period of time must elapse (such as in a term endowment or life interest gift) before the principal becomes available for other restricted or unrestricted purposes.
- The principal must be maintained in perpetuity (as in a permanent endowment gift).
- Amounts must be used for acquisitions of plant and equipment.

Forms of Gifts, Grants, and Bequests

4.06 Gifts, grants, and bequests are received in the form of (*a*) cash, (*b*) services, (*c*) securities, materials, facilities, and other nonmonetary items, and (*d*) future interests and interest-free loans.

Cash Contributions

4.07 Contributions of cash are obtained from the following:

a. Solicitations
   - By direct mail or telephone.
   - By radio or television (such as spot announcements and telethons).

- By direct contact ("in person" solicitations), including door-to-door and street contacts.

b. Unsolicited gifts and bequests.

c. Special events (such as fund-raising dinners and theater parties) or "sales" in which the organization's supporters may pay substantially more than the fair value of articles, services, or tokens of appreciation that are "sold."

d. Allotments by federated fund-raising agencies.

e. Grants from others, including foundations, trusts, and governmental units.

4.08 The audit objective in the examination of cash contributions should be to obtain reasonable assurance that such contributions have been recorded properly with regard to amount, account, and period and that they are presented in conformity with generally accepted accounting principles.

4.09 *Internal Control Structure Policies and Procedures Pertaining to Mail Receipts.* Many nonprofit organizations receive contributions by mail, and effective control over mail receipts is essential. Control may be achieved by procedures such as the following:

- Joint control of mail received by the organization—Two or more persons (1) jointly control and open all incoming mail, (2) restrictively endorse checks, (3) prepare a list in duplicate of amounts received, (4) sign the list to attest to its accuracy, and (5) send one copy of the list to the organization's accounting department for recording in the accounting records, and send the second copy of the list, with the cash receipts, to the person responsible for making the bank deposit (who should be independent of the accounting function). A person who does not have access to cash receipts compares the bank deposit record with the accounting department cash receipts record.
- Use of a bank lock box service—The organization's fund-raising solicitations direct that contributions by mail be sent to a post office box controlled by a bank. The bank opens the mail, deposits the receipts, and furnishes the organization with a list of the lock box receipts and an authenticated deposit slip.

4.10 The following procedures are sometimes used to supplement internal control structure policies and procedures pertaining to contributions received by mail:

- An outside agency may make test mailings of "contributions" that are subsequently traced into the records.
- An outside fund-raising service, having no access to cash receipts, may handle the mailing of all fund-raising literature and follow up on lack of adequate responses to campaigns.

4.11 *Control Over Direct Contact Solicitations.* If direct contact campaigns are conducted, the following are important controls:

- Appropriate supervision of the solicitors. This often is accomplished by a pyramid structure of area chairmen, division captains, neighborhood captains, and door-to-door solicitors, with each level reporting to the next higher level.

- Restriction of solicitation materials to authorized solicitors. This may involve a specific form of identification authorizing them to solicit contributions for the organization.
- Separation of physical control of cash from the accounting control over the contributions received. This separation should be achieved at the earliest possible point. For example, a door-to-door solicitor should submit a report to the neighborhood captain. The report should reconcile the contributions received (some of which may be in the form of pledges) with the cash collected. The solicitor should also send a copy of the report directly to the organization's accounting department to establish accounting control and to permit later comparison with the amounts deposited.
- Minimization of the number of persons having access to cash and of the amount of cash in any one person's control. The cash collected should be deposited in a bank at the earliest practical time (such as by the neighborhood captain).
- The use of fund-raising reports to check the results of each solicitation against street maps or other controls to ascertain that all areas and all solicitors have been accounted for.
- Preparation of summaries of all fund-raising reports, reconciliation of all reports with the organization's records, and comparison of the recorded amounts with total bank deposits.
- Accounting for all sealed containers that are used to collect cash.

4.12 Some organizations may not have adequate internal control structure policies and procedures pertaining to cash contributions. In that circumstance, it may be difficult for the auditor to obtain reasonable assurance that the amount of cash contributions is not materially misstated. If there is a significant risk that such revenue may be materially unrecorded or underrecorded, the auditor should consider the effect that this may have on his report. (See chapter 8.)

4.13 *Other Control Procedures.* Other internal control structure policies and procedures that may be appropriate for cash contributions include the following:

- Use of procedures similar to those for incoming mail to control the counting of the contents of sealed containers or of open plate collections. Containers, once collected, and open plate collections should be maintained under the joint control of two or more responsible persons until they are counted.
- Establishment of separate accountabilities for donor-restricted gifts to appropriately classify and account for them and to monitor compliance with donor restrictions.
- Use of prenumbered contribution acknowledgment forms, when practicable.
- Maintenance of a record of gifts contingent on future events (such as bequests), which is reviewed periodically.
- Budgeting of contributions that can reasonably be estimated, and investigation of differences between actual contributions and such budgeted amounts.
- Restrictive endorsement (for example, "for deposit only" to the organization's account) of all checks received by the organization

immediately upon receipt to prevent the unauthorized cashing of such checks.

- Publication of donors' names in a journal or program, and investigation of complaints from donors whose names were omitted, or the amount of whose gifts did not agree. The investigator should be a person who is independent of the contribution receiving and recording functions.

4.14 *Tests of Contributions and Grants.* These tests should include procedures to detect unrecorded or underrecorded contributions. Examples of procedures that the auditor should consider include—

- Testing for unrecorded or underrecorded contributions or grants and for unrecognized donor or grantor restrictions by (*a*) selecting names from available solicitation lists, lists of current and prior years' contributors or grantors, lists of grants for which the organization has applied, or other appropriate populations of donors or grantors (lists that are maintained independently of the accounting function should be used for this purpose); (*b*) comparing the amounts (if any) that the lists indicate have been donated in the current year with the amounts recorded in the accounting records; (*c*) requesting confirmation from the person selected of whether a contribution or grant was made and, if so, of the amount and date of the contribution or grant and whether any restrictions were placed on the use of the funds; and (*d*) comparing the confirmation replies with the organization's records.
- Testing the recording of grants received by referring to notifications from grantors and other documents.
- Comparing the names of contributors and amounts contributed that are listed in the annual journal or other publication with recorded receipts.
- Reading minutes of meetings of the governing board and appropriate committees and looking for mention of contributions and grants received. The auditor should obtain satisfaction that any such contributions and grants have been properly recorded.
- When there are direct contact solicitations, testing recapitulation schedules that summarize contributions that have been raised and comparing the totals with recorded receipts.
- Applying analytical procedures by comparing amounts received in the current period with amounts received in prior periods and with budgeted amounts (if applicable) by solicitation areas.

4.15 *Procedures Relating to Donor Restrictions.* To obtain reasonable assurance that donor restrictions have been properly recognized, the auditor should examine documents supporting gifts, grants, and bequests (such as pledge cards, correspondence, wills, and grant notifications). The auditor should review the classification of contributions between unrestricted and donor-restricted categories. (In addition, see paragraph 4.14.)

4.16 *Other General Procedures.* The following procedures should also be considered:

- Requesting confirmation from federated fund-raising organizations (that is, organizations that raise funds for distribution to other nonprofit organizations) (1) of amounts allocated to the nonprofit organization, (2) of the period(s) to which such amounts pertain, and (3) of other pertinent data, if any.

- Requesting information, including data on any restrictions, from estate administrators or legal counsel with respect to estate or bequest settlements or any other significant completed or pending contributions.
- Inquiring whether any legal requirements (such as registration or reporting) exist for states or other localities in which the nonprofit organization is engaged in fund-raising activities, and investigating whether the organization is complying with any such requirements.
- Reviewing the results of grantor audits, if any, and considering the potential effect on the financial statements.

Donated or Contributed Services

4.17 Sometimes donated or contributed services are recorded as support and expense. [FASB Statement No. 116 states that contributions of services should be recognized only if the services received (*a*) create or enhance nonfinancial assets or (*b*) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. See paragraph 1.07.]

4.18 When the auditor performs procedures with respect to donated or contributed services, the audit objective should be to obtain reasonable assurance that such services have been properly valued and recorded and that they are included as support and expense in the appropriate period.

4.19 Examples of internal control structure policies and procedures that may apply to donated or contributed services include—

- A policy statement clearly defining the types of donated or contributed services that should be accounted for and reported.
- Use of forms (such as time sheets) and other procedures for the accumulation of data relating to donated or contributed services, including subsequent review and approval by an appropriate person.
- Review and approval of the methods used and the reasonableness of the valuations assigned to donated or contributed services.

4.20 Examples of procedures that the auditor should consider include—

- Evaluating the appropriateness of the organization's policy concerning the recording of donated or contributed services.
- Obtaining a list of recorded amounts, including the name and position of the person or organization rendering the service, the gross valuation of the service rendered, the amounts paid in cash (if any), and the net contributions recorded by program or activity.
- Examining time records and other evidence supporting the amount recorded for the donated service and the program or activity that the service benefited.
- Obtaining reasonable assurance that the gross value assigned to donated services is (1) comparable to other salaries paid or consistent with local compensation levels if the services would otherwise be performed by an employee or (2) comparable to fees for similar services if professional services are donated.

Gifts of Securities, Materials, Facilities, and Other Nonmonetary Items

4.21 Donations of securities, materials, facilities (and use thereof), and other nonmonetary items (including purchases by the non-profit organization at prices significantly less than fair value) generally are recorded at fair value when received, provided the organization has a clearly measurable and objective basis for determining the value. If values are not reasonably determinable, the donations are not recorded. [FASB Statement No. 116 does not require that the organization have a "clearly measurable and objective basis for determining the value" of donated materials and facilities. See paragraph 1.07.] If donated items pass through the organization to its charitable beneficiaries and the organization serves only as an agent for the donors, the donated items usually are not recorded as support.

4.22 The audit objective in the examination of donated securities, materials, facilities, and other nonmonetary items should be to obtain reasonable assurance that:

- Donated items have been properly recorded.
- Amounts ascribed to the donated items are proper, the amounts are recorded in the appropriate period, and any associated liabilities or restrictions are recognized.
- The basis of valuation of donated items is disclosed in the financial statements.

4.23 Examples of internal control structure policies and procedures that may apply to the receipt of donated items include—

- Separation of responsibilities for receiving and recording, and establishment of accounting procedures for such items.
- Physical inspection of donated items when they are received.
- Review and approval by the governing board of methods used for determining the valuations assigned to donated items and of the reasonableness of such valuations.

4.24 Examples of procedures that the auditor should consider include—

- Obtaining a listing of recorded amounts, including name of donor, type of donation, gross valuation, amount paid in cash (in the case of a bargain purchase), and the net contribution, recorded by source or activity.
- For donated marketable securities, comparing published quotations on the date of donation with the assigned value.
- For donated securities for which market quotations are not readily available, obtaining a valuation from an investment banker or securities dealer.[2]
- For other items, obtaining reasonable assurance that the values placed on the donated items are comparable to prices paid for similar items recently acquired, are consistent with appropriate market rates, or are based on a reasonable appraisal or other expert valuation. (See SAS No. 11, *Using the Work of a Specialist.*[*])

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[2] See the AICPA audit and accounting guide *Audits of Investment Companies* for a discussion of factors to be considered when securities are valued "in good faith."

[*] The AICPA's Auditing Standards Board has voted to issue a Statement on Auditing Standards that will supersede SAS No. 11. The new SAS is expected to be issued in July 1994 and to be effective for audits of financial statements for periods ending on or after December 15, 1994.

- Reviewing receiving reports and other evidence supporting the donated items to obtain reasonable assurance that they were properly recorded.
- With respect to donated collections (such as works of art, books, and botanical specimens), reading the organization's correspondence and any newspaper clippings (the nonprofit organization may keep a file of such items) for gifts of this nature, physically inspecting such gifts, and obtaining reasonable assurance that, if applicable, they have been properly recorded and disclosed.[3]
- Requesting confirmation from donors regarding the description and quantities of donated items and any restrictions imposed on them.

Future Interests and Interest-Free Loans

4.25 Donors may give nonprofit organizations various types of future interests, such as:

- *Life income gifts*—resources made available to the nonprofit organization with the donor restriction that the organization pay the income earned thereon to designated beneficiaries for a specified period of time (usually the lives of the designated beneficiaries).
- *Annuity gifts*—similar to life income gifts, except that the donor requires the nonprofit organization to pay a fixed amount periodically (an annuity) to the designated beneficiaries.
- *Unitrust gifts*—gifts in which the donor retains some rights (usually not in the entirety) in either the principal or income.

In certain jurisdictions, the acceptance of an annuity by a nonprofit organization is subject to the regulations of a governmental agency, which may stipulate the conditions under which annuities can be accepted, designate the types of investments that can be made with annuity funds, and require that the investments (or other security) be deposited with a governmental agency.

4.26 In addition, funds may be made available to the nonprofit organization interest-free, to be repaid either on demand or after a specified period. The earnings and sometimes the principal amounts of these funds are available for use (restricted or unrestricted) by the organization.

4.27 When the auditor is performing procedures with respect to gifts of future interests and interest-free loans, the audit objective should be to obtain reasonable assurance that:

- Such gifts and loans have been properly recorded.
- Amounts ascribed to such gifts are proper and recorded in the appropriate period, and any significant associated liabilities or restrictions are recognized.
- The basis of valuation of the gifts is disclosed in the financial statements.

4.28 Examples of internal control structure policies and procedures that may relate to gifts of future interests include—

- Establishment of procedures to adequately identify, segregate, record, and control the cash and investments of these gifts in compliance with applicable restrictions.

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[3] See chapter 5 for a discussion of valuing collections of art and similar items.

- Maintenance of records for each gift, including such information as the nature of the principal, the restrictions on investment or on the uses of principal or income, and the termination dates of such restrictions. This may involve the maintenance of an up-to-date register for each of these gifts, as well as individual files of correspondence with donors and their representatives and copies of bequests and other documents pertinent to the administration of each gift.
- Establishment of controls to properly record and distribute the income from such gifts.
- Establishment of procedures to determine the termination of required payments to beneficiaries of life income and annuity funds.

4.29 Examples of procedures that the auditor should consider include—

- Reading the agreements under which gifts of future interests were received, tracing the amounts of such gifts from the donor agreements or other original documents to the accounting records, and, in the case of annuity-type gifts, testing the computation and recording, if appropriate, of the annuity liability.
- Obtaining reasonable assurance that the requirements of any applicable governmental regulatory agencies are being observed.
- Testing distributions to beneficiaries to obtain reasonable assurance that they were made in accordance with the applicable agreements, and requesting confirmation from the beneficiaries of amounts received.
- Reviewing procedures and supporting documentation (such as death certificates and obituaries) for determining when required payments to beneficiaries of life income and annuity funds should be discontinued.
- When restrictions on gifts of future interests terminate, examining the supporting documentation and reviewing the propriety of subsequent accounting for such gifts.
- Obtaining reasonable assurance that imputed interest, if any, has been properly calculated for interest-free loans.

Chapter 5

Assets

Types of Assets of Nonprofit Organizations

5.01 Many assets of nonprofit organizations (such as cash, receivables, and marketable securities) are similar to those found in profit-oriented organizations. Accordingly, the auditor's objectives, the internal control structure policies and procedures, and the auditing procedures for these assets are in most respects the same as those for assets of profit-oriented organizations.

5.02 Nonprofit organizations may have restricted resources and assets with unique characteristics, however, such as the following:

- Pledges or grants receivable.
- Historic or restored buildings that are landmarks or works of art and are used for display rather than for operating or investment purposes.
- Collections of art, first editions and other valuable books, plants, animals, and other unique assets.

Restricted Resources

5.03 Many nonprofit organizations receive resources (such as endowments and plant funds) subject to donor-imposed restrictions. Such restrictions ordinarily are in the form of limitations on the use of principal or income, which in the case of term endowments lapse at some future time. In addition, donors or regulatory agencies sometimes stipulate that the donated resources must be segregated from other assets. For example, the provisions of applicable law frequently require the segregation of resources given subject to an annuity agreement. When there is no requirement to segregate the assets, they sometimes are commingled (or pooled) with those of other restricted or unrestricted funds of the organization.

5.04 Many nonprofit organizations segregate certain assets according to fund groupings. This action frequently is taken with respect to assets of endowment, annuity, and life income funds of a restricted nature. In addition to those procedures with respect to gifts of assets subject to donor restriction discussed in chapter 4, the auditor should:

- Be aware of legal requirements pertinent to restricted resources. It may be necessary to obtain information from legal counsel and to request confirmation from other third parties about the requirements for segregation of assets.
- Obtain reasonable assurance that the organization has complied with the restrictions imposed by the donor or other third party and that significant restrictions are disclosed in the financial statements.

Investment Pools

5.05 Nonprofit organizations frequently pool investments of various funds. The income from such investments, and the realized and unrealized gains and losses on the investments, should be allocated equitably to the participating funds.

5.06 With respect to investment pools, the auditor should consider whether there are any restrictions (by donors or regulatory agencies) that would prohibit the pooling of investments of certain funds, whether there are appropriate controls over the allocations to participating funds of investment income and of realized and unrealized gains or losses, and whether the method of computing such allocations is appropriate. In addition, the auditor should consider testing the computation of such allocations.

Grants, Reimbursements, and Pledges Receivable

5.07 Many nonprofit organizations have receivables in the form of (1) grants and third-party reimbursements from governmental units and other organizations and (2) pledges from contributors. With respect to grants, reimbursements, and pledges receivable, the auditor should:

- Obtain reasonable assurance that grants, reimbursements, and pledges are properly reflected in the financial statements.
- Apply procedures similar to those used in the examination of other receivables (such as requesting confirmations) and consider the applicable portions of SAS No. 67, *The Confirmation Process.*
- Obtain reasonable assurance that the allowance for uncollectible pledges (or grants or reimbursements, if applicable) is reasonable. Factors to be considered include the age of the pledges (or grants), the organization's past collection experience, its policy with respect to the enforcement of the pledge obligation, and the credit standing of the donors (or grantors).

Property and Equipment

5.08 Nonprofit organizations' property and equipment may be acquired by purchase, donation, or lease. The amount and type of the investment in property and equipment vary significantly among nonprofit organizations. For example, a trade association or political party may own only furniture and office equipment; a private school or a public broadcasting company may have significant amounts invested in buildings and equipment; a country club or botanical garden may have major investments in land improvements, and a performing arts organization may have items such as sets and costumes. In addition, title to fixed assets acquired with certain restricted funds, especially from government grants, often must be returned to the granting agency.

5.09 Examples of auditing procedures that the auditor should consider in addition to those that he would otherwise apply include

- Reviewing compliance with any restrictions imposed by donors, grantors, or government agencies on the uses or dispositions of donated property and equipment.
- When assets not previously capitalized are being capitalized for the first time, reviewing the basis used to record the assets. If appraisals have been used, the guidance provided in SAS No. 11, *Using the Work of a Specialist,** should be followed.
- Reviewing the proper disposition of assets acquired with donor-restricted funds.

Collections of Works of Art and Similar Items

5.10 Donors frequently make gifts of works of art and similar items to museums, libraries, schools, churches, and other nonprofit organizations. It is

* The AICPA's Auditing Standards Board has voted to issue a Statement on Auditing Standards that will supersede SAS No. 11. The new SAS is expected to be issued in July 1994 and to be effective for audits of financial statements for periods ending on or after December 15, 1994.

often impracticable, however, to value these gifts, and, accordingly, they often are not capitalized. In addition, these items may be purchased either with unrestricted resources or with resources donated specifically for such purposes. Some nonprofit organizations recognize values for such items on their balance sheets. [FASB Statement No. 116 requires that collections that are not capitalized (1) be held for public exhibition, education or research in furtherance of public service rather than financial gain, (2) be protected, kept unencumbered, cared for, and preserved, and (3) be subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for the collection. Collections that do not meet those criteria must be capitalized. See paragraph 1.07.]

5.11 Organizations acquiring these items ordinarily should catalogue (such as by maintaining a register of accessions or otherwise identifying and describing the objects acquired), control (by assigning an identification number and placing an identification tag or mark on the item), and provide adequate physical safeguards from theft or damage for such items. Periodic inventories of such assets should be taken (using the identification numbers) and reconciled with the register of accessions.

5.12 With respect to collections of works of art and similar items, examples of auditing procedures that the auditor should consider include

- Evaluating the procedures for recording accessions and deaccessions and inspecting approvals or acknowledgments to donors of the acquired items.
- Obtaining reasonable assurance that the valuation basis on the balance sheet is appropriate and that such basis is disclosed.
- Evaluating the procedures for controlling the collections and for periodically conducting a physical inventory of them. If the value of the collections is included in the financial statements, the auditor should consider observing the physical inventory or otherwise obtaining reasonable assurance that the collections exist.

Chapter 6

Liabilities, Deferred Revenue and Support, and Fund Balances

Liabilities

6.01 Liabilities of nonprofit organizations generally are similar to those of profit-oriented organizations. Accordingly, the audit objectives, the internal control structure policies and procedures, and the auditing procedures that should be considered for liabilities are in most respects the same as those applicable for liabilities of profit-oriented organizations.

6.02 Liabilities of nonprofit organizations that have unusual characteristics include tax-deferred annuities for employees and interfund borrowings, which are discussed in this chapter, and refunds due to third parties for amounts collected under reimbursement agreements, which are discussed in chapter 3.

Tax-Deferred Annuities

6.03 Nonprofit entities organized under Internal Revenue Code section 501(c)(3) may adopt tax-deferred annuity plans for their employees. Such plans, which are covered in Internal Revenue Code section 403(b), may be noncontributory, or the employees may contribute to the plan. The nonprofit organization is responsible for the accuracy of the calculation of the amount that may be contributed to the plan annually for each employee. The auditor, in addition to considering the organization's compliance with the Employee Retirement Income Security Act of 1974, should review the calculation of the maximum annual contribution permitted by the Internal Revenue Code. In addition, the auditor should review the actuary's report and compare the calculation of the maximum annual contribution with the recorded expense to see that the accounting treatment conforms to generally accepted accounting principles.

Interfund Borrowings

6.04 Nonprofit organizations may transfer amounts among funds either temporarily (borrowings) or permanently (transfers).

6.05 A governing board may authorize borrowings from endowment or other restricted funds. When it becomes evident that contemplated sources of funds for repayment are not readily available, such interfund borrowings generally are considered permanent and are recorded as transfers. There may, however, be legal prohibitions against lending endowment or other restricted funds to unrestricted funds or against making such transfers.

6.06 When the auditor is performing procedures with respect to interfund borrowings, the audit objective should be to obtain reasonable assurance that the transactions are properly authorized, recorded (with the appropriate interest charge, if applicable), classified, and disclosed in the financial statements and that the organization has complied with any legal restrictions.

6.07 Examples of internal control structure policies and procedures that may apply to interfund borrowings of a nonprofit organization include procedures (*a*) for determining that borrowings are in accordance with authorizations and legal restrictions and (*b*) for periodically reviewing the collectibility of interfund balances.

6.08 Examples of procedures that the auditor should consider include—

- Obtaining reasonable assurance through inquiries of legal counsel that borrowings do not violate any legal restrictions. If the auditor becomes aware of violations of such restrictions, he should follow the guidance in SAS No. 54, *Illegal Acts by Clients.*
- Reviewing minutes of governing board meetings or other documentation for approval of borrowings.
- Obtaining reasonable assurance that interfund borrowings are recorded at the same amount in both funds.
- Evaluating the collectibility of amounts due from other funds.
- Obtaining reasonable assurance that interest accruals and payments of interfund borrowings are proper.
- Obtaining reasonable assurance that transfers have been properly classified and disclosed in the financial statements.

Deferred Revenue and Support

6.09 Deferred revenue may include items (such as membership dues and subscriptions to periodicals) that have not been earned as of the balance sheet date but that are expected to be recognized as revenue in subsequent periods. Deferred revenue items of nonprofit organizations generally are similar to those found in many profit-oriented organizations.

6.10 Deferred support may include unexpended balances of gifts, grants, and bequests restricted for specific operating purposes or for use in future periods. It also may include any unexpended balance of income earned on endowment funds that is restricted for operating purposes and any capital gifts and grants restricted for acquisition of plant assets until they are used for the intended purpose. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 1.07.]

6.11 When the auditor is performing procedures with respect to deferred revenue and support, the audit objective should be to obtain reasonable assurance that amounts applicable to future periods are recorded properly in regard to amount, account, and period.

6.12 Examples of internal control structure policies and procedures that may apply to deferred revenue and support include—

- Controls to ensure that records of the amounts and time periods to which deferred revenue relates are properly maintained.
- Controls to ensure that records of restrictions on deferred support are properly maintained and that amounts expended are appropriate.
- Establishment of procedures to review the calculation and underlying amounts of the amortization of deferred revenue.
- Periodic reviews of expenditures to determine that deferred support has been properly recognized.

6.13 Examples of procedures that the auditor should consider include—

- Examining the calculations of deferred revenue and reviewing the propriety of the amortization periods.
- Examining expenditures of deferred restricted funds to determine whether they are in compliance with the donor's or grantor's restrictions and whether the proper amounts of such restricted funds have been recognized as revenues or other additions.
- Considering whether matching requirements, if any, have been met.
- If current restricted gifts, grants, bequests, and other income are recognized as revenue, support, and capital additions to the extent that, during the period, expenditures have been made for the purposes specified by the donor or grantor (as recommended in SOP 78-10), reviewing other expenditures to determine whether any of them satisfy such restrictions and should give rise to recognition of deferred revenue and support as current-period revenues, support, or capital additions.

Fund Balances

6.14 Fund balances represent the organization's net assets and may include funds restricted by donors, such as funds for endowment, property and equipment, and loan purposes. Disclosures of the restricted portions of fund balances are made by major classifications, with individual funds being grouped with those of similar types. [FASB Statement No. 117 requires that net assets be reported in three classes—unrestricted, temporarily restricted, and permanently restricted—and requires disclosure of information about the nature and extent of restrictions. See paragraph 1.07.]

6.15 When he is performing auditing procedures with respect to fund balances, the auditor's objectives should be to obtain reasonable assurance that restricted resources have been treated in accordance with the restrictions imposed by third parties and that proper disclosure is made of the restricted and unrestricted portions of fund balances.

6.16 Examples of internal control structure policies and procedures that may apply to fund balances of nonprofit organizations include—

- Controls to ensure that records of donor-imposed restrictions are properly maintained.
- Periodic reviews for compliance with such restrictions.
- A chart of accounts that ensures proper classification and accounting for restricted funds.
- Controls to ensure that transfers are processed in accordance with board approvals.

6.17 Examples of procedures that the auditor should consider include—

- Obtaining reasonable assurance that funds are in balance.
- Examining competent evidence to support restrictions.
- Obtaining reasonable assurance that all funds included in a particular classification have similar characteristics.
- Examining documentation supporting payments and transfers to obtain reasonable assurance that they are properly approved and recorded.
- Obtaining reasonable assurance that proper segregation and disclosures are made in the financial statements.

Chapter 7

Other Matters

Affiliated Organizations

[The AICPA Not-for-Profit Organizations Committee has prepared and issued an exposure draft of a proposed statement of position that would amend the guidance concerning reporting related entities in this guide.]

7.01 The independent auditor should inquire whether there are organizations that are affiliated with, or otherwise financially related to, the organization whose financial statements are being audited. The auditor should consider whether combined financial statements are necessary for fair presentation in conformity with generally accepted accounting principles. If combined financial statements are not necessary, the auditor should consider whether appropriate disclosure of affiliations is made in the notes to the financial statements.

Related-Party Transactions

7.02 SAS No. 45, *Omnibus Statement on Auditing Standards—1983,* "Related Parties," provides guidance concerning procedures that the auditor should consider to identify related-party transactions and to obtain reasonable assurance in regard to the substance of such transactions and the accounting for them, including financial statement disclosure. (See paragraph 49 of SOP 78-10 for a discussion of related-party considerations.)

Illegal Acts by Clients

7.03 The auditor should be familiar with SAS No. 54, *Illegal Acts by Clients,* which discusses the attention that the auditor should give to the possibility that illegal acts may have occurred. SAS No. 54 also provides guidance when the auditor becomes aware of client acts that appear to be illegal.

Errors and Irregularities

7.04 The auditor also should be familiar with SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities,* which provides guidance concerning the auditor's responsibility for detecting errors and irregularities and which discusses his responsibilities when material errors or irregularities come to his attention.

Client Representations

7.05 The auditor is required to obtain certain written representations from management as part of an audit made in accordance with generally accepted auditing standards. (See SAS No. 19, *Client Representations.*) In addition to the representations contained in the illustrative letter in SAS No. 19, for nonprofit organizations the auditor should consider obtaining representations concerning the following, if applicable:

- Compliance with restrictions on resources.
- Taxation and tax-exemption status.
- Reasonableness of bases for allocation of functional expenses.
- Propriety of interfund transfers and collectibility of interfund loans.
- Inclusion of all funds under the entity's control in the financial statements.

Use of the Work of Internal Auditors

7.06 Nonprofit organizations may have internal auditors who, among other functions, may monitor the performance of an organization's controls and perform substantive procedures. Although the work of an internal auditor cannot be substituted for the work of the independent auditor, the independent auditor should consider, in accordance with SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements,* the procedures performed by internal auditors in determining the nature, timing, and extent of his own auditing procedures.

Audit Committees

7.07 Some nonprofit organizations have formal audit committees. Their responsibilities generally are similar to those of profit-oriented organizations' audit committees. SAS No. 61, *Communication With Audit Committees,* establishes a requirement for the auditor to determine that certain matters related to the conduct of an audit are communicated to audit committees.

7.08 The audit committee generally serves as liaison between the organization's governing board and the auditor. The auditor should establish a working relationship with the audit committee and should inform its members of the results of the audit, particularly the discovery of material errors and irregularities, illegal acts, or significant deficiencies in the design or operation of the internal control structure, as well as other matters described in SAS No. 61. The auditor often may be requested to attend meetings of the audit committee and to assist the committee in connection with its duties.

Other Information in Documents Containing Audited Financial Statements

7.09 Information not covered by the auditor's report may sometimes be included in a document prepared by a nonprofit organization that contains audited financial statements. For example, the organization may present a comparison of budgeted revenues and expenses with actual revenues and expenses. If such a comparison is included in the financial statements, the information ordinarily should be appropriately identified as "not covered by the auditor's report," in accordance with paragraph 46 of SAS No. 58, *Reports on Audited Financial Statements.* The organization may also present such information outside the financial statements. SAS No. 8, *Other Information in Documents Containing Audited Financial Statements,* applies to other information in published annual reports of nonprofit organizations for charitable or philanthropic purposes.

7.10 Although the auditor is not required to perform procedures on budget information beyond the requirements of the applicable SAS, he may consider comparing the budget information with the organization's approved budget.

Inclusion of Summary Financial Data in Printed Reports or Fund-Raising Literature

7.11 Frequently, nonprofit organizations include summary or condensed financial data in a printed annual report or in fund-raising literature. Such data often do not include notes and similar information necessary for presentation in conformity with generally accepted accounting principles. In such cases, an auditor should not allow his name to be associated with the data. However, a statement can be made that the data were extracted from the audited financial statements as long as the auditor is not identified. It is preferable that the statement indicate where a copy of the audited financial statements may be inspected or obtained.

Chapter 8

The Auditor's Report

8.01 For guidance concerning the form and content of the auditor's report, the auditor should consult AICPA Statements on Auditing Standards. This chapter illustrates the application of auditing standards, in specific circumstances, to reports on the financial statements of nonprofit organizations covered by the guide.

Auditor's Standard Report

8.02 When the auditor concludes that the financial statements present fairly the financial position, results of operations, and, if presented, changes in financial position, in conformity with generally accepted accounting principles consistently applied, the auditor's report might read as follows:[4]

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying balance sheet of XYZ Nonprofit Organization as of December 31, 19X2, and the related statement[s] of activity [and changes in financial position] for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Nonprofit Organization as of [at] December 31, 19X2, and the results of its operations [and the changes in its financial position] for the year then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

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[4] The term *results of operations* relates to both the results of current activities and the results of other changes in fund balances, whether presented in the form of one statement or two. Nonprofit organizations are excluded from APB Opinion No. 19, *Statement of Changes in Financial Position*. According to that opinion, a profit-oriented business entity whose financial statements purport to present both financial position and results of operations must present, as a basic financial statement, a statement summarizing changes in financial position for each period for which an income statement is presented. SOP 78-10 states that the nonprofit organizations covered by the SOP also should present statements of changes in financial position in such circumstances. (See chapter 1 for a discussion of the status of SOP 78-10.) [Note: APB Opinion No. 19 has been superseded by FASB Statement No. 95, *Statement of Cash Flows*. Not-for-profit entities are excluded from the scope of FASB Statement No. 95. FASB Statement No. 117 amends FASB Statement No. 95 to extend its provisions to not-for-profit organizations and to expand its description of cash flows from financing activities to include certain donor-restricted cash that must be used for long-term purposes. See paragraph 1.07.]

Reports on Comparative Financial Statements

8.03 Guidance concerning reports on comparative financial statements is provided in SAS No. 58, *Reports on Audited Financial Statements.* When the financial statements for each year presented are intended to present financial position, results of operations, and, if applicable, changes in financial position, the auditor's report might read as follows:

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying balance sheets of XYZ Nonprofit Organization as of December 31, 19X2 and 19X1, and the related statements of activity [and of changes in financial position] for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Nonprofit Organization as of [at] December 31, 19X2 and 19X1, and the results of its operations [and the changes in its financial position] for the years then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

8.04 When sufficient detail for prior years is not presented, footnote *27* of SAS No. 58 provides the following guidance:

> A continuing auditor need not report on the prior-period financial statements if only summarized comparative information of the prior period(s) is presented. For example, entities such as state and local governmental units and not-for-profit organizations frequently present total-all-funds information for the prior period(s) rather than information by individual funds because of space limitations or to avoid cumbersome or confusing formats. In some circumstances, the client may request the auditor to express an opinion on the prior period(s) as well as the current period. In those circumstances, the auditor should consider whether the information included for the prior period(s) contains sufficient detail to constitute a fair presentation in conformity with generally accepted accounting principles. In most cases, this will necessitate including additional columns or separate detail by fund, or the auditor would need to modify his report.

Modified Audit Reports and Disclaimers of Opinion

8.05 The following examples illustrate the guidance provided in SAS No. 58 concerning modified audit reports and disclaimers of opinion.

Scope Limitation

8.06 In some cases the audit may be limited because circumstances do not allow him to obtain reasonable assurance that all contributions have been properly recorded. For example, the independent auditor may perform all auditing procedures that he believes are practicable but, nevertheless, cannot satisfy himself that substantially all contributions are recorded. If in such circumstances the auditor has no reason to believe that possible unrecorded contributions are material enough to negate his opinion on the financial statements, he may express an opinion that is qualified in regard to the effects of any unrecorded contributions. His qualified opinion might be worded as follows:

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying balance sheet of XYZ Nonprofit Organization as of December 31, 19X2, and the related statement[s] of activity [and of changes in financial position] for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

No accounting controls are exercised over door-to-door cash collections prior to the initial entry of such contributions in the accounting records. Accordingly, it was impracticable to extend our audit of such receipts beyond the amounts recorded.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the collections of cash contributions referred to above been susceptible to satisfactory audit tests, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of XYZ Nonprofit Organization as of [at] December 31, 19X2, and the results of its operations [and the changes in its financial position] for the year then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

8.07 When the auditor, after investigation, has reason to believe that the unrecorded amounts may be great enough to negate his opinion on the financial statements, he should disclaim an opinion on the financial statements. His disclaimer might be worded as follows:

Independent Auditor's Report

[*Addressee*]

We were engaged to audit the accompanying balance sheet of XYZ Nonprofit Organization as of December 31, 19X2, and the related statement[s] of activity [and of changes in financial position] for the year then ended. These financial statements are the responsibility of the Organization's management.

[*Second paragraph of the standard report should be omitted*]

No accounting controls are exercised over door-to-door cash collections prior to the initial entry of such contributions in the accounting records. Accordingly, it was impracticable to extend our audit of such receipts beyond the amounts recorded.

Since we were unable to satisfy ourselves concerning the amounts of cash contributions, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

[*Signature*]

[*Date*]

Departure From Generally Accepted Accounting Principles

8.08 The auditor should determine whether the effects of a departure from generally accepted accounting principles require a qualified or an adverse opinion. In making a judgment concerning the materiality of the departure, the auditor should consider factors such as the dollar magnitude of the effects, the significance of the item to the organization, the pervasiveness of the misstatement, and the impact of the misstatement on the financial statements taken as a whole.

8.09 The following is an example of report language that might be used when there has been a departure from generally accepted accounting principles, such as the organization's failure to record the fair value of a material amount of donated marketable securities when the organization has a clearly measurable and objective basis for determining the value. For illustrative purposes, it is assumed that the financial statements are comparative but the departure from generally accepted accounting principles did not affect the financial statements for the prior year (19X1) and that the auditor concludes that a qualified opinion is appropriate for the current year. The explanatory and opinion paragraphs might read as follows:

Independent Auditor's Report

[*Addressee*]

[*Same first and second paragraphs as the standard report*]

The Organization does not record donated marketable securities as contributions until they are sold, at which time the proceeds from the sale of the securities are recorded as a contribution. As a result, certain marketable securities received as donations during 19X2 that were not sold prior to year-end were not recorded at December 31, 19X2. In our opinion, generally accepted accounting principles require that such donated marketable securities be recorded at their fair value at the date they are received. If such donated marketable securities were recorded, investments in marketable securities and the unrestricted fund balance would be increased by $____ as of December 31, 19X2, and contributions and the excess of support and revenue over expenses [*expenses over support and revenue*] would be increased [*decreased*] by $________ for the year then ended.

In our opinion, except for the effects on the 19X2 financial statements of not recording certain donated marketable securities received as contributions, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Nonprofit Organization as of [at] December 31, 19X2 and 19X1, and the results of its operations [and the changes in its financial position] for the years then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

Inconsistent Application of Accounting Principles

8.10 Guidance concerning reporting when there have been accounting changes is provided in SAS No. 58, *Reports on Audited Financial Statements.* Paragraph 59 of SAS No. 58 states that the auditor should evaluate a change in accounting principle to satisfy himself that (*a*) the newly adopted accounting principle is a generally accepted accounting principle, (*b*) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, and (*c*) management's justification for the change is reasonable. If a change in accounting principle does not meet these conditions, the auditor's report should so indicate, and his opinion should be appropriately qualified. If a change in accounting principle does meet the conditions described above, the auditor should not qualify his opinion because of the change, but should add an explanatory paragraph to the standard report. The following is an example of an appropriate explanatory paragraph in such circumstances:

Independent Auditor's Report

[*Same first, second, and third paragraphs as the standard report*]

As discussed in Note X to the financial statements, the Organization changed its method of accounting for marketable securities in 19X2.

[*Signature*]

[*Date*]

8.11 Such an explanatory paragraph in the auditor's report is required in reports on financial statements of subsequent years as long as the year of the change is presented and reported on. However, if the accounting change is accounted for by retroactive restatement of the financial statements affected, the additional paragraph is required only in the year of the change since, in subsequent years, all periods presented will be comparable.

8.12 If a change in accounting principle is made to adopt the recommendations of SOP 78-10, the SOP states that the changes should be applied retroactively by prior-period adjustment. Thus, in those circumstances, the explanatory paragraph is required only in the year of change.

Uncertainties

8.13 Nonprofit organizations, like business entities, may be affected by uncertainties. Uncertainties may include, for example, the outcome of litigation, claims involving disallowed costs under contracts or grants, and challenges to the tax-exempt status of the organization.

8.14 If the auditor concludes that there is a material uncertainty, reporting guidance is provided in SAS No. 58, *Reports on Audited Financial Statements.* In addition, although questions about an entity's continued existence are more closely associated with the activities of business enterprises, a question about the ability of a nonprofit organization to continue may arise. Circumstances may cause an auditor to question a nonprofit organization's ability to meet its obligations as they become due without substantial disposal of assets, restructuring of debt, externally forced revisions of its programs, or similar actions. When there is substantial doubt about a nonprofit organization's ability to continue as a going concern, the auditor needs to consider the information contrary to the ordinary assumption that the organization will continue and any related mitigating factors. SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern,* provides guidance on such considerations and on the auditor's reporting responsibilities in those circumstances.

Special Reports

8.15 Special reports are those issued in connection with:

- Financial statements that are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles.
- Specified elements, accounts, or items of a financial statement.
- Compliance with aspects of contractual agreements or regulatory requirements related to audited financial statements.
- Financial information presented in prescribed forms or schedules that require a prescribed form of auditor's report.

Guidance with respect to these reports is provided by SAS No. 62, *Special Reports.*

8.16 The following is an example of report language that might be used when reporting on financial statements prepared on a statutory basis of accounting that differs from generally accepted accounting principles:

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statement of assets, liabilities, and fund balances—statutory basis of XYZ Nonprofit Organization as of December 31, 19X2, and the related statements of support, revenue, and expenses and changes in fund balances—statutory basis and of functional expenses—statutory basis for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note X, these financial statements were prepared in conformity with the accounting practices prescribed or permitted by the [*name of regulatory agency*], which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and fund balances of XYZ Nonprofit Organization as of [at] December 31, 19X2, and its support, revenue, and expenses, and the changes in its fund balances for the year then ended, on the basis of accounting described in Note X.

This report is intended solely for the information and use of the board of directors and management of XYZ Nonprofit Organization and for filing with the [*name of regulatory agency*] and should not be used for any other purpose.[5]

[*Signature*]

[*Date*]

8.17 A government regulatory agency may require a nonprofit organization to file with it financial statements using certain accounting principles that are generally accepted but that differ from the generally accepted accounting principles normally used by the organization for public reporting. In such cases, the auditor may wish to change the first sentence of the

[5] This form of reporting is appropriate even though the regulatory agency may make the auditor's report a matter of public record.

explanatory paragraph to read as follows: "As explained in Note X, the accompanying financial statements are prepared on the basis of accounting prescribed by the [government regulatory agency], which differs in some respects from the generally accepted accounting principles followed by the organization."

8.18 Some nonprofit organizations may find that financial statements prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, such as the cash basis or modified cash basis, are adequate for their needs (see chapter 1). The following is an example of the report language that might be used when reporting on financial statements prepared on a modified cash basis.

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statement of assets, liabilities, and fund balances—modified cash basis of XYZ Nonprofit Organization as of December 31, 19X2, and the related statements of support, revenue, and expenses—modified cash basis and of changes in fund balances—modified cash basis for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note X, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities of XYZ Nonprofit Organization as of [at] December 31, 19X2, and its support, revenue and expenses, and the changes in its fund balances for the year then ended, on the basis of accounting described in Note X.

[*Signature*]

[*Date*]

8.19 The following illustrates a report on a statement of cash receipts and disbursements:

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statement of cash receipts and disbursements of ABC Association for the years ended December 31, 19X2 and 19X1. This financial statement is the responsibility of the Association's management. Our responsibility is to express an opinion on this financial statement based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note X, this financial statement was prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the cash receipts and disbursements of ABC Association for the years ended December 31, 19X2, and 19X1.

[*Signature*]

[*Date*]

Reporting on the Financial Statements of a Component of a Nonprofit Organization

8.20 An auditor may be engaged to express an opinion on the financial statements of a component of a nonprofit organization presented separately from the financial statements of the organization as a whole.[6] SAS No. 62, states that the term *financial statements* refers to a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in conformity with a comprehensive basis of accounting.

8.21 If the auditor has not audited the financial statements of the entire organization, he may have to apply additional procedures to obtain reasonable assurance that transactions relating to the component are not recorded in the records of other parts of the organization. In addition, the auditor would have to obtain information concerning other matters, such as transactions with other components and allocations of common costs, that could affect the presentation of the financial statements of the component and the disclosures therein. Thus, auditing procedures often may have to be applied with respect to the records pertaining to the other components of the nonprofit organization. Also, the auditor generally should obtain representations from the management of the organization that there were no material transactions or other matters applicable to the component being examined that have not been properly recorded in the underlying accounting records or disclosed in the financial statements of that component.

8.22 The financial statements of the component should clearly indicate what part of the organization is included and, when misunderstanding could result, what parts are not included. For example, the financial statements generally should disclose such matters as the existence of affiliated or controlling interests and the nature and volume of material transactions (individually or in the aggregate) with related parties, including any services either performed or received for a nominal charge or without charge and any allocations of common expenses.

8.23 In other circumstances, the auditor may be engaged to express an opinion on a special-purpose financial presentation (see SAS No. 62), such as a statement of revenue and allowable expenses relating to an individual grant. When the auditor is asked to report on these types of presentations, the measurement of materiality for purposes of expressing an opinion should be related to the presentations taken as a whole (see SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*). Further, the presentations should differ from complete financial statements only to the extent necessary to meet the special purposes for which they were prepared. In addition, when these financial presentations contain items that are the same as, or similar to, those contained in a full set of financial statements prepared in conformity with generally accepted accounting principles, similar informative disclosures are appropriate. The auditor should also be satisfied that the financial statements presented are suitably titled to avoid any implication that the special-purpose financial statements on which he or she is reporting are intended to present financial position, results of operations, or changes in financial position.

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[6] For organizations covered by this guide, a component may be in the form of a branch, operation, or fund, provided that its assets, results of operations, and activities can be clearly distinguished, physically and operationally and for financial reporting purposes, from the other assets, results of operations, and activities of the organization.

8.24 Examples of auditor's reports on the financial statements of a component of a nonprofit organization follow.

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying balance sheet of the Washington Branch Office of the XYZ Trade Association as of June 30, 19X2, and the related statement[s] of revenues and expenses and changes in home office account [and of changes in financial position] for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Washington Branch Office of XYZ Trade Association as of [at] June 30, 19X2, and the results of its operations [and the changes in its financial position] for the year then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statement of assets and liabilities of the Blank Street Center of the XYZ Nonprofit Organization as of June 30, 19X2, and the related statement of revenues and expenses for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities of the Blank Street Center of the XYZ Nonprofit Organization at June 30, 19X2, and its revenues and expenses for the year then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

Independent Auditor's Report

[*Addressee*]

We have auditied the accompanying statement of assets, liabilities, and fund balance of the Endowment Fund of XYZ Nonprofit Organization as of September 30, 19X2, and the related statement of changes in the fund balance for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities and fund balance of the Endowment Fund of XYZ Nonprofit Organization as of [at] September 30, 19X2, and the changes in its fund balance for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note X, the financial statements being presented are only for the fund referred to above and do not include the assets, liabilities, and fund balances and the support, revenue, expenses, and capital additions of XYZ Nonprofit Organization that are recorded in its [*list funds not presented*]. Accordingly, the accompanying financial statements are not intended to present the financial position of XYZ Nonprofit Organization as of [at] December 31, 19X2, or its results of operations [and changes in fund balances] for the year then ended in conformity with generally accepted accounting principles.[7]

[*Signature*]

[*Date*]

8.25 The following is an example of an auditor's report on a special-purpose financial presentation:

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statement of grant revenues and allowable expenses of the XYZ Nonprofit Organization for the year ended March 31, 19X2, pursuant to grant no. 78743, described in Note X, between XYZ Nonprofit Organization and the grantor, dated January 1, 19XX. This statement is the responsibility of the Organization's management. Our responsibility is to express an opinion on this statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying statement was prepared for the purpose of complying with the provisions of grant no. 78743 as described in Note X and is not intended to be a complete presentation of the Organization's revenues and expenses.

In our opinion, the statement of grant revenues and allowable expenses referred to above presents fairly, in all material respects, the grant revenues and allowable expenses of XYZ Nonprofit Organization for the year ended March 31, 19X2, pursuant to the grant referred to above in accordance with generally accepted accounting principles.

[*Signature*]

[*Date*]

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[7] Financial statements of one or more separate funds, but not all the funds, may have the appearance of presenting the complete financial position of the nonprofit organization. As a result, reports on such financial statements should include an explanatory paragraph describing the incomplete nature of the financial presentation.

Appendix A

Statement of Position 78-10

Accounting Principles and Reporting Practices for Certain Nonprofit Organizations

December 31, 1978

A Proposed Recommendation to the Financial Accounting Standards Board

Issued by
Accounting Standards Division

American Institute of
Certified Public Accountants

AICPA

This edition includes Statement of Position (SOP) 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations,* as it was originally published in 1978, and SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal,* issued by the Accounting Standards Division in August 1987. In using SOP 78-10, readers should refer to SOP 87-2, which amends paragraph 97 of SOP 78-10.

In June 1993, the FASB issued Statements of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made,* and No. 117, *Financial Statements of Not-for-Profit Organizations.* FASB Statement No. 116 establishes accounting standards for contributions and applies to all entities that receive or make contributions. FASB Statement No. 116 is effective for financial statements issued for fiscal years beginning after December 15, 1994 and interim periods within those fiscal years, except for not-for-profit organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It is effective for annual financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Some of the guidance in those Statements is inconsistent with guidance in this SOP. The AICPA Not-for-Profit Organizations Committee is currently developing a new Audit and Accounting Guide for not-for-profit organizations which is expected to supersede this SOP and provide new guidance that is in conformity with the FASB Statements. Guidance in FASB Statements No. 116 and No. 117 that is inconsistent with guidance in this SOP supersedes the guidance in this SOP, as of the application date of those Statements.

This edition of the SOP includes annotations that are intended to make readers aware of differences between the accounting principles prescribed by this guide and those in FASB Statements No. 116 and No. 117. Preparers of financial statements of organizations that adopt FASB Statements No. 116 and No. 117 may find the annotations useful, but should also read the Statements themselves. Organizations that have not yet adopted FASB Statements No. 116 and No. 117 may find the annotations useful to point out areas in which potential changes may be necessary when the Statements are adopted.

NOTICE TO READERS

Statements of Position of the Accounting Standards Division present the conclusions of at least a majority of the Accounting Standards Executive Committee, which is the senior technical body of the AICPA authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report,* identifies AICPA Statements of Position as sources of established accounting principles that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this Statement of Position should be used or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances. However, an entity need not change an accounting treatment followed as of March 15, 1992 to the accounting treatment specified in this Statement of Position.

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Accounting Principles and Reporting Practices for Certain Nonprofit Organizations

Introduction

1. The American Institute of Certified Public Accountants has issued the following industry audit guides applicable to certain types of nonprofit organizations.

- *Audits of Providers of Health Care Services*
- *Audits of Colleges and Universities*
- *Audits of Voluntary Health and Welfare Organizations*
- *Audits of State and Local Governmental Units*

2. However, many nonprofit organizations are not covered by any of those guides. This statement of position is issued to recommend financial accounting principles and reporting practices for nonprofit organizations not covered by existing guides that prepare financial statements in conformity with generally accepted accounting principles. This statement is not intended to supersede or amend any of the listed guides. For numerous nonprofit organizations, complex accounting may be neither practical nor economical, and reporting based on cash receipts and disbursements or some other basis may be adequately informative. Under those circumstances, special-purpose financial reports should be prepared.

2a. In June 1993, the FASB issued Statements of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117, *Financial Statements of Not-for-Profit Organizations*. FASB Statement No. 116 establishes accounting standards for contributions and applies to all entities that receive or make contributions. FASB Statement No. 116 is effective for financial statements issued for fiscal years beginning after December 15, 1994 and interim periods within those fiscal years, except for not-for-profit organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It is effective for annual financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. Some of the guidance in those Statements is inconsistent with guidance in this SOP. The AICPA Not-for-Profit Organizations Committee is currently developing a new Audit and Accounting Guide for not-for-profit organizations which is expected to supersede this SOP and provide new guidance that is in conformity with the FASB Statements. Guidance in FASB Statements No. 116 and No. 117 that is inconsistent with guidance in this SOP supersedes the guidance in this SOP, as of the application date of those Statements.

2b. This edition of the SOP includes annotations that are intended to make readers aware of differences between the accounting principles prescribed by this guide and those in FASB Statements No. 116 and No. 117. Preparers of financial statements of organizations that adopt FASB Statements No. 116 and No. 117 may find the annotations useful, but should also read the Statements themselves. Organizations that have not yet adopted FASB Statements No. 116 and No. 117 may find the annotations useful to point out areas in which potential changes may be necessary when the Statements are adopted.

3. The provisions of this statement need not be applied to immaterial items.

4. A number of terms with specialized meanings are used throughout this statement and are defined in Appendix A.

5. This statement of position applies to all nonprofit organizations not covered by the guides listed in paragraph 1, other than those types of entities that operate essentially as commercial businesses for the direct economic benefit of members or stockholders. Examples of the latter category are employee benefit and pension plans, mutual insurance companies, mutual banks, trusts, and farm cooperatives. Although this list is not all-inclusive, the following organizations are among those covered by this statement:

Cemetery organizations

Civic organizations

Fraternal organizations

Labor unions

Libraries

Museums

Other cultural institutions

Performing arts organizations

Political parties

Private and community foundations

Private elementary and secondary schools

Professional associations

Public broadcasting stations

Religious organizations

Research and scientific organizations

Social and country clubs

Trade associations

Zoological and botanical societies

6. This statement of position applies to many diverse organizations. Some believe that separate accounting guidelines should be issued that fit the special requirements of each type of organization. Others, however, have criticized the published guides and this statement of position because of inconsistencies among the guides, contending that many of the inconsistencies cannot be justified. The accounting standards division believes that continuing to publish separate accounting papers or guidelines for different types of organizations would proliferate accounting practices unnecessarily. Similar transactions generally should be treated similarly by all organizations. The accounting standards division believes that it has considered the principal special requirements or conditions of the organizations covered by this statement of position and has provided special rules or exceptions where deemed appropriate.

7. Some have contended that the division has not sufficiently considered the costs and efforts involved in implementing its recommendations—especially for smaller organizations. Some organizations may believe that special-purpose reports prepared on a basis other than generally accepted accounting principles better serve their needs—especially in light of the relationship between costs and benefits; these recommendations do not preclude such organizations from continuing to use appropriate special-purpose reports.

Users of Financial Statements

8. A wide variety of persons and groups are interested in the financial statements of nonprofit organizations. Among the principal groups are (a) contributors to the organization, (b) beneficiaries of the organization, (c) the organization's trustees or directors, (d) employees of the organization, (e) governmental units, (f) the organization's creditors and potential creditors, and (g) constituent organizations.

9. A principal purpose of a nonprofit organization's financial statements is to communicate the ways resources have been used to carry out the organization's objectives. It requires reporting the nature and amount of available resources, the uses made of the resources, and the net change in fund balances during the period. In addition, while adequate measures of program accomplishment generally are not available in the context of present financial statements, the financial statements should identify the organization's principal programs and their costs. A third aspect of financial reporting for nonprofit organizations is disclosure of the degree of control exercised by donors over use of resources. A fourth aspect is that the financial statements of a nonprofit organization should help the reader evaluate the organization's ability to carry out its fiscal objectives.

10. The division has prepared this statement of position based on the foregoing concepts as a guide to preparing financial statements to be used primarily by persons outside the management of the organization. It recognizes that financial statements prepared for use by management or members of the governing board often require more detail than is prescribed in this statement.

Accrual Basis of Accounting

11. The accrual basis of accounting is widely accepted as providing a more appropriate record of all an entity's transactions over a given period of time than the cash basis of accounting. The cash basis or any basis of accounting other than the accrual basis does not result in a presentation of financial information in conformity with generally accepted accounting principles. Accordingly, financial statements of nonprofit organizations represented as being in conformity with generally accepted accounting principles should be prepared using the accrual basis of accounting.[1]

12. For example, under accrual basis accounting, goods and services purchased should be recorded as assets or expenses at the time the liabilities arise, which is normally when title to the goods passes or when the services are received. Encumbrances representing outstanding purchase orders and other commitments for materials or services not yet received are not liabilities as of the reporting date and should not be reported as expenses nor included in

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[1] Some organizations keep their books on a cash basis throughout the period and, through adjustment at the end of the period, prepare statements on the accrual basis. The requirement is only that the financial statements be presented on the accrual basis and not that the books be kept on that basis throughout the period.

liabilities on the balance sheet. However, significant commitments should be disclosed in the notes to the financial statements, and an organization may designate in its balance sheet the portion of the fund balance so committed.

13. For numerous nonprofit organizations, complex accounting procedures may be neither practical nor economical, and reporting based essentially on cash receipts and disbursements may be adequately informative. If financial statements prepared on the cash basis are not materially different from those prepared on the accrual basis, the independent auditor may still be able to conclude that the statements are presented in conformity with generally accepted accounting principles. Otherwise, cash basis financial statements should be considered to be special purpose financial statements and should be reported on accordingly.

Fund Accounting

14. Many nonprofit organizations receive resources restricted for particular purposes. To facilitate observance of limitations, the accounts are often maintained using fund accounting, by which resources are classified for accounting and reporting purposes into funds associated with specified activities or objectives. Each fund is a separate accounting entity with a self-balancing set of accounts for recording assets, liabilities, fund balance, and changes in the fund balance. Although separate accounts are maintained for each fund, the usual practice in preparing financial statements is to group funds that have similar characteristics.

15. The division believes that reporting on a fund accounting basis may be helpful where needed to segregate unrestricted from restricted resources. If an organization has restricted resources and elects not to report on a fund accounting basis, the financial statements should disclose all material restrictions and observe the specific requirements indicated in paragraphs 16 through 41, "Basic Financial Statements." [FASB Statement No. 117 permits the use of fund accounting, but does not recognize it as a necessary part of financial reporting. See paragraph 2a.]

Basic Financial Statements

16. The basic financial statements, including related notes, of nonprofit organizations covered by this statement are—

- Balance sheet
- Statement of activity
- Statement of changes in financial position

[FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It requires that all not-for-profit organizations provide a statement of financial position, a statement of activities, and a statement of cash flows. It requires reporting amounts for the organization's total assets, liabilities, and net assets in a statement of financial position; reporting the change in an organization's net assets in a statement of activities; and reporting the change in its cash and cash equivalents in a statement of cash flows. FASB Statement No. 117 requires classification of an organization's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. It requires that the amounts for each of three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities. See paragraph 2a.]

17. The balance sheet is intended to present financial position. The statement of activity, including changes in fund balances, is intended to present results of operations. However, when it is intended that the financial statements present both financial position and results of operations, all three statements listed in paragraph 16 should be presented.

18. Although the division has identified the basic financial statements to be prepared, for the most part, it does not prescribe specific titles or formats. Each organization should develop the statement formats most appropriate to its needs in conformity with the principles discussed in this statement. A number of illustrative financial statements are presented in Appendix C to demonstrate the diversity of formats that can be used.

Balance Sheet

19. The balance sheet should summarize the assets, liabilities, and fund balances of the organization. [FASB Statement No. 117 (paragraphs 10 through 16) sets forth basic information that is required to be included in the balance sheet of a not-for-profit organization. See paragraph 2a.]

20. An organization's unrestricted fund balance represents the net amount of resources available without restriction for carrying out the organization's objectives. Those resources include amounts designated by the board for specific purposes, undesignated amounts, and, frequently, amounts invested in operating plant. While the balance sheet may set forth amounts designated for a program or other purposes, the total of all unrestricted fund balances, other than amounts shown in a plant fund, as discussed in paragraph 22, should be shown and labeled on the balance sheet.

21. Current restricted resources and resources restricted for future acquisition of fixed assets should be reported in the balance sheet as deferred revenue until the restrictions are met. Other restricted resources such as endowment funds should be reflected separately in the fund balance section of the balance sheet. If significant, the nature of the restrictions on fund balances and deferred revenues should be described in the notes to the financial statements. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 2a.]

22. Many organizations use a separate fund to account for the investments in operating plant, art collections, rare books and manuscripts, and similar items. The sources of the funds used to acquire those assets often are a combination of unrestricted and restricted funds. It may not be clear whether assets purchased with restricted funds continue to bear the original donor restrictions. While the division believes an organization should indicate whether the fund balances are restricted or unrestricted, that may not be possible for the plant fund. Thus, the plant fund may be reported separately or combined with either the unrestricted or restricted funds, as appropriate. [FASB Statement No. 116 permits organizations to choose between two alternatives for implying time restrictions on contributions of long-lived assets and cash or other assets for the purchase of long-lived assets. See paragraph 2a.]

23. Many organizations covered by this statement have only unrestricted funds. Those organizations should classify their assets as current, fixed, and other long-term assets and should classify their liabilities as current and long-term. To be classified as "current," the assets generally should be realizable and the liabilities payable within a normal operating cycle; however, if there is no normal operating cycle or the operating cycle is less than one year, all assets expected to be converted to cash or other liquid resources within one year and all liabilities to be liquidated within one year should be classified as current.

24. Other organizations have both unrestricted and restricted funds. Frequently, the fund classifications themselves adequately disclose the current and long-term nature of the assets and liabilities. If not, a classified balance sheet should be presented.

Statement of Activity

25. Throughout this statement of position the term *statement of activity* identifies the financial statement that reports the support, revenue, capital or nonexpendable additions, and functional expense categories. The statement might carry a different title, such as *statement of support, revenue, expense, capital additions, and changes in fund balances*, or simply *statement of changes in fund balances*. The statement of activity should include the activity for the period and a reconciliation between the beginning and ending fund balances. However, an organization may prepare two separate statements: a statement of activity and a statement of changes in fund balances. Changes in fund balances should include the excess or deficiency of revenue and support over expenses after capital additions for the period, adjustments to reflect changes in the carrying amount of certain marketable securities and other investments, as discussed in paragraph 80, and the additions and deductions of interfund transfers. [FASB Statement No. 117 (paragraphs 17 through 28) sets forth basic information that is required to be included in the statement of activities of a not-for-profit organization. See paragraph 2a.]

26. The division has considered the diverse practices used to report details of financial activity. It has concluded that variations in format and presentation are appropriate, provided that the statement of activity shows the major sources and amounts of revenue and support, as well as the principal sources and amounts of additions to plant, endowment, and other capital funds. This does not prohibit an organization from reporting revenue and expenses separately from sources of support in its financial statements.

27. Nonprofit organizations derive revenues from a variety of sources—dues, sale of services, ticket sales, investment income, and so forth—but they are often not sufficient to cover the cost of providing services. Many organizations, therefore, solicit support to enable them to fulfill their program objectives. Such support may be obtained from individuals, foundations, corporations, governmental units, and other entities.

28. Certain contributions cannot be spent currently for program or supporting services because of donor or legal restrictions and have many of the characteristics of "capital." Such items include gifts, grants, and bequests to endowment, plant, and loan funds restricted either permanently or for a period of time by parties outside the organization. Those items also include investment income that has been restricted by donors and gains or losses on investments held in such funds that must be added to the principal.[2] The

[2] The division does not suggest that gains on the sales of restricted assets are legally restricted or that they cannot be used at the discretion of the organization. Those are legal questions that depend on applicable law, donor intent, or both.

accounting standards division has concluded that disclosure of those items would be useful, and they should be differentiated from items that are available for current operations. Captions such as "capital additions," or "nonexpendable additions," should be used.

29. Capital additions do not include restricted gifts, grants, bequests, or gains on the sale of assets that can be used for current activities even though the contributions have been deferred until the organization incurs an expense that satisfies the terms of the restriction, nor do they include unrestricted amounts that the board designates as nonexpendable. See paragraphs 54 through 62 for a further discussion on current restricted gifts, grants, bequests, and other income.

30. While there is wide diversity of practice, the division concluded that an "excess" line-item caption in the statement of activity is useful. Although the purpose of the organizations covered by this statement is not to make "profits" as this term is generally used, nonprofit entities can survive only if they have support, revenue, and other additions equal to or in excess of expenses. This measure is an important indictor of financial health and is therefore of interest to management, members of the governing board, donors, beneficiaries, and other users of the financial statements. Accordingly, the statement of activity should report the excess (deficiency) of revenues and support over expenses for the period. [FASB Statement No. 117 permits, but does not require, a measure of operations. See paragraph 2a.]

31. If financial activities include capital additions, there should be *two* clearly labeled "excess" line-item captions, such as "excess (deficiency) of revenue and support over expenses before capital additions" and "excess (deficiency) of revenue and support over expenses after capital additions" (alternative wording may be used).

Statement of Changes in Financial Position

32. The statement of changes in financial position provides a summary of available resources and their use during the period. [FASB Statement No. 117 amends FASB Statement No. 95, *Statement of Cash Flows,* to extend its provisions to not-for-profit organizations and to expand its description of cash flows from financing activities to include certain donor-restricted cash that must be used for long term purposes. See paragraph 2a.]

33. Many nonprofit organizations obtain their resources from contributions, borrowed money, investment income, and so forth. The statement of changes in financial position provides the user with information about both the methods of financing programs and activities and the use and investment of resources during the period.

34. The statement of changes in financial position should summarize all changes in financial position, including capital additions, changes in deferred support and revenue, and financing and investing activities.

Other Types of Fund Classifications

35. Rather than using the traditional fund accounting classifications, some organizations prefer using classifications such as expendable and nonexpendable or unrestricted and restricted in their financial statements. Such classifications are appropriate provided that all the required disclosures indicated in paragraphs 16 through 41 are met.

Columnar vs. Layered Presentation

36. The practice of presenting data by major fund groups has evolved to emphasize meaningful distinctions between the types of unrestricted and restricted resources for which an organization is accountable. Many organizations report financial position and results of activities in a multicolumn format. Others report their financial statements in a layered or "pancake" format, and still others report certain data in a columnar format and other data in a layered format. Each organization should develop the statement format most appropriate to its needs to conform with the principles discussed in this statement of position.

Totals of All Funds

37. Some organizations present their financial statements (either in columnar or layered format) only by major fund groups without showing totals of all funds. They do not consider totals of all funds to be meaningful and sometimes consider such totals to be misleading because of restrictions on the use of certain resources; however, other organizations, believing that totals are meaningful, present details by major fund groups and totals of all funds in one or more of their statements. [FASB Statement No. 117 requires the presentation of totals for the entity taken as a whole. See paragraph 2a.]

38. Certain organizations present financial statements showing only the totals of all funds and do not show the major fund groups. Organizations do that if they do not establish separate funds for reporting purposes, if the financial information concerning particular funds is not significant, or if such information can be adequately set forth in other ways in the statements or the notes.

39. Financial statements in columnar format lend themselves to presenting totals of all funds. Financial statements presented in layered format lend themselves to fund group presentations with comparative data for the preceding period.

40. The presentation of totals of all fund groups in all financial statements is preferable, although not required. In presenting such totals, the specifics of the major fund groups should also be provided, and care should be taken to assure that the captions are not misleading and that adequate information is provided concerning interfund borrowings and important restrictions on the uses of resources.

Comparative Financial Statements

41. Although it is not required, financial statements of the current period should be presented on a comparative basis with financial statements for one or more prior reporting periods. If multi-column financial statements are presented for the current period, some organizations prefer to present only summarized, total-all-funds information (in a single column) for each of the prior periods because of space limitations and to avoid the confusion that a second set of multi-column statements might cause. However, where it is intended to present financial statements of the prior periods as well as the current period in accordance with generally accepted accounting principles, care must be taken that there is sufficient disclosure in the summarized data and in the supporting notes.

Financially Interrelated Organizations

[The AICPA Not-for-Profit Organizations Committee has prepared and issued an exposure draft of a proposed statement of position that would amend the guidance concerning reporting related entities in this guide.]

42. For a reporting organization that controls another organization having a compatible purpose, it is presumed that combined or combining financial statements are more meaningful than separate statements and are usually necessary for a fair presentation in conformity with generally accepted accounting principles. *Control* means the direct or indirect ability to determine the direction of the management and policies through ownership, by contract, or otherwise.

43. The accounting standards division has considered the foregoing definition in relation to the nonprofit organizations covered by this statement of position and has concluded that it may be construed by some to be so broad, considering the structure of some nonprofit organizations, that presentation of combined financial statements might have relatively little value to users of such combined statements, particularly in relation to the cost of their preparation.

44. Nevertheless, the division has concluded that combined financial statements are necessary for informative presentation of certain financially interrelated organizations. To balance these objectives, combined financial statements should be presented if (1) control exists as defined in paragraph 42 and (2) any of the following circumstances exists:

a. Separate entities solicit funds in the name of and with the expressed or implicit approval of the reporting organization, and substantially all of the funds solicited are intended by the contributor or are otherwise required to be transferred to the reporting organization or used at its discretion or direction.

b. A reporting organization transfers some of its resources to another separate entity whose resources are held for the benefit of the reporting organization.

c. A reporting organization assigns functions to a controlled entity whose funding is primarily derived from sources other than public contributions.

The basis for combining financial statements, including the interrelationship of the combined organizations, should be disclosed in the notes to the financial statements.

45. Legally unrestricted resources held by organizations related to the reporting organization may be effectively restricted with respect to the reporting organization. In combined financial statements that include both the related organization and the reporting organization, it may be appropriate to present all resources of the related organization, both unrestricted and restricted, as restricted resources.

46. A national or international organization may have state or local chapters with varying degrees of autonomy. Affiliated organizations may be separate corporate entities or unincorporated boards, committees, or chapters. It is not intended to require a national or "parent" organization with loosely affiliated local organizations whose resources are principally derived and expended locally to combine the local organizations' financial statements with its own. The loose affiliation of the local organization would be characterized by locally determined program activities, financial independence of the local

organization, and local organization control of its assets. Therefore, combined financial statements need not be presented unless the financial relationships between the entities are as described in paragraph 44.

47. If affiliated organizations are not combined because they do not meet the combining criteria or have loosely affiliated local organizations, the existence of the affiliates and their relationships to the reporting organization should be disclosed.

48. In view of the unique and complex organizational relationships and degrees of local autonomy common in religious organizations, there may be many circumstances in which application of this section on combination would not result in meaningful financial information. Thus, if a religious organization concludes that meaningful financial information would not result from the presentation of combined financial statements, the provisions of this section need not be applied.

Related-Party Transactions

49. Contributions made to an organization by its governing board members, officers, or employees need not be separately disclosed if the contributors receive no reciprocal economic benefits.

Revenue, Support, and Capital Additions

50. The statement of activity should report revenue, support, and capital additions. Revenue and support are discussed under "Statement of Activity," paragraphs 25 through 31.

Capital Additions

51. Capital additions include nonexpendable gifts, grants, and bequests restricted by donors to endowment, plant, or loan funds either permanently or for extended periods of time. Capital additions also include legally restricted investment income and gains or losses on investments held in such funds that must be added to the principal.[3] Capital additions do not include donor-restricted gifts for program or supporting services.

52. Capital additions that are restricted for acquisition of plant assets should be treated as deferred capital support in the balance sheet until they are used for the indicated purpose. Once used, these amounts should be reported as capital additions in the statement of activity. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 2a.]

53. Some organizations may prefer to use the caption "nonexpendable additions" instead of "capital additions." As previously noted, that or other wording is acceptable.

Current Restricted Gifts, Grants, Bequests, and Other Income

54. Current restricted gifts, grants, bequests, and other income provide expendable resources that have been restricted by donors, grantors, or other

[3] See footnote 2.

outside parties to the purposes for which they may be used. Such restrictions usually involve written assertions expressed in restrictive language by one party to the other. Amounts received from appeals for restricted funds by solicitation letter, radio, television, newspaper, and so forth are generally deemed to be restricted according to the nature of the appeal. [FASB Statement No. 116 requires not-for-profit organizations to distinguish between contributions received that increase permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets. See paragraph 2a.]

55. Two alternative accounting conventions have been used for reporting current restricted resources. Some report the full amount of such resources when received as "revenue and support" in a current restricted fund column in the statement of activity, without regard to whether the resources were used or the restrictions met.[4] Unspent amounts are reported in the "excess (deficiency) of revenue and support over expenses" and included in the fund balance of the current restricted fund.

56. This accounting convention is used because restricted resources are available for current use regardless of whether they are spent, and full accountability requires that this be recognized by reflecting receipt of such resources as revenue and support. Those who disagree express concern that the recognition of such amounts as revenue and support overlooks the legal obligation to return the resources if they are not used for the restricted purpose. They further contend that large amounts received near the end of the period may significantly distort the financial statements of the organization.

57. The other accounting convention has been based on an assumption that a donee organization should not recognize such amounts as revenue until the particular resources are used for the purpose specified by the donors, since they are not "earned" until they are used and the restrictions met.[5] Under this accounting convention, receipts of current restricted funds are not reported as revenue until the resources are expended for the purpose specified. Until then, they are reported as a direct addition to the fund balance of the current restricted fund.

58. This approach may be satisfactory for restricted grants that impose conditions of discrete accountability with the requirement that unspent balances be refunded to the grantors. However, it allows management to defer recognition of restricted support as revenues although applicable expenses have been incurred.

59. The accounting standards division believes that neither accounting convention is entirely satisfactory and that the conventions should be changed based on the following concepts:

a. The recognition of the receipt of restricted funds as revenues should be determined by economic events rather than by arbitrary management decisions. The same economic events affecting two similar organizations in a similar manner should not appear to produce two different results because of differences in the management objectives.

b. For accounting purposes, donor restrictions are complied with when the organization incurs an expense for the function, program, project, or object and in the manner specified in the donative instru-

[4] This is the approach recommended by the AICPA industry audit guide *Audits of Voluntary Health and Welfare Organizations.*

[5] This is the approach recommended by the AICPA audit and accounting guides for providers of health care services and for colleges and universities.

ment or grant award unless such expense is attributable to other restricted funds.

c. Unexpended restricted funds should be reported in a manner that reflects the restrictions attached to such funds.

[FASB Statement No. 116 establishes standards for the expiration of donor-imposed restrictions. See paragraph 2a.]

60. For example, if a donor restricted a contribution or responded to an appeal for restricted contributions to be used for a specific program service and the organization subsequently, or in anticipation of receiving the restricted contributions, incurred expenses for that particular program service, the accounting standards division believes the obligation imposed by the restriction should be deemed to have been met even if unrestricted funds were used. Management should not avoid recognizing the restricted contribution as support in that period simply because it chose to use dollars attributed to unrestricted funds at the time the expense was incurred.

61. Unless the donor specifies to the contrary, the donee organization should consider only expenses incurred after the receipt of the restricted contribution as meeting the restriction. This does not apply if the donor or grantor contributes in response to an appeal that specifies that the related expenses may have already been incurred in whole or in part.

62. The division has concluded, therefore, that current restricted gifts, grants, bequests, and other income should be accounted for as revenue and support in the statement of activity to the extent that expenses have been incurred for the purpose specified by the donor or grantor during the period. The balances should be accounted for as deferred revenue or support in the balance sheet outside the fund balance section until the restrictions are met. The specific language in the donative instrument or grant award should govern whether restrictions have been met. Recognition of expenses that satisfy donor restrictions results in recognition of equivalent amounts of revenue or support in that period. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 2a.]

Unrestricted Gifts, Grants, and Bequests

63. Unrestricted gifts, grants, and bequests should be reported in the unrestricted fund in the statement of activity above the caption "excess (deficiency) of revenue and support over expenses before capital additions."

Pledges

64. Pledges an organization can legally enforce should be recorded as assets and reported at their estimated realizable values. In determining these values, such matters as the donee organization's past collection experience, the credit standing of the donor, and other matters affecting the collectibility of the pledges should be considered. [FASB Statement No. 116 requires that contributions received, including unconditional promises to give, be recognized as revenues in the period received at their fair values. FASB Statement No. 116 also requires that conditional promises to give be recognized when they

become unconditional, that is, when conditions are substantially met. Legal enforceability of the pledge is not a necessary condition for recognition of unconditional promises to give in accordance with FASB Statement No. 116. See paragraph 2a.]

65. The estimated realizable amount of pledges should be recognized as support in the period designated by the donor. If the period designated by the donor extends beyond the balance sheet date, the pledge should be accounted for as deferred support in the balance sheet. In the absence of a specified support period, the net estimated realizable amount of pledges scheduled to be received over a future period should be assumed to be support for that period and should be accounted for as deferred support in the balance sheet. [FASB Statement No. 116 requires that, in the absence of donor stipulations to the contrary, organizations should imply a time restriction on unconditional promises to give with payments due in future periods. Such promises are recognized as restricted revenues rather than as deferred support. See paragraph 2a.]

66. Pledges for fixed assets should also be recorded in the balance sheet at their estimated realizable values and reported in the statement of activity as provided in paragraph 52.

Donated and Contributed Services

67. The nature and extent of donated or contributed services received by organizations vary and range from the limited participation of many individuals in fund-raising activities to active participation in the organization's service program. Because it is difficult to place a monetary value on such services, their values are usually not recorded. The accounting standards division believes that those services should not be recorded as an expense, with an equivalent amount recorded as contributions or support, unless all of the following circumstances exist:

a. The services performed are significant and form an integral part of the efforts of the organization as it is presently constituted; the services would be performed by salaried personnel if donated or contributed services were not available for the organization to accomplish its purpose; and the organization would continue this program or activity.

b. The organization controls the employment and duties of the service donors. The organization is able to influence their activities in a way comparable to the control it would exercise over employees with similar responsibilities. This includes control over time, location, nature, and performance of donated or contributed services.

c. The organization has a clearly measurable basis for the amount to be recorded.

d. The services of the reporting organization are not principally intended for the benefit of its members. Accordingly, donated and contributed services would not normally be recorded by organizations such as religious communities, professional and trade associations, labor unions, political parties, fraternal organizations, and social and country clubs.

[FASB Statement No. 116 states that contributions of services should be recognized only if the services received (*a*) create or enhance nonfinancial assets or (*b*) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. See paragraph 2a.]

68. Participation of volunteers in philanthropic activities generally does not meet the foregoing criteria because there is no effective employer-employee relationship. (See criterion *b*, above.)

69. Services that generally are not recorded as contributions, even though the services may constitute a significant factor in the operation of the organization, include the following:

a. Supplementary efforts of volunteer workers that are provided directly to beneficiaries of the organization. Such activities usually involve auxiliary activities or other services that would not otherwise be provided by the organization as a part of its operating program.

b. Periodic services of volunteers in concentrated fund-raising drives. The activities of volunteer solicitors are not usually subject to a degree of operating supervision and control by the organization sufficient to provide a basis for measuring and recording the value of time devoted. However, if individuals perform administrative functions in positions that would otherwise be held by salaried personnel, consideration should be given to recording the value of those services.

70. Notes to the financial statements should disclose the methods used by the organization in valuing, recording, and reporting donated or contributed services and should distinguish between donated or contributed services for which values have and have not been recorded.

Donated Materials and Facilities

71. Donated materials and facilities, if significant in amount, should be recorded at their fair value, provided the organization has a clearly measurable and objective basis for determining the value. [FASB Statement No. 116 does not require that the organization have a "clearly measurable and objective basis for determining the value" of donated materials and facilities. See paragraph 2a.] If the materials are such that values cannot reasonably be determined, such as clothing, furniture, and so forth, which vary greatly in value depending on condition and style, they should not be recorded as contributions. If donated materials pass through the organization to its charitable beneficiaries, and the organization serves only as an agent for the donors, the donation should not be recorded as a contribution. The recorded value of the use of contributed facilities should be included as revenue and expense during the period of use.

Investment Income and Gains and Losses

72. Unrestricted investment income (interest and dividends) from all funds should be reported as revenue in the statement of activity when it is earned. All unrestricted gains and losses on investments of unrestricted and current restricted funds should also be reported in the statement of activity before the excess (deficiency) of revenue and support over expenses before capital additions. See paragraphs 77 through 82 for a discussion of the carrying amount of investments and the bases of reporting gains and losses.

73. As discussed in paragraph 21, restricted investment income and restricted gains and losses from investments of current restricted funds and restricted plant funds should be reported as deferred amounts in the balance

sheet. Restricted expendable income from investments of endowment funds should also be reported as deferred amounts. Income from investments of endowment funds that must be added to the principal by direction of the donor should be reported as capital additions. Gains and losses on investments of endowment funds should be reported as capital additions or deductions. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 2a.]

74. Traditionally, nonprofit organizations have accounted for income yield (dividends, interest, rents, royalties, and so forth) as revenues available for current purposes and have excluded from that category capital gains on investment transactions of the endowment fund.

75. In recent years, some institutions have adopted what is usually referred to as a "total return" approach to the management of investments of endowment and quasi-endowment funds. This investment approach emphasizes total investment return consisting of traditional yield plus or minus gains and losses. Typically, the governing board establishes a "spending rate" that is satisfied by traditional yield first, that is, by dividends and interest. To the extent that traditional yield is inadequate to meet the spending rate, the governing board may make a portion of realized, and in some cases unrealized, net gains available for current use. The use of net gains on investments of true endowment funds by the governing board is usually done with the advice of legal counsel.

76. A problem arises in the method of accounting for the available net gains from endowment funds because the concept thus far has produced few, if any, applications that appear to be objectively determinable. For example, some institutions have reported net gains made available as revenues, while most others follow existing AICPA industry audit guides and account for this transaction as a transfer from endowment funds to other funds. In some situations when traditional yield has exceeded the spending rate, the excess has been added directly to endowment fund balances rather than being reported as revenue. The spending rate policies of many institutions tend to place primary emphasis on spending without regard to the effect on endowment fund principal. While all of the total return approaches emphasize the use of prudence and a rational and systematic formula, those matters are subjective and not susceptible to measurement. Consequently, the accounting standards division concludes that the portion of available net gains from endowment investments utilized should be reported in the statement of activity as a transfer from endowment funds to other funds. To the extent such gains are transferred to a restricted fund in which unexpended gifts and investment income are reported as deferred support and revenues, the gains should be transferred to deferred revenue of that fund. Since quasi-endowment funds are to be accounted for as a part of current funds, using net gains on the investments of these funds does not involve a transfer. Such gains and losses should be accounted for in the manner specified in paragraph 72. [FASB Statement No. 117 requires that gains and losses be classified as unrestricted unless their use is temporarily or permanently restricted by explicit donor stipulations or law. See paragraph 2a.]

Carrying Amount of Investments

77. Nonprofit organizations have traditionally carried purchased investments at cost and donated investments at fair value at date of receipt. Investments have normally been written down to market value when market values have declined below the carrying value and the declines were deemed to be permanent impairments. Beginning in 1973 with the issuance of the AICPA industry audit guide for colleges and universities, some nonprofit organizations have been carrying their investments at market, as a permissible alternative to cost, adjusting the carrying amount each year for value increases and decreases.

78. An organization carrying investments at market value recognizes the gains or losses that result from market fluctuations for the period in which the fluctuations occur. Those who are against carrying investments at market are concerned both with the difficulty of valuing nonmarketable investments and the effect that market fluctuations have on an organization's results of activity as reflected in the financial statements.

79. The division has concluded that organizations covered by this statement of position should report investments in the financial statements as follows:

- Marketable debt securities, when there is both the ability and intention to hold the securities to maturity, should be reported at amortized cost, market value, or the lower of amortized cost or market value;
- Marketable equity securities and marketable debt securities that are not expected to be held to maturity should be reported at either market value or the lower of cost or market value;
- Other types of investments, for example, real estate or oil and gas interests, should be reported at either fair value or the lower of cost or fair value.

The basis selected to value each of these three groups of investments should apply to all investments in that group. When investments are carried at other than market value, disclosure of market value for that group at the balance sheet date should be made.

80. For investments carried at the lower of (amortized) cost or market value, the division believes that declines should be recognized when the aggregate market value by fund group is less than the carrying amount. Recoveries of aggregate market amount in subsequent periods should be recorded in those periods subject only to the limitation that the carrying amount should not exceed the original cost. The adjustments to recognize the increases or decreases resulting from the application of this paragraph for noncurrent investments should be recognized as a direct addition or deduction to the fund balance; the adjustments applicable to current investments should be reflected in the statement of activity in the same manner as realized gains and losses. Investments held in current restricted funds should normally be considered to be current investments for purposes of this paragraph.

81. For investments carried at market value, increases or decreases in market value should be recognized in the period in which they occur, as described in paragraphs 72 and 73.

82. Interfund sales or exchanges of investments that involve a restricted fund should be recorded in the purchasing fund at fair value. The difference between the carrying amount and the fair value at the date of the sale or

exchange should be accounted for in the selling fund in the same manner as realized gains and losses and appropriately disclosed.

83. The notes to the financial statements should set forth a summary of the total realized and unrealized gains and losses and income derived during the fiscal period from investments held by all funds except life income and custodial funds.

Subscription and Membership Income

84. Subscriptions and revenues derived from the performance of services or the sale of goods should be recognized as revenue in the periods in which they are provided. Revenue derived from membership dues should be recognized by the organization over the period to which the dues relate. Nonrefundable initiation and life membership fees should be recognized as revenue in the period the fees are receivable, if future dues or fees can reasonably be expected to cover the cost of future services; otherwise, the fees should be amortized to future periods based on average membership duration, life expectancy, or other appropriate methods. However, if items such as dues, assessments, and nonrefundable initiation fees are in substance contributions and services are not to be provided to the member, they should be recognized as revenue and support in the periods in which the organization is entitled to them.

Expenses

Functional Classification of Expenses

85. Organizations that receive significant support in the form of contributions from the general public should summarize the cost of providing various services or other activities on a functional basis in the statement of activity. (For purposes of this paragraph, the accounting standards division believes that organizations receiving support from federated fund-raising or similar organizations are deemed to have received support from the general public.) Organizations receiving no significant support from such contributors are encouraged to report on a functional basis but may choose to summarize expenses on another basis (such as natural classifications) that would be considered useful to readers of the statement of activity. If expenses are not reported on a functional basis, the notes should contain a description of the basic programs of the organization. The remainder of this section is for those organizations that report expenses on a functional basis. [FASB Statement No. 117 requires that information about expenses be presented on a functional basis. It also requires that all expenses be presented as decreases in unrestricted net assets. See paragraph 2a.]

86. The functional classifications should include specific program services that describe the organization's service activities and supporting services, such as management and general and fund-raising.

87. The statement of activity should present costs separately for each significant program and supporting activity. Program activities are those directly related to the purposes for which the organization exists. Supporting activities do not relate directly to the purposes for which the organization exists. Fund raising, membership development, and unallocated management and general expense are three examples of supporting activities that should be reported separately.

88. An organization may also present as supplementary information a schedule of functional expenses by object classification, that is, classifying expenses by type rather than function, such as salaries, employee-benefit expenses, and purchased services.

Program Services

89. Functional reporting classifications for program services vary according to the nature of the service rendered. For some organizations, a single functional reporting classification may be adequate to portray the program service provided. In most cases, however, several separate and identifiable services are provided, and in such cases, expenses for program services should be reported by the type of service function or group of functions. The purposes of the various functions should be clearly described, and each functional classification should include all of the applicable service costs.

90. Some local organizations remit a portion of their receipts to an affiliated state or national organization. The amount to be paid to the affiliates should be reported as either an expense or a deduction from total support and revenue in the statement of activity. The appropriate treatment depends on the arrangements: A reporting organization that is, in effect, a collecting agent for the state or national organization, such as local organizations that are required to remit a fixed percentage of all contributions, should report the remittance as a deduction from total support and revenue; other organizations should report the remittance as a program expense.

Management and General Costs

91. Management and general costs are those not identifiable with a single program or fund-raising activity but are indispensable to the conduct of those activities and to an organization's existence, including expenses for the overall direction of the organization's general board activities, business management, general recordkeeping, budgeting, and related purposes. Costs of overall direction usually include the salary and expenses of the chief officer of the organization and his staff. However, if such staff spend a portion of their time directly supervising program services or categories of supporting services, their salaries and expenses should be prorated among those functions. The costs of disseminating information to inform the public of the organization's "stewardship" of contributed funds, announcements concerning appointments, the annual report, and so forth, should likewise be classified as management and general expenses.

Fund-Raising and Other Supporting Services

92. Fund-raising costs are incurred in inducing others to contribute money, securities, time, materials, or facilities for which the contributor will receive no direct economic benefit. They normally include the costs of personnel, occupancy, maintaining mailing lists, printing, mailing, and all direct and indirect costs of soliciting, as well as the cost of unsolicited merchandise sent to encourage contributions. The cost of such merchandise should be disclosed. Fund-raising costs paid directly by a contributor should be reported as support and as fund-raising expenses.

93. Some organizations hold special fund-raising events, such as banquets, dinners, theater parties, and so forth, in which the donor receives a direct benefit (for example, a meal or theater ticket). Some organizations sell merchandise as a fund-raising technique. The costs of such merchandise or direct benefits are not considered fund-raising costs and should be applied against gross proceeds received from the person receiving such direct benefit. The costs of such merchandise or direct benefit costs should be disclosed. [FASB Statement No. 117 allows organizations to report net amounts for special events if they result from peripheral or incidental transactions. However, if they are ongoing and major activities, organizations should report gross amounts of revenues and expenses. See paragraph 2a.]

94. A growing number of users of financial statements are seeking financial information that will enable them to evaluate fund-raising costs. A single functional reporting classification ordinarily is adequate to portray the fund-raising activity; however, other organizations may believe that reporting total public support and total fund-raising expense does not provide adequate information for a useful evaluation because the organizations conduct a number of fund-raising activities with widely varying relationships. For those organizations, it may be appropriate to report fund-raising costs and the corresponding support obtained separately for each type of fund-raising function, either in the statement of activity or in the notes. The various fund-raising functions should be adequately described and should include all of the applicable costs. The total of all fund-raising activities should be disclosed whether the entity reports expenses on a functional or some other basis.

95. Fund-raising efforts made in one year, such as those made to obtain bequests or to compile a mailing list of prospective contributors, often result in contributions that will be received in future years. Some have advocated deferring the costs of such fund-raising efforts until the period in which the contributions are expected to be received. Although there may be valid reasons to consider deferring those costs, the accounting standards division is concerned with the difficulty of assessing their ultimate recovery and the possibility of misstating the fund-raising cost relationships. Accordingly, fund-raising costs should be expensed when incurred. However, if pledges or restricted contributions that have already been received are recorded as deferred revenue and support, related fund-raising costs, if specifically identifiable with the contributions, may also be deferred if it is clear that the contributor intended that the contribution could be used to cover such costs. Similarly, costs incurred in the acquisition of literature, materials, and so forth, that will be used in connection with a fund-raising drive to be conducted in a succeeding period should be deferred to that period.

96. Costs incurred in the solicitation of grants from foundations or governments and cost of membership development in bona fide membership organizations should be shown as separate categories of supporting expenses. If the membership fee includes an element of contribution, the costs of membership development should be allocated between membership development and fund raising.

97. If an organization combines the fund-raising function with a program function (for example, a piece of educational literature with a request for funds), the costs should be allocated to the program and fund-raising categories on the basis of the use made of the literature, as determined from its content, the reasons for its distribution, and the audience to whom it is addressed. [Amended, August 1987, by the Accounting Standards Division Statement of Position 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal,* paragraphs 15—22.] (See SOP 87-2, paragraphs 15-22.) [The AICPA Not-for-Profit Organizations Committee has prepared and issued an exposure draft of a proposed statement of position that would revise SOP 87-2.]

Allocation of Costs That Pertain to Various Functions

98. In some larger organizations, individual functions are performed by separate departments, with expenses classified by types within each department. Many other organizations incur items of cost that apply to more than one functional purpose. For those organizations, it may be necessary to allocate the costs among functions. Examples include salaries of persons who perform more than one type of service, rental of a building used for various

program services, management and general expenses, and expenses of fund-raising activities.

99. The salaries of employees who perform duties relating to more than one function, as well as all other expenses pertaining to more than one function, should be allocated to the separate functional categories according to procedures that determine, as accurately as possible, the portion of the cost related to each function.

100. A reasonable allocation of an organization's functional expenses may be made on a variety of bases, and costs that have been allocated to programs and supporting services should be disclosed in the notes to the financial statements. It is not the intention of this statement to require organizations to undertake extensive detailed analyses and computations aimed at making overly meticulous allocations. The division recognizes that meaningful financial statements can often be prepared using estimates and overall computations when appropriate. (See Appendix B for illustrative allocation procedures.)

Grants

101. Organizations that make grants to others should record grants as expenses and liabilities at the time recipients are entitled to them. That normally occurs when the board approves a specific grant or when the grantee is notified.

102. Some grants stipulate that payments are to be made over a period of several years. Grants payable in future periods subject only to routine performance requirements by the grantee and not requiring subsequent review and approval for continuance of payment should be recorded as expenses and liabilities when the grants are first made. However, if the grant instrument specifically states that the grantor reserves the right to revoke the grant regardless of the performance of the grantee, unpaid grants should not be recorded. Grants subject to periodic renewal should be recorded as expenses and liabilities at renewal with a disclosure of the remaining commitment in the notes to the financial statements.

Tax Allocation

103. Certain organizations are subject to a federal excise tax on investment income or to federal and state income taxes on certain unrelated business income. If timing differences exist between the income base for tax and financial reporting purposes, interperiod allocation of tax should be made.

Transfers

104. Allocations of resources among fund groups are neither revenues nor expenses of the related funds and should be distinguished from support and revenues that increase the total resources available to fulfill the objectives of an organization. Therefore, interfund transfers, including board-designated transfers of gains under the total-return concept, should be reported as changes in fund balances under the caption "fund balance beginning of the period." Transfers required under contractual arrangements with third parties should be separately disclosed.Transfers required as a result of the expiration of a term endowment fund also should be separately disclosed.

Balance Sheet

Fixed Assets

105. Nonprofit organizations should capitalize purchased fixed assets at cost. Donated fixed assets should be recorded at their fair value at the date of the gift. Organizations that have not previously capitalized their fixed assets should do so retroactively. If historical costs are unavailable for assets already in service, another reasonable basis may be used to value the assets. Other bases might be cost-based appraisals, insurance appraisals, replacement costs, or property tax appraisals adjusted for market. However, an alternative basis should be used only if historical cost information is unavailable and only to establish a value at the date an organization adopts this statement of position. Subsequent additions should be recorded at cost, or fair value for donated assets. The basis of valuation and the amount of any assets pledged to secure outside borrowing should be disclosed in the financial statements.

Depreciation

106. In Accounting Terminology Bulletin No. 1, *Review and Resume*, the AICPA Committee on Terminology defined *depreciation accounting* as a means of allocating the cost or other carrying value of tangible capital assets to expense over their useful lives:

> *Depreciation accounting* is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not valuation. *Depreciation for the year* is the portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be a measurement of the effect of all such occurrences.

107. Exhaustible fixed assets should be depreciated over their estimated useful lives. The relative effort being expended by one organization compared with others and the allocation of the efforts to various programs of the organization are indicated, in part, by cost determinations. Depreciation of fixed assets used in providing such services is relevant as an element of that cost. Although depreciation can be distinguished from most other elements of cost in that it requires no current equivalent cash outlay, recognition of depreciation as a cost is not optional. Most assets used in providing services are both valuable and exhaustible. Thus, a cost is associated with the use of exhaustible assets whether they are owned or rented, acquired by gift or by purchase or used by a business or a nonprofit organization.

108. FASB Statement No. 93, *Recognition of Depreciation by Not-for-Profit Organizations,* requires that not-for-profit organizations recognize the cost of using up the future economic benefits or service potentials of (all of) their long-lived tangible assets—depreciation—and shall disclose:

a. Depreciation expense for the period;

b. Balances of major classes of depreciable assets, by nature or function, at the balance sheet date;

c. Accumulated depreciation, either by major classes of depreciable assets or in total, at the balance sheet date;

d. A general description of the method or methods used in computing depreciation for major classes of depreciable assets.

109. An organization may receive grants, allocations, or reimbursements from other organizations on the basis of the cost associated with its program

and supporting services. Recording depreciation as an element of cost does not indicate that it necessarily should be included in the base on which grants, allocations, or reimbursements will be determined; whether the base includes or excludes depreciation depends on the agreement or understanding reached between the two organizations.

110. The amount of depreciation provided on assets carried at historical cost and the amount, if any, provided on assets carried on a basis other than historical cost should be disclosed.

111. Depreciation accounting is sometimes confused with funding replacements. The means of replacing fixed assets and the degree to which replacements should be funded currently are financing decisions to be made by the governing board and do not directly affect the current costs of providing program or supporting services. Depreciation accounting is designed to determine and present those costs, not to provide replacement funds.

112. Retroactive adjustments should be made to reflect accumulated depreciation as of the date an organization adopts this statement of position. For this purpose, the determination of asset lives should be based on a combination of the period from acquisition to the adoption date, plus estimated remaining life based on the current condition and planned use of the assets. When an organization records fixed assets using one of the "current value" methods referred to in paragraph 105, it is not necessary to disclose accumulated depreciation that would have been recorded had cost-based data been available.

Collections

[FASB Statement No. 116 establishes accounting standards for contributions, including contributed collection items. See paragraph 2a.]

113. The accounting standards division considered at length the desirability of capitalizing (but not depreciating) the inexhaustible collections owned by museums, art galleries, botanical gardens, libraries, and similar entities. In view of the stewardship of those organizations to the public, it is desirable to catalogue and control the collections. Some believe that it is also desirable to present values for the collections on the organizations' balance sheets, since those values usually represent the largest assets of the organizations. The division has concluded that it is often impracticable to determine a value for such collections and accordingly has concluded that they need not be capitalized. If records and values do exist for the collections, the division encourages capitalization, at cost, if purchased, and at a fair value, if acquired by donation. If historical cost is indeterminable, the alternative methods of valuing described in the section on fixed assets should be used. If such collections are not capitalized, the caption "collections" should appear on the balance sheet with no amount shown but with a reference to a note that describes the collections.

114. The nature and the cost or contributed value of current-period accessions and the nature of and proceeds from deaccessions should be disclosed in the financial statements.

115. Collections that are exhaustible, such as exhibits with a limited display life, and that have been capitalized should be amortized over their useful lives.

Investment Pools

116. To obtain investment flexibility, nonprofit organizations frequently pool investments of various funds. Inasmuch as the realized and unrealized

gains or losses and income of specific investments cannot be identified with the specific funds participating in the pool, realized and unrealized gains or losses and income should be allocated equitably. To accomplish an equitable allocation, investment pools should be operated using the "market value unit method." Under that method, each fund is assigned a number of units based on the relationship of the market value of all investments at the time of entry in the pool. Periodically, the pooled assets are valued and new unit values are calculated. The new unit value is used to determine the number of units to be allocated to new funds entering the pool or to calculate the equity of funds withdrawing from the pool. Investment pool income, gains, and losses should be allocated periodically to participating funds based on the number of units held by each fund during the period. Other methods based on market value, including percentage participation, may also accomplish the same result.

117. Pooled investments may include investments carried at other than market value even though, as indicated in paragraph 116, the pool itself must be operated on the basis of market value. Differences may exist between the carrying amounts of assets and fund balances withdrawn from the investment pool. Such differences should be allocated to the participating funds remaining in the pool in the same manner as income, gains, and losses. Alternatively, such adjustments could be reported separately from the carrying amount of specific investments or the fund balances of funds remaining in the pool.

Interfund Borrowings

118. A governing board may sometimes authorize borrowings from restricted, endowment, or plant funds. The organization should determine if interest should be accrued. Interfund borrowings should be considered permanent and recorded as transfers when it becomes evident that contemplated sources of funds for repayment are not readily available. There may be legal prohibitions against lending such funds and against recording such transfers. If so, appropriate disclosure should be made.

119. Material interfund borrowings should be disclosed when restricted funds have been loaned or when the liquidity of either fund is in question. If summary financial information is presented for a prior period, similar disclosure should be made.

Designations of Fund Balances

120. The governing board of an organization may designate a portion of an unrestricted fund balance for a specific purpose. The designation is proper to the board's managerial function. However, such designations of fund balances are not expenses and should not be shown as such in the statement of activity. (See examples of designations in the Illustrative Financial Statements, Appendix C.)

Other Funds

121. Donors frequently make gifts of future interests. The present value of the actuarially determined liability resulting from an annuity gift should be recorded at the date of the gift. The excess (or deficiency) in the amount of the annuity gift over the liability should be recorded as support in the year of the gift if it may be used immediately for the general purposes of the organization; in other instances, the excess should be reported as deferred revenue if restricted for specific purposes. The principal amount of life income gifts, in which the donor reserves the right to the income generated from the gift for life or some other stipulated period of time, should also be recorded as deferred support in the balance sheet in the period the gift is received. The amount

previously recorded as deferred support should be reflected as support or a capital addition at the future date when the terms of the annuity or life income gifts have been met. [FASB Statement No. 116 requires that unconditional restricted gifts and investment income, gains and losses be recognized as increases or decreases in temporarily or permanently restricted net assets when received. Deferring recognition of unconditional restricted revenue until the restriction is met is not appropriate under FASB Statement No. 116. When donor-imposed restrictions are met, net assets are reclassified from temporarily restricted net assets to unrestricted net assets. Conditional transfers with a promise to contribute the assets when the conditions are met are reported as refundable advances. See paragraph 2a.]

122. Funds that are held in trust by others under a legal trust instrument created by a donor independently of the reporting organization and that are neither in the possession nor under the control of the organization but are held and administered by outside fiscal agents with the organization deriving income from such funds should not be included in the balance sheet with funds administered by the organization. The funds contemplated by this paragraph are those of which the reporting organization is not the remainderman in the trust. Their existence should be disclosed either parenthetically in the endowment funds group in the balance sheet or in the notes to the financial statements. Significant income from such trusts should be reported separately.

123. Certain organizations have customarily used other fund groups not specifically mentioned in this statement. Those fund groups are used to account for resources relating to activities such as agency or custodial relationships, self-administered pensions, and permanent maintenance funds. Such fund groups are frequently useful and informative and, therefore, may be reported separately in the financial statements. Alternatively, those funds may be combined with other similar fund groups to simplify statement presentation. In either case, the accountability for the fund group should be classified according to the exact nature of the funds involved, so that balances that are liabilities (such as agency, custodial, and self-administered pension funds) are distinguished from those that are fund balances (such as permanent maintenance funds). If there are true fund balances, changes in the balances should be accounted for in the statement of activity. The restricted nature of such funds should also be disclosed.

Transition

124. The accounting standards division recognizes that the Financial Accounting Standards Board presently has on its agenda a project on "Objectives of Financial Reporting by Nonbusiness Organizations." The results of that project may affect financial reporting by the entities covered by this statement of position. On completion of that project, any recommendations in this statement of position that conflict with the FASB's conclusions would need to be changed. Accordingly, the division has concluded that the principles contained in this statement of position need not be adopted until after the Financial Accounting Standards Board completes its project. At that time, a specific date on which the adoption of these principles is recommended will be announced. Organizations may voluntarily adopt these principles.

125. Organizations that adopt the conclusions of this statement of position should apply them retroactively by prior-period adjustments. If financial statements for periods prior to adoption are not presented, the conclusions of the statement of position should be applied by adjusting opening fund balances for the initial application period. When financial statements for periods prior to adoption are presented, they should be restated to reflect the prior-period adjustments. The nature of the restatements and their effects should be disclosed in the period of change.

APPENDIX A

Glossary

A number of terms used throughout this document are commonly used by nonprofit organizations and, because these terms have specialized meaning, this glossary is included.

accessions Additions, both purchased and donated, to collections held by museums, art galleries, botanical gardens, libraries, and similar entities.

agency fund *See* custodian funds.

annuity gift A gift of money or other property given to an organization on the condition that the organization bind itself to make periodic stipulated payments that terminate at a specified time to the donor or other designated individuals.

auxiliary activity An activity providing a service that is not part of the basic program services of the organization. A fee is normally charged that is directly related to, although not necessarily equal to, the cost of the service.

capital additions Gifts, grants, bequests, investment income, and gains and losses on investments restricted either permanently or for a period of time by parties outside of the organization to endowment and loan funds. Capital additions also include similar resources restricted for fixed asset additions but only to the extent expended during the year.

collections Works of art, botanical and animal specimens, books, and other items held for display or study by museums and similar institutions.

custodian funds Funds received and held by an organization as fiscal agent for others.

deaccessions Dispositions of items in collections held by museums, art galleries, botanical gardens, libraries, and similar entities.

deferred capital additions Capital additions received or recorded before the related restrictions are met. *See also* capital additions.

deferred revenue and support Revenue or support received or recorded before it is earned, that is, before the conditions are met, in whole or in part, for which the revenue or support is received or is to be received.

designated funds Unrestricted funds set aside for specific purposes by action of the governing board. *See also* quasi-endowment funds.

encumbrances Commitments in the form of orders, contracts, and similar items that will become payable when goods are delivered or services rendered.

endowment fund A fund in which a donor has stipulated in the donative instrument that the principal is to be maintained inviolate and in perpetuity and only the income from the investments of the fund may be expended. *See also* term endowment.

expendable funds Funds that are available to finance an organization's program and supporting services, including both unrestricted and restricted amounts.

functional classification A classification of expenses that accumulates expenses according to the purpose for which costs are incurred. The primary functional classifications are program and supporting services.

fund An accounting entity established for the purpose of accounting for resources used for specific activities or objectives in accordance with special regulations, restrictions, or limitations.

fund group A group of funds of similar character, for example, operating funds, endowment funds, and annuity and life income funds.

funds held in trust by others Resources held and administered, at the direction of the donor, by an outside trustee for the benefit of the organization.

investment pool Assets of several funds pooled or consolidated for investment purposes.

life income agreement An agreement whereby money or other property is given to an organization on the condition that the organization bind itself to pay periodically to the donor or other designated individual the income earned by the assets donated to the organization for the lifetime of the donor or of the designated individual.

loan funds Resources restricted for loans. When both principal and interest on the loan funds received by the organization are loanable, they are included in the loan-fund group. If only the income from a fund is loanable, the principal is included in endowment funds, while the cumulative income constitutes the loan fund.

natural expense classification *See* object classification of expenses.

net investment in plant The total carrying value of all property, plant, equipment, and related liabilities, exclusive of those real properties that are held for investment.

nonexpendable additions *See* capital additions.

object classification of expenses A method of classifying expenditures according to their natural classification, such as salaries and wages, employee benefits, supplies, purchased services, and so forth.

pledge A promise to make a contribution to an organization in the amount and form stipulated.

quasi-endowment funds Funds that the governing board of an organization, rather than a donor or other outside agency, has determined are to be retained and invested. The governing board has the right to decide at any time to expend the principal of such funds. *See also* designated funds.

restricted funds Funds whose use is restricted by outside agencies or persons as contrasted with funds over which the organization has complete control and discretion.

revenues Gross increases in assets, gross decreases in liabilities, or a combination of both from delivering or producing goods, rendering services, or other earning activities of an organization during a period, for example, dues, sale of services, ticket sales, fees, interest, dividends, and rent.

support The conveyance of property from one person or organization to another without consideration, for example, donations, gifts, grants, or bequests.

term endowment A fund that has all the characteristics of an endowment fund, except that at some future date or event it will no longer be required to be maintained as an endowment fund.

transfer Moving fund balances from one fund to another, usually as a result of an intended change in the use of assets.

unrestricted funds Funds that have no external restriction on their use or purpose, that is, funds that can be used for any purpose designated by the governing board as distinguished from funds restricted externally for specific purposes (for example, for operations, plant, and endowment).

APPENDIX B

Illustrative Allocation Procedures Under Paragraph 100

Although the following allocation procedures are illustrative only, using them or similar procedures ordinarily results in a reasonable allocation of an organization's multiple function expenses:

- A study of the organization's activities may be made at the start of each fiscal year to determine the best practicable allocation methods. The study should include an evaluation of the preceding year's time records or activity reports of key personnel, the use of space, the consumption of supplies and postage, and so forth. The results of the study should be reviewed periodically, and the allocation methods should be revised, if necessary, to reflect significant changes in the nature or level of the organization's current activities.
- Periodic time and expense records may be kept by employees who spend time on more than one function as a basis for allocating salaries and related costs. The records should indicate the nature of the activities in which the employee is involved. If the functions do not vary significantly from period to period, the preparation of time reports for selected test periods during the year might be sufficient.
- Automobile and travel costs may be allocated on the basis of the expense or time reports of the employees involved.
- Telephone expense may be allocated on the basis of use by extensions, generally following the charge assigned to the salary of the employee using the telephone, after making direct charges for the toll calls or other service attributable to specific functions.
- Stationery, supplies, and postage costs may be allocated based on a study of their use.
- Occupancy costs may be allocated on the basis of a factor determined from a study of the function of the personnel using the space involved.
- Depreciation and rental of equipment may be allocated based on asset usage.

APPENDIX C

Illustrative Financial Statements

The following illustrative financial statements (exhibits 1 through 13) demonstrate the practical applications of the reporting practices discussed in this statement of position. Specific types of nonprofit organizations have been selected to illustrate a wide diversity of reporting practices; it is not intended that these illustrations represent either the only types of disclosure or the only statement formats that would be appropriate. Nonprofit organizations are urged to develop financial statement formats that are appropriate for their individual circumstances while being consistent with the accounting and reporting practices discussed in this document.

The notes to the financial statements in exhibit 1 are representative of the basic types of disclosure a typical nonprofit organization would include in its financial report. To avoid unnecessary repetition, the notes to the financial statements of exhibits 2 through 13 have been condensed to indicate only major topics of disclosure, except in those instances in which it is appropriate to include additional items that are unique to a particular type of nonprofit organization.

For conciseness, only some of the sample financial statements have been presented in comparative format. As noted in the text of the statement, the division encourages the presentation of comparative statements.

These illustrative financial statements do not include all disclosures that might be required to constitute a fair presentation in conformity with generally accepted accounting principles. In particular, they do not include certain disclosures required by AICPA and FASB pronouncements issued subsequent to the original issuance of this guide.

Readers should also note that FASB Statement No. 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. It is effective for annual financial statements issued for fiscal years beginning after December 15, 1994, except for organizations with less than $5 million in total assets and less than $1 million in annual expenses. For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged. These illustrative financial statements do not conform to the requirements of FASB Statement No. 117.

Index to Illustrative Financial Statements

Exhibit 1—INDEPENDENT SCHOOL

Exhibit 1A

Sample Independent School

Balance Sheet

June 30, 19X1

	Operating Funds	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Assets				
Cash	$ 87,000	$ 15,000	$ 19,000	$ 121,000
Accounts receivable, less allowance for doubtful receivables of $3,000	34,000	—	—	34,000
Pledges receivable, less allowance for doubtful pledges of $10,000	—	75,000	—	75,000
Inventories, at lower of cost (FIFO) or market	7,000	—	—	7,000
Investments (Note 2)	355,000	10,000	100,000	465,000
Land, buildings, equipment, and library books, at cost less accumulated depreciation of $980,000 (Note 3)	—	2,282,000	—	2,282,000
Other assets	17,000	—	—	17,000
Total assets	$500,000	$2,382,000	$119,000	$3,001,000
Liabilities and Fund Balances				
Accounts payable and accrued expenses	$ 13,000	—	—	$ 13,000
Deferred amounts (Note 6)				
Unrestricted	86,000	—	—	86,000
Restricted	27,000	$ 100,000	—	127,000
Long-term debt (Note 4)	—	131,000	—	131,000
Total liabilities	126,000	231,000	—	357,000
Fund balances				
Unrestricted				
Designated by the governing board for long-term investment	355,000	—	—	355,000
Undesignated	19,000	—	—	19,000
	374,000	—	—	374,000
Restricted—nonexpendable	—	—	$119,000	119,000
Net investment in plant	—	2,151,000	—	2,151,000
Total fund balances	374,000	2,151,000	119,000	2,644,000
Total liabilities and fund balances	$500,000	$2,382,000	$119,000	$3,001,000

Exhibit 1B

Sample Independent School

Statement of Support and Revenue, Expenses, Capital Additions, and Changes in Fund Balances

Year Ended June 30, 19X1

	Operating Funds					
	Unrestricted	*Restricted*	*Total*	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Support and revenue						
Tuition and fees	$ 910,000	—	$ 910,000	—	—	$ 910,000
Contributions	104,000	$80,500	184,500	—	—	184,500
Endowment and other investment income	23,000	1,500	24,500	—	—	24,500
Net loss on investment transactions	(8,000)	—	(8,000)	—	—	(8,000)
Auxiliary activities	25,000	—	25,000	—	—	25,000
Summer school and other programs	86,000	—	86,000	—	—	86,000
Other sources	26,000	—	26,000	—	—	26,000
Total support and revenue	1,166,000	82,000	1,248,000	—	—	1,248,000
Expenses						
Program services						
Instruction and student activities	798,000	43,000	841,000	$ 69,000	—	910,000
Auxiliary activities	24,000	—	24,000	—	—	24,000
Summer school and other programs	91,000	—	91,000	7,000	—	98,000
Financial aid	—	37,000	37,000	3,000	—	40,000
Total program services	913,000	80,000	993,000	79,000	—	1,072,000

Supporting services						
General administration	147,000	2,000	149,000	13,000	—	162,000
Fund raising	12,000	—	12,000	1,000	—	13,000
Total supporting services	159,000	2,000	161,000	14,000	—	175,000
Total expenses	1,072,000	82,000	1,154,000	93,000	—	1,247,000
Excess (deficiency) of support and revenue over expenses before capital additions	94,000	—	94,000	(93,000)	—	1,000
Capital additions						
Contributions and bequests	—	—	—	80,000	$ 30,000	110,000
Investment income	—	—	—	5,000	—	5,000
Net gain on investment transactions	—	—	—	1,000	2,000	3,000
Total capital additions	—	—	—	86,000	32,000	118,000
Excess (deficiency) of support and revenue over expenses after capital additions	94,000	—	94,000	(7,000)	32,000	119,000
Fund balances at beginning of year	387,000	—	387,000	2,047,000	91,000	2,525,000
Transfers						
Equipment acquisitions and principal debt service payments	(111,000)	—	(111,000)	111,000	—	—
Realized gains on endowment funds utilized	4,000	—	4,000	—	(4,000)	—
Fund balances at end of year	$ 374,000	—	$ 374,000	$2,151,000	$119,000	$2,644,000

Exhibit 1C

Sample Independent School

Statement of Changes in Financial Position

Year Ended June 30, 19X1

	Operating Funds	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Resources provided				
Excess (deficiency) of support and revenue over expenses before capital additions	$ 94,000	$ (93,000)	—	$ 1,000
Capital additions				
Contributions and bequests	—	80,000	$ 30,000	110,000
Investment income	—	5,000	—	5,000
Net gain on investments	—	1,000	2,000	3,000
Excess (deficiency) of support and revenue over expenses after capital additions	94,000	(7,000)	32,000	119,000
Items not using (providing) resources				
Provision for depreciation	—	93,000	—	93,000
Net (gain) loss on investment transactions	8,000	(1,000)	(2,000)	5,000
Decrease in inventories	2,000	—	—	2,000
Increase in deferred amounts	3,000	75,000	—	78,000
Proceeds from sale of investments	160,000	2,000	47,000	209,000
Total resources provided	267,000	162,000	77,000	506,000
Resources used				
Purchases of equipment	—	145,000	—	145,000
Reduction of long-term debt	—	52,000	—	52,000
Purchases of investments	210,000	6,000	136,000	352,000
Increase in other assets	1,000	—	—	1,000
Increase in accounts and pledges receivable	3,000	60,000	—	63,000
Decrease in accounts payable and accrued expenses	3,000	—	—	3,000
Total resources used	217,000	263,000	136,000	616,000
Transfers				
Equipment acquisitions and principal debt service payments	(111,000)	111,000	—	—
Realized gains on endowment funds utilized	4,000	—	(4,000)	—
Total transfers	(107,000)	111,000	(4,000)	—
Increase (decrease) in cash	$ (57,000)	$ 10,000	$ (63,000)	$ (110,000)

Exhibit 1D

Sample Independent School

Notes to Financial Statements

Year Ended June 30, 19X1

Note 1—Summary of Significant Accounting Policies

The financial statements of Sample Independent School have been prepared on the accrual basis. The significant accounting policies followed are described below to enhance the usefulness of the financial statements to the reader.

Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources available to the school, the accounts of the school are maintained in accordance with the principles of fund accounting. This is the procedure by which resources for various purposes are classified for accounting and reporting purposes into funds established according to their nature and purposes. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds that have similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported by fund group.

The assets, liabilities, and fund balances of the school are reported in three self-balancing fund groups as follows:

- Operating funds, which include unrestricted and restricted resources, represent the portion of expendable funds that is available for support of school operations.
- Plant funds represent resources restricted for plant acquisitions and funds expended for plant.
- Endowment funds represent funds that are subject to restrictions of gift instruments requiring in perpetuity that the principal be invested and the income only be used.

Expendable Restricted Resources

Operating and plant funds restricted by the donor, grantor, or other outside party for particular operating purposes or for plant acquisitions are deemed to be earned and reported as revenues of operating funds or as additions to plant funds, respectively, when the school has incurred expenditures in compliance with the specific restrictions. Such amounts received but not yet earned are reported as restricted deferred amounts.

Plant Assets and Depreciation

Uses of operating funds for plant acquisitions and principal debt service payments are accounted for as transfers to plant funds. Proceeds from the sale of plant assets, if unrestricted, are transferred to operating fund balances, or, if restricted, to deferred amounts restricted for plant acquisitions. Depreciation of buildings and equipment is provided over the estimated useful lives of the respective assets on a straight-line basis.

Other Matters

All gains and losses arising from the sale, collection, or other disposition of investments and other noncash assets are accounted for in the fund that owned the assets. Ordinary income from investments, receivables, and the like is accounted for in the fund owning the assets, except for income derived from investments of endowment funds, which is accounted for, if unrestricted, as revenue of the expendable operating fund or, if restricted, as deferred amounts until the terms of the restriction have been met.

Legally enforceable pledges less an allowance for uncollectible amounts are recorded as receivables in the year made. Pledges for support of current operations are recorded as operating fund support. Pledges for support of future operations and plant acquisitions are recorded as deferred amounts in the respective funds to which they apply.

Note 2—Investments

Investments are presented in the financial statements in the aggregate at the lower of cost (amortized, in the case of bonds) or fair market value.

	Cost	*Market*
Operating funds	$355,000	$365,000
Plant funds	10,000	11,000
Endowment funds	100,000	109,000
	$465,000	$485,000

Investments are composed of the following:

	Cost	*Market*
Corporate stocks and bonds	$318,000	$320,000
U.S. government obligations	141,000	159,000
Municipal bonds	6,000	6,000
	$465,000	$485,000

The following tabulation summarizes the relationship between carrying values and market values of investment assets.

	Carrying Value	*Market Value*	*Excess of Market Over Cost*
Balance at end of year	$465,000	$485,000	$ 20,000
Balance at beginning of year	$327,000	$335,000	8,000
Increase in unrealized appreciation			12,000
Realized net loss for year			(5,000)
Total net gain for year			$ 7,000

The average annual yield exclusive of net gains (losses) was 7% and the annual total return based on market value was 9% for the year ended June 30, 19X1.

Note 3—Plant Assets and Depreciation

A summary of plant assets follows.

Land	$255,000
Buildings	2,552,000
Equipment	340,000
Library books	115,000
	3,262,000
Less accumulated depreciation	980,000
	$2,282,000

Note 4—Long-Term Debt

A summary of long-term debt follows.

7½% unsecured notes payable to bank due in quarterly installments of $2,500	$29,000
8½% mortgage payable in semiannual installments of $3,500 through 19Y6	102,000
	$131,000

Aggregate maturities of long-term debt are summarized as follows:

19X2	$ 17,000
19X3	17,000
19X4	16,000
19X5	7,000
19X6	7,000
19X7 and after	67,000
	$131,000

Note 5—Pension and Other Postretirement Benefit Plans

The School has a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation during the last five years of employment. The School's funding policy is to contribute annually at a rate that is intended to remain a level percentage of compensation for the covered employees (presently 12 percent). Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth the plan's funded status and amounts recognized in the School's financial statements at December 31, 19X1:

	December 31, 19X1
Funded status of plan:	
Actuarial present value of benefit obligations:	
Accumulated benefit obligation, including vested benefits of $250,000	$276,000
Projected benefit obligation for service rendered to date	(347,000)
Assets available for benefits:	
Plan assets at fair value, primarily listed stocks and U.S. government securities	426,000
Plan assets in excess of projected benefit obligation	79,000
Unrecorded net gain from past experience different from that assumed and effects of changes in assumptions	(111,000)
Unrecognized net obligation at January 1, 19X0 being recognized over 15 years	40,000
Prepaid pension cost included in other assets	$ 8,000

Net pension expense included the following components:

	19X1
Service cost-benefits earned during the year	$ 26,000
Interest cost on projected benefit obligation	39,000
Actual return on plan assets	(45,000)
Amortization of unrecognized net obligation	10,000
Net periodic pension expense	$ 30,000

The weighted average discount rate and rate of increase in future compensation levels in determining the actuarial present value of the projected benefit obligation were 6 percent and 5 percent, respectively. The expected long-term rate of return on assets was 8 percent.

The School also sponsors a defined contribution postretirement health care plan covering substantially all of its employees. The School's contributions and cost are determined annually as 2 percent of each covered employee's salary and totalled $31,000 in 19X1.

Note 6—Changes in Deferred Restricted Amounts

	Operating Funds	*Plant Funds*
Balances at beginning of year	$ 24,000	$ 25,000
Additions		
Contributions and bequests	79,000	158,000
Investment income	6,000	1,000
Net gain on investment transactions	—	2,000
	109,000	186,000
Deductions—funds expended during the year	82,000	86,000
Balances at end of year	$ 27,000	$100,000

Note 7—Functional Allocation of Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis in the statement of support and revenue, expenses, capital additions, and changes in fund balances. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 8—Commitments

The school has entered into various agreements aggregating approximately $80,000 for the purchase of equipment to be received subsequent to June 30, 19X1.

Exhibit 2—CEMETERY ORGANIZATION

Exhibit 2A

Sample Cemetery Organization

Balance Sheet

June 30, 19X1, and 19X0

Assets	*19X1*	*19X0*
Current		
Cash	$ 47,000	$ 27,000
Receivables, net	15,000	15,000
Inventory of supplies	55,000	46,000
Prepaid expenses	4,000	3,000
Total current assets	121,000	91,000
Inventory		
Investment in real estate	370,000	370,000
Space development	197,000	110,000
Total inventory	567,000	480,000
Property, plant, and equipment, at cost (Note 2)		
Land, other than burial spaces	125,000	125,000
Buildings	105,000	105,000
Equipment	75,000	70,000
	305,000	300,000
Less accumulated depreciation	217,000	125,000
Fixed assets, net	88,000	175,000
Total	$776,000	$746,000

Liabilities and Fund Balance	*19X1*	*19X0*
Current		
Accounts payable	$ 90,000	$ 41,000
Accrued expenses	12,000	8,000
Portion of long-term debt currently due	30,000	30,000
Total current liabilities	132,000	79,000
Long-term debt (Note 4)	240,000	270,000
Fund balance	404,000	397,000
Total	$776,000	$746,000

Exhibit 2B

Sample Cemetery Organization
Statement of Revenue and Expenses
Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Revenue		
Net sales		
Spaces	$210,000	$201,000
Memorials and inscriptions	36,000	30,000
Interment fees	20,000	14,000
Other fees	6,000	2,000
Total	272,000	247,000
Cost of sales		
Spaces	150,000	151,000
Memorials	19,000	14,000
Burial services	16,000	13,000
Total	185,000	178,000
Gross margin	87,000	69,000
Expenses		
Maintenance	60,000	50,000
General administration	30,000	18,000
Commissions	10,000	9,000
Total	100,000	77,000
Operating margin	(13,000)	(8,000)
Other revenue		
Income from care and maintenance funds (Note 3)	20,000	13,000
Excess of revenue over expenses	7,000	5,000
Fund balance—beginning	397,000	392,000
Fund balance—ending	$404,000	$397,000

Exhibit 2C

Sample Cemetery Organization

Statement of Changes in Financial Position

Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Source of cash		
Excess of revenue over expenses	$ 7,000	$ 5,000
Charges not requiring (providing) cash in the current period—depreciation and amortization	92,000	74,000
Cash provided from operations	99,000	79,000
Increases in accounts payable and accrued expenses	53,000	14,000
Total sources of cash	152,000	93,000
Uses of cash		
Space development and equipment	92,000	40,000
Increase in accounts receivable	—	15,000
Reduction of long-term debt	30,000	30,000
Increase in supplies and prepaid expenses	10,000	2,000
Total uses of cash	132,000	87,000
Increases in cash	20,000	6,000
Cash, beginning of year	27,000	21,000
Cash, end of year	$ 47,000	$ 27,000

Exhibit 2D

Sample Cemetery Organization

Notes to Financial Statements *

June 30, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Revenue Recognition

Sales of spaces are recorded when contracts of sales are signed.

Cost of Spaces Sold

The cost of each space sold is computed based on allocation of total expenses incurred in developing the cemetery.

Note 2—Property, Plant, and Equipment

Note 3—Maintenance Funds

General Maintenance

Under the State Cemetery Act, Sample Cemetery is required, among other things, to collect and pay into a general maintenance fund the following fees and charges:

> Fifteen percent (15%) of the gross sales price of each plot sold.
>
> Ten dollars ($ 10) for each interment.
>
> Five cents ($.05) per square unit of surface area of the base of a memorial.

The general maintenance fund principal is restricted by the State Cemetery Act for major improvements and repairs and, accordingly, is not included in the financial statements. At June 30, 19X1, and 19X0 this fund amounted to $383,000 and $338,000, respectively. Investment income is unrestricted and is included in other income.

Specific Trusts

Specific trust funds are restricted for flowers, seeding, sodding, and other maintenance of the specific plots as prescribed by the external source and are not available for general use by the cemetery. During the years ended June 30, 19X1, and June 30, 19X0, $11,000 and $2,000, respectively, were expended for specific trust maintenance and have been reflected in the statement of revenue and expense.

Note 4—Long-Term Debt

Note 5—Functional Allocation of Expenses

Note 6—Commitments

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* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 3—COUNTRY CLUB

Exhibit 3A

Sample Country Club

Balance Sheet

March 31, 19X1, and 19X0

	19X1	*19X0*
Assets		
Current assets		
Cash	$ 44,413	$ 37,812
Investments (Note 2)	289,554	388,007
Accounts receivable, less allowances of $5,000 in 19X1, and $6,000 in 19X0	71,831	45,898
Inventories, at lower of cost (FIFO) or market	27,930	28,137
Prepaid expenses	19,154	13,948
Total current assets	452,882	513,802
Property and equipment, at cost (Note 3)		
Land and land improvements	1,085,319	1,098,828
Buildings	1,331,590	1,200,585
Furniture, fixtures, and equipment	274,761	254,540
	2,691,670	2,553,953
Less accumulated depreciation	864,564	824,088
	1,827,106	1,729,865
Other assets		
Deferred charges	15,077	16,524
Beverage license	10,500	10,500
	25,577	27,024
	$2,305,565	$2,270,691
Liabilities and Membership Equity		
Current liabilities		
Accounts payable and accrued expenses	$ 61,426	$ 63,600
Deferred revenues—initiation fees (Note 1)	15,677	7,755
Due to resigned members	16,400	12,900
Taxes	20,330	23,668
Total current liabilities	113,833	107,923
Membership equity		
Proprietary certificates, 500 at $1,500 each—no change during the years	750,000	750,000
Cumulative excess of revenue over expenses	1,441,732	1,412,768
	2,191,732	2,162,768
	$2,305,565	$2,270,691

Exhibit 3B

Sample Country Club

Statement of Revenue, Expenses, and Changes in Cumulative Excess of Revenue Over Expenses

Years Ended March 31, 19X1, and 19X0

	19X1	*19X0*
Revenue		
Dues	$ 590,000	$ 600,000
Restaurant and bar charges	270,412	265,042
Greens fees	171,509	163,200
Tennis and swimming fees	83,829	67,675
Initiation fees	61,475	95,220
Locker and room rentals	49,759	49,954
Interest and discounts	28,860	28,831
Golf cart rentals	26,584	24,999
Other—net	4,011	3,893
Total revenue	1,286,439	1,298,814
Expenses		
Greens	241,867	244,823
House	212,880	210,952
Restaurant and bar	153,035	136,707
Tennis and swimming	67,402	48,726
General and administrative	533,838	690,551
Net (gains) losses on investments	98,453	(98,813)
Total expenses	1,307,475	1,232,946
Excess (deficiency) of revenue over expenses before capital additions	(21,036)	65,868
Capital additions		
Assessments for capital improvements	50,000	—
Excess (deficiency) of revenue over expenses after capital additions	28,964	65,868
Cumulative excess of revenue over expenses—beginning of year	1,412,768	1,346,900
Cumulative excess of revenue over expenses—end of year	$1,441,732	$1,412,768

Exhibit 3C

Sample Country Club

Statement of Changes in Financial Position

Years Ended March 31, 19X1, and 19X0

	19X1	19X0
Sources of funds		
Excess (deficiency) of revenue over expenses before capital additions	$(21,036)	$ 65,868
Capital additions	50,000	—
Excess (deficiency) of revenue over expenses after capital additions	28,964	65,868
Add-back provision for depreciation, which does not affect working capital	40,476	61,618
Total from operations	69,440	127,486
Decrease in deferred charges—net	1,447	—
Total sources	70,887	127,486
Applications of funds		
Purchases of property and equipment	137,717	84,377
Increase in deferred charges—net	—	8,909
Total applications	137,717	93,286
Increase (decrease) in working capital	$(66,830)	$ 34,200
Changes in the components of working capital are summarized as follows:		
Increase (decrease) in current assets		
Cash	$ 6,601	$(70,928)
Investments	(98,453)	98,813
Accounts receivable	25,933	5,000
Inventories	(207)	8,112
Prepaid expenses	5,206	2,056
	(60,920)	43,053
(Increase) decrease in current liabilities		
Accounts payable and accrued expenses	2,174	(5,597)
Deferred revenues—initiation fees	(7,922)	(3,517)
Due to resigned members	(3,500)	(2,700)
Taxes	3,338	2,961
	(5,910)	(8,853)
Increase (decrease) in working capital	$(66,830)	$ 34,200

Exhibit 3D

Sample Country Club

Notes to Financial Statements *

March 31, 19X1, and 19X0

Note 1—Summary of Significant Accounting Principles

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Membership Dues and Initiation Fees

Membership dues are recognized as revenue in the applicable membership period. Initiation fees are recorded as revenue in the period when the fees are due.

Note 2—Investments

Note 3—Property and Equipment and Depreciation

Note 4—Pension and Other Postretirement Benefit Plans

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 4—LIBRARY

Exhibit 4A

Sample Library
Balance Sheet
December 31, 19X1
(With Comparative Totals for 19X0)

	December 31, 19X1							December 31, 19X0
	Unrestricted			Current Restricted	Plant	Endowment	Total	Total
	Operating	Investment	Total					
Assets								
Current assets								
Cash, including interest-bearing accounts of $600,000 in 19X1, and $400,000 in 19X0	$ 690,000	—	$ 690,000	$ 3,000	$ 7,000	—	$ 700,000	$ 411,000
Certificates of deposit	375,000	—	375,000	75,000	—	—	450,000	525,000
Grants receivable (Note 1)								
Governments	120,000	—	120,000	—	—	—	120,000	161,000
Other	30,000	—	30,000	27,000	8,000	—	65,000	35,000
Pledges receivable, at estimated net realizable value (Note 1)	15,000	—	15,000	—	—	—	15,000	15,000
Prepaid expenses and other current assets	70,000	—	70,000	—	—	—	70,000	85,000
Total current assets	1,300,000	—	1,300,000	105,000	15,000	—	1,420,000	1,232,000
Investments—at market (Note 2)	—	$920,000	920,000	—	165,000	$985,000	2,070,000	2,172,000
Land, buildings, and equipment—at cost, less accumulated depreciation of $90,000 and $79,000, respectively (Note 3)	—	—	—	—	1,525,000	—	1,525,000	1,491,000
Inexhaustible collections and books (Note 1)	—	—	—	—	—	—	—	—
Total assets	$1,300,000	$920,000	$2,220,000	$105,000	$1,705,000	$985,000	$5,015,000	$4,895,000

(Continued)

Exhibit 4A

Sample Library
Balance Sheet
December 31, 19X1
(With Comparative Totals for 19X0)

	December 31, 19X1							December 31, 19X0
	Unrestricted			Current Restricted	Plant	Endowment	Total	Total
	Operating	Investment	Total					
Liabilities and Fund Balances								
Current liabilities								
Accounts payable, accrued expenses, and current portion of long-term debt	$ 200,000	—	$ 200,000	—	$ 10,000	—	$ 210,000	$ 130,000
Deferred restricted contributions, etc. (Note 6)	—	—	—	$105,000	5,000	—	110,000	100,000
Total current liabilities	200,000	—	200,000	105,000	15,000	—	320,000	230,000
Long-term debt (Note 4)	—	—	—	—	180,000	—	180,000	190,000
Total liabilities	200,000	—	200,000	105,000	195,000	—	500,000	420,000
Fund balances								
Unrestricted								
Designated by the board for								
Investment	—	$920,000	920,000	—	—	—	920,000	740,000
Purchase of equipment	50,000	—	50,000	—	—	—	50,000	35,000
Undesignated	1,050,000	—	1,050,000	—	1,510,000	—	2,560,000	2,725,000
Restricted	—	—	—	—	—	$985,000	985,000	975,000
Total fund balances	1,100,000	920,000	2,020,000	—	1,510,000	985,000	4,515,000	4,475,000
Total liabilities and fund balances	$1,300,000	$920,000	$2,220,000	$105,000	$1,705,000	$985,000	$5,015,000	$4,895,000

Exhibit 4B

Sample Library

Statement of Support, Revenue, and Expenses and Changes in Fund Balances

Year Ended December 31, 19X1

(With Comparative Totals for 19X0)

	Year Ended December 31, 19X1							*Year Ended December 31, 19X0*
	Unrestricted							
	Operating	*Investment*	*Total*	*Current Restricted*	*Plant*	*Endowment*	*Total*	*Total*
Support and revenue								
Support								
Grants (Note 1)								
Governments	$ 150,000	—	$ 150,000	—	—	—	$ 150,000	$ 150,000
Other	25,000	—	25,000	—	—	—	25,000	—
Contributions, legacies, and bequests (Note 1)	350,000	$ 90,000	440,000	$ 75,000	—	—	515,000	490,000
Contributed services of volunteers (Note 1)	75,000	—	75,000	—	—	—	75,000	50,000
Use of contributed facilities (Note 1)	47,000	—	47,000	—	—	—	47,000	50,000
Total support	647,000	90,000	737,000	75,000	—	—	812,000	740,000
Revenue								
Fees for services	50,000	—	50,000	—	—	—	50,000	45,000
Book rentals and fines	320,000	—	320,000	—	—	—	320,000	250,000
Investment income including net gains	25,000	93,000	118,000	10,000	—	—	128,000	103,000
Total revenue	395,000	93,000	488,000	10,000	—	—	498,000	398,000
Total support and revenue	1,042,000	183,000	1,225,000	85,000	—	—	1,310,000	1,138,000

(Continued)

Exhibit 4B

Sample Library

Statement of Support, Revenue, and Expenses and Changes in Fund Balances

Year Ended December 31, 19X1

(With Comparative Totals for 19X0)

Expenses (Note 7)								
Program services								
Circulating library	390,000	—	390,000	75,000	$ 5,000	—	470,000	430,000
Research library	169,000	—	169,000	—	1,000	—	170,000	155,000
Collections and exhibits	49,000	—	49,000	10,000	1,000	—	60,000	50,000
Educational services	49,000	—	49,000	—	1,000	—	50,000	55,000
Community services	29,500	—	29,500	—	500	—	30,000	20,000
Total program services	686,500	—	686,500	85,000	8,500	—	780,000	710,000
Supporting services								
General administration	315,500	3,000	318,500	—	21,500	—	340,000	290,000
Fund raising	200,000	—	200,000	—	5,000	—	205,000	200,000
Total supporting services	515,500	3,000	518,500	—	26,500	—	545,000	490,000
Total expenses	1,202,000	3,000	1,205,000	85,000	35,000	—	1,325,000	1,200,000
Excess (deficiency) of support and revenue over expenses before capital additions	(160,000)	180,000	20,000	—	(35,000)	—	(15,000)	(62,000)
Capital additions								
Contributions	—	—	—	—	40,000	—	40,000	95,000
Investment income including net gains	—	—	—	—	5,000	—	5,000	17,000
Contributed materials, equipment, etc. (Note 1)	—	—	—	—	10,000	—	10,000	—
	—	—	—	—	55,000	—	55,000	112,000
Excess (deficiency) of support and revenue over expenses after capital additions	(160,000)	180,000	20,000	—	20,000	—	40,000	50,000
Fund balances at beginning of year	1,270,000	740,000	2,010,000	—	1,480,000	$985,000	4,475,000	4,425,000
Mandatory transfers—principal of indebtedness	(10,000)	—	(10,000)	—	10,000	—	—	—
Fund balances at end of year	$1,100,000	$920,000	$2,020,000	—	$ 1,510,00	$985,000	$4,515,000	$4,475,000

Exhibit 4C

Sample Library
Statement of Changes in Financial Position
Year Ended December 31, 19X1
(With Comparative Totals for 19X0)

	Year Ended December 31, 19X1						*Year Ended December 31, 19X0*
	Unrestricted						
	Operating	*Investment*	*Total*	*Current Restricted*	*Plant*	*Total*	*Total*
Sources of working capital							
Excess (deficiency) of support and revenue over expenses before capital additions	$(160,000)	$180,000	$ 20,000	—	$ (35,000)	$ (15,000)	$ (62,000)
Capital additions	—	—	—	—	55,000	55,000	112,000
Excess (deficiency) of support and revenue over expenses after capital additions	(160,000)	180,000	20,000	—	20,000	40,000	50,000
Add (deduct) items not using (providing) working capital							
Depreciation	—	—	—	—	11,000	11,000	11,000
Contributed equipment	—	—	—	—	(10,000)	(10,000)	—
Working capital provided by operations	(160,000)	180,000	20,000	—	21,000	41,000	61,000
Deferred restricted contributions and investment income received	—	—	—	$85,000	—	85,000	100,000
Sale of investments	22,000	245,000	267,000	—	—	267,000	110,000
	(138,000)	425,000	287,000	85,000	21,000	393,000	271,000

(Continued)

Exhibit 4C

Sample Library
Statement of Changes in Financial Position
Year Ended December 31, 19X1
(With Comparative Totals for 19X0)

Uses of working capital							
Purchase of investments	—	—	—	—	165,000	165,000	—
Purchase of fixed assets	—	—	—	—	35,000	35,000	35,000
Reduction of long-term debt	—	—	—	—	10,000	10,000	10,000
Deferred restricted contributions and investment income recognized as support	—	—	—	85,000	—	85,000	100,000
Transfers between funds	10,000	—	10,000	—	(10,000)	—	—
	10,000	—	10,000	85,000	200,000	295,000	145,000
Increase (decrease) in working capital	$(148,000)	$425,000	$277,000	—	$(179,000)	$ 98,000	$126,000
Changes in working capital components							
Increase (decrease) in current assets							
Cash	$(129,000)	$425,000	$296,000	$ (7,000)	—	$289,000	$ (5,000)
Certificates of deposit	22,000	—	22,000	20,000	$(117,000)	(75,000)	61,000
Grants receivable	54,000	—	54,000	(8,000)	(57,000)	(11,000)	60,000
Pledges receivable	—	—	—	—	—	—	(5,000)
Prepaid expenses and other current assets	(15,000)	—	(15,000)	—	—	(15,000)	—
	(68,000)	425,000	357,000	5,000	(174,000)	188,000	111,000
(Increase) decrease in current liabilities							
Accounts payable, accrued expenses, and current portion of long-term debt	(80,000)	—	(80,000)	—	—	(80,000)	15,000
Deferred restricted contributions, etc.	—	—	—	(5,000)	(5,000)	(10,000)	—
Increase (decrease) in working capital	$(148,000)	$425,000	$277,000	—	$(179,000)	$ 98,000	$126,000

Exhibit 4D

Sample Library

Notes to Financial Statements *

December 31, 19X1

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Contributed Facilities

The library occupies without charge certain premises located in government-owned buildings. The estimated fair rental value of the premises is reported as support and expense in the period in which the premises are used.

Grants

The library records income from unrestricted grants in the period designated by the grantor.

Inexhaustible Collections and Books

Because the values of the existing inexhaustible collections, including research books, are not readily determinable, the library has not capitalized them. Collections that are exhaustible are capitalized and included with equipment in the financial statements and are amortized over their estimated useful lives. Accessions and deaccessions during 19X0 and 19X1 were not significant. Books used in the circulating library have not been capitalized because their estimated useful lives are less than one year.

Summarized Financial Information for 19X0

The financial information for the year ended December 31, 19X0, presented for comparative purposes, is not intended to be complete financial statement presentation.

Note 2—Investments

Note 3—Plant Assets and Depreciation

Note 4—Long-Term Debt

Note 5—Pension and Other Postretirement Benefit Plans

Note 6—Changes in Deferred Restricted Amounts

Note 7—Functional Allocation of Expenses

Note 8—Commitments and Contingencies

The library receives a substantial amount of its support from federal, state, and local governments. A significant reduction in the level of this support, if this were to occur, may have an effect on the library's programs and activities.

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 5—MUSEUM

Exhibit 5A

Sample Museum

Balance Sheet

June 30, 19X1

(With Comparative Totals for 19X0)

	Operating Fund	*Plant Fund*	*Endowment Fund*	*Total*	*Year Ended June 30, 19X0 Total*
Assets					
Current assets					
Cash	$ 19,800	—	—	$ 19,800	$ 23,700
Receivables, less reserve of $7,700	145,500	—	—	145,500	125,800
Investments (Note 2)	210,000	—	—	210,000	—
Inventories, at lower of cost (FIFO) or market	121,000	—	—	121,100	120,600
Prepayments	26,600	—	—	26,600	12,700
Total current assets	523,000	—	—	523,000	282,800
Fixed assets, net of depreciation (Note 3)	—	$1,964,000	—	1,964,000	1,866,800
Art collection (Note 11)					
Cash held for investment	—	—	$ 6,000	6,000	3,800
Investments (Note 2)	4,044,500	—	7,688,400	11,732,900	11,709,300
Total	$4,567,500	$1,964,000	$7,694,400	$14,225,900	$13,862,700

Liabilities and Fund Balances

Current liabilities					
Accounts payable and accrued expenses	$ 256,900	—	—	$ 256,900	$ 252,900
Deferred revenue and restricted gifts, current portion (Note 5)	242,100	—	—	242,100	208,100
Total current liabilities	499,000	—	—	499,000	461,000
Deferred revenue and restricted gifts, noncurrent portion (Note 5)	409,900	—	—	409,900	167,300
Fund balances					
Endowment	—	—	$7,694,400	7,694,400	7,621,800
Land, buildings, and equipment	—	$1,964,000	—	1,964,000	1,866,800
Unrestricted					
Designated for investment	3,490,000	—	—	3,490,000	3,490,000
Designated for plant expansion	150,000	—	—	150,000	—
Unappropriated	18,600	—	—	18,600	255,800
Total fund balances	3,658,600	1,964,000	7,694,400	13,317,000	13,234,400
Total	$4,567,500	$1,964,000	$7,694,400	$14,225,900	$13,862,700

Exhibit 5B

Sample Museum

Statement of Activity

Year Ended June 30, 19X1

(With Comparative Totals for 19X0)

	Operating Fund	*Plant Fund*	*Endowment Fund*	*Total*	*Year Ended June 30, 19X0 Total*
Support and revenue					
Admissions	$ 131,100	—	—	$ 131,100	$ 123,400
Government appropriations	110,700	—	—	110,700	104,000
Gifts and grants (Notes 5 and 8)	130,000	—	—	130,000	124,700
Memberships	48,400	—	—	48,400	39,900
Investment income	828,800	—	—	828,800	841,700
Net realized investment gains (losses)	6,300	—	—	6,300	(2,600)
Revenue, auxiliary activities	483,100	—	—	483,100	417,200
Total	1,738,400	—	—	1,738,400	1,648,300

Expenses					
Program					
Curatorial and conservation	578,600	$ 27,400	—	606,000	602,000
Exhibits	108,600	—	—	108,600	109,100
Education	133,400	4,800	—	138,200	131,600
Fellowships	68,200	—	—	68,200	52,800
Public information	66,400	2,700	—	69,100	67,700
Accession of art for collection, net of deaccessions (Note 11)	200,000	—	—	200,000	170,000
Supporting services					
Management and general	67,400	10,800	—	78,200	77,300
Fund raising	10,300	—	—	10,300	9,600
Cost of sales and expense of auxiliary activities	441,100	8,700	—	449,800	384,600
Total	1,674,000	54,400	—	1,728,400	1,604,700
Excess (deficiency) of support and revenue over expenses before capital additions	64,400	(54,400)	—	10,000	43,600
Capital additions					
Gifts and grants (Note 8)	—	—	$ 76,400	76,400	18,200
Net investment income	—	—	4,700	4,700	1,800
Net realized investment gains (losses)	—	—	(8,500)	(8,500)	(2,000)
Total	—	—	72,600	72,600	18,000
Excess (deficiency) of support and revenue over expenses after capital additions	64,400	(54,400)	72,600	82,600	61,600
Fund balances, beginning of period	3,745,800	1,866,800	7,621,800	13,234,400	13,172,800
Add (deduct) transfers (Note 9)	(151,600)	151,600	—	—	—
Fund balances, end of period	$3,658,600	$1,964,000	$7,694,400	$13,317,000	$13,234,400

Exhibit 5C

Sample Museum

Statement of Changes in Financial Position

Year Ended June 30, 19X1

Sources of working capital	
Excess of support and revenue before capital additions	$ 10,000
Capital additions	72,600
Excess of support and revenue after capital additions	82,600
Depreciation	54,400
Deferred revenue and restricted gifts received in excess of expenses incurred	242,600
Investments sold	952,200
	1,331,800
Uses of working capital	
Fixed assets purchased	151,600
Investments purchased	978,000
	1,129,600
Increase in working capital	$ 202,200
Changes in working capital, increase (decrease)	
Cash	$ (3,900)
Receivables	19,700
Investments	210,000
Inventories	500
Prepayments	13,900
Accounts payable and accrued expenses	(4,000)
Deferred revenue and restricted gifts, current portion	(34,000)
	$ 202,200

Exhibit 5D

Sample Museum

Notes to Financial Statements *

June 30, 19X1

Note 1—Summary of Significant Accounting Policies

Note 2—Investments

Note 3—Fixed Assets and Depreciation

Note 4—Pension and Other Postretirement Benefit Plans

Note 5—Deferred Revenue and Restricted Gifts

Note 6—Functional Allocation of Expenses

Note 7—Commitments

Note 8—Gifts Received

Note 9—Interfund Transfers

During the year ended June 30, 19X1, the trustees authorized a transfer from the Operating Fund to the Plant Fund in the amount of $151,600 representing fixed assets purchased with resources of the Operating Fund.

Note 10—Contributed Services

A substantial number of unpaid volunteers have made significant contributions of their time to develop the Museum's programs, principally in membership development and educational programs. The value of this contributed time is not reflected in these statements since it is not susceptible to objective measurement or valuation.

Note 11—Art Collection

In conformity with the practice followed by many museums, art objects purchased and donated are not included in the balance sheet.

The value of the objects acquired by gift for which the Museum can make a reasonable estimate is reported as gifts in the Statement of Activity ($28,000 in the year ended June 30, 19X1).

The cost of all objects purchased together with the value of objects acquired by gift as indicated in the preceding paragraph, less the proceeds from deaccessions of objects, is reported as a separate program expense. During the year ended June 30, 19X1, purchase of art objects amounted to $185,000 and the proceeds from deaccessions was $13,000.

Gifts of cash or other property restricted by donors for the purchase of items for the collection are classified as deferred revenue until acquisitions are made in accordance with the terms of the gifts.

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* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 6—PERFORMING ARTS ORGANIZATION

Exhibit 6A

Sample Performing Arts Organization

Balance Sheet

June 30, 19X1, and 19X0

	19X1	*19X0*
Assets		
Current assets		
Cash	$216,074	$ 169,466
Marketable securities (Note 2)	266,330	50,967
Accounts receivable, net of allowance for doubtful accounts	70,051	26,685
Grants receivable	—	6,100
Other	39,378	13,441
Total current assets	591,833	266,659
Noncurrent assets		
Investments and endowment funds cash (Note 2)	267,869	256,648
Property and equipment at cost, net of accumulated depreciation (Note 3)	55,061	40,226
Rent and other deposits	3,839	9,130
	$918,602	$ 572,663
Liabilities and Entity Capital		
Current liabilities		
Accounts payable and accrued expenses	$111,150	$ 166,351
Deferred revenues—subscriptions (Note 1)	297,430	193,042
Deferred revenues—grants (Note 1)	42,562	—
Current portion of long-term debt	50,000	50,000
Total current liabilities	501,142	409,393
Long-term debt (Note 4)	32,000	69,740
Contingencies (Note 6)		
Entity capital		
Plant fund	33,061	38,594
Endowment funds (Note 5)	267,869	256,648
Unrestricted funds	84,530	(201,712)
	$918,602	$ 572,663

Exhibit 6B

Sample Performing Arts Organization
Statement of Activity
Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Revenue and support from operations		
Admissions	$1,557,567	$1,287,564
Dividends and interest	21,555	2,430
Net realized gains and losses	54,700	18,300
Tuition	242,926	130,723
Concessions and other support	103,582	68,754
	1,980,330	1,507,771
Production costs	476,982	427,754
Operating expenses	797,044	685,522
Ballet school	473,658	301,722
Neighborhood productions	378,454	81,326
General and administrative expense	390,487	469,891
	2,516,625	1,966,215
Deficiency from operations	(536,295)	(458,444)
Donated services, materials, and facilities	—	8,000
Annual giving	150,379	78,469
Grants	702,368	678,322
Fund-raising costs	(35,743)	(50,454)
	817,004	714,337
Excess from current endeavors	280,709	255,893
Capital additions	11,221	18,250
Total increase in entity capital	$ 291,930	$ 274,143

Exhibit 6C

Sample Performing Arts Organization
Statement of Changes in Entity Capital
Years Ended June 30, 19X1, and 19X0

	Endowment Funds	*Plant Fund*	*Unrestricted Funds*	*Total*
Entity capital—June 30, 19X9	$238,398	$43,214	$(462,225)	$(180,613)
Excess from current endeavors	—	(4,620)	260,513	255,893
Capital additions	18,250	—	—	18,250
Entity capital—June 30, 19X0	256,648	38,594	(201,712)	93,530
Excess from current endeavors	—	(5,533)	286,242	280,709
Capital additions	11,221	—	—	11,221
Entity capital—June 30, 19X1	$267,869	$33,061	$ 84,530	$385,460

Exhibit 6D

Sample Performing Arts Organization
Statement of Changes in Financial Position
Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Funds provided by		
Excess from current endeavors	$ 280,709	$ 255,893
Add expenses not requiring outlay of working capital in current period		
Depreciation	5,533	4,620
Other deferred charges	—	7,500
Funds provided from current endeavors	286,242	268,013
Increase in long-term debt	12,260	—
Other	5,291	—
Capital additions	11,221	18,250
Total funds provided	315,014	286,263
Funds applied		
Increase in noncurrent investments and cash	11,221	—
Acquisition of property, plant, and equipment	20,368	4,362
Reduction of long-term debt	50,000	25,280
Total funds applied	81,589	29,642
Increase in working capital	$ 233,425	$ 256,621
Changes in the components of working capital		
Increase (decrease) in current assets		
Cash	$ 46,608	$ 220,342
Marketable securities	215,363	42,312
Accounts receivable	43,366	21,269
Grants receivable	(6,100)	—
Other	25,937	15,413
Increase in current assets	325,174	299,336
(Increase) decrease in current liabilities		
Accounts payable and accrued expenses	55,201	36,149
Deferred revenues—subscriptions	(104,388)	(78,864)
Deferred revenues—grants	(42,562)	—
(Increase) in current liabilities	(91,749)	(42,715)
Increase in working capital	$ 233,425	$ 256,621

Exhibit 6E

Sample Performing Arts Organization

Notes to Financial Statements *

June 30, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

Note 2—Investments

Note 3—Property and Equipment

Note 4—Long-Term Debt

Note 5—Endowments

An endowment in the amount of $125,000 required the establishment of a ballet school. The second endowment, in the amount of $100,000, established the organization's neighborhood production program. Income from those endowments, including capital gains, is to be used for those programs.

Note 6—Commitments and Contingencies

The organization leases its theatre and offices under a lease expiring in 19X8 at $25,000 per year with a renewal option for ten years at the same rent. Heating, ventilating, and air-conditioning are paid separately as common area charges. The lease is not considered a capital lease under FASB Statement 13.

Grants, bequests, and endowments require the fulfillment of certain conditions as set forth in the instrument of grant. Failure to fulfill the conditions, or in the case of endowments, failure to continue to fulfill them, could result in the return of the funds to grantors. Although that is a possibility, the Board deems the contingency remote, since by accepting the gifts and their terms, it has accommodated the objectives of the organization to the provisions of the gift.

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* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 6F

Sample Performing Arts Organization

Schedule of Functional Expenses—Supplementary Schedule

Year Ended June 30, 19X1

(With Comparative Totals for 19X0)

	Program Services					*Support Services*			
Item of Expense	*Production Costs*	*Operating Expenses*	*Ballet School*	*Neighborhood Productions*	*Total Program Services*	*General and Administrative*	*Fund Raising*	*Total Year Ended 19X1*	*Total Year Ended 19X0*
Salaries, payroll taxes, and employee benefits	$219,370	$464,570	$388,113	$306,026	$1,378,079	$260,755	$15,782	$1,654,616	$1,312,504
Professional fees	7,864	—	2,785	—	10,649	15,624	—	26,273	21,722
Supplies	15,628	17,128	—	3,728	36,484	25,823	—	62,307	43,784
Telephone	—	—	—	—	—	10,725	1,211	11,936	10,783
Postage and shipping	—	—	—	—	—	3,816	14,439	18,255	15,622
Occupancy	—	258,622	82,760	5,478	346,860	41,540	1,527	389,927	322,147
Rental and maintenance of equipment	—	56,724	—	—	56,724	6,927	2,784	66,435	52,764
Printing and publications	—	—	—	—	—	10,381	—	10,381	10,078
Travel	—	—	—	—	—	5,824	—	5,824	4,728
Conferences, conventions, and meetings	—	—	—	—	—	2,783	—	2,783	1,568
Membership dues	—	—	—	—	—	756	—	756	2,064
Scenery	154,682	—	—	35,540	190,222	—	—	190,222	143,523
Costumes	79,438	—	—	27,682	107,120	—	—	107,120	70,762
Depreciation and amortization	—	—	—	—	—	5,533	—	5,533	4,620
Total, year ended June 30, 19X1	$476,982	$797,044	$473,658	$378,454	$2,126,138	$390,487	$35,743	$2,552,368	
Total, year ended June 30, 19X0	$427,754	$685,522	$301,722	$ 81,326	1,496,324	$469,891	$50,454		$2,016,669

Exhibit 7—PRIVATE FOUNDATION

Exhibit 7A

Sample Private Foundation

Balance Sheet

December 31, 19X1, and 19X0

	19X1	*19X0*
Assets		
Cash	$ 75,000	$ 50,000
Accrued interest and dividends receivable	175,000	225,000
Securities, at market (cost, 19X1—$17,800,000; 19X0—$17,400,000) (Note 2)		
U.S. government obligations	2,000,000	1,750,000
Corporate and other obligations	5,000,000	7,000,000
Stocks	12,000,000	10,000,000
	19,000,000	18,750,000
Total assets	$19,250,000	$19,025,000
Liabilities and Fund Balance		
Federal excise taxes payable (Note 3)	$ 41,000	$ 39,000
Accrued expenses payable	9,000	11,000
Deferred taxes	10,000	5,000
Unconditional grants payable	40,000	75,000
Total liabilities	100,000	130,000
Commitments (Note 4)		
Fund balance	19,150,000	18,895,000
Total liabilities and fund balance	$19,250,000	$19,025,000

Exhibit 7B

Sample Private Foundation

Statement of Revenue, Expense, and Changes in Fund Balance

Years Ended December 31, 19X1, and 19X0

	19X1	*19X0*
Revenue and support		
Dividends	$ 525,000	$ 500,000
Interest	500,000	585,000
Unrestricted donations	100,000	—
Total revenue and support	1,125,000	1,085,000
Expense		
Program services		
Program grants		
Health	530,000	525,000
Education	390,000	375,000
Program management	82,500	80,000
	1,002,500	980,000
Management and general expenses	72,500	70,000
Provision for federal excise taxes	40,000	38,000
	112,500	108,000
Total expense	1,115,000	1,088,000
Excess (deficiency) of revenue and support over expense before gains (losses) on securities	10,000	(3,000)
Net gains (losses) on securities	245,000	(172,000)
Excess (deficiency) for the year	255,000	(175,000)
Fund balance, beginning of year	18,895,000	19,070,000
Fund balance, end of year	$19,150,000	$18,895,000

Exhibit 7C

Sample Private Foundation

Statement of Changes in Cash

Years Ended December 31, 19X1, and 19X0

	19X1	*19X0*
Sources of cash		
Excess (deficiency) for the year	$ 255,000	$ (175,000)
Net (gains) losses on securities	(245,000)	172,000
Decrease in accrued interest and dividends receivable	50,000	40,000
Proceeds on disposition of securities	5,105,000	4,000,000
	5,165,000	4,037,000
Uses of cash		
Purchase of securities	5,110,000	4,007,000
Decrease in liabilities	30,000	40,000
	5,140,000	4,047,000
Increase (decrease) in cash for year	25,000	(10,000)
Cash, beginning of year	50,000	60,000
Cash, end of year	$ 75,000	$ 50,000

Exhibit 7D

Sample Private Foundation

Notes to Financial Statements *

December 31, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Office Furnishings

Costs of office furnishings and equipment are consistently charged to expense because the foundation does not deem such amounts to be sufficiently material to warrant capitalization and depreciation.

Note 2—Investment in Securities

Note 3—Federal Excise Taxes

In accordance with the applicable provisions of the Tax Reform Act of 1969, the foundation is subject to an excise tax on net investment income, including realized gains, as defined in the act. Accordingly, federal excise taxes have been accrued in amounts of $41,000 and $39,000 as of December 31, 19X1, and 19X0, respectively.

In addition, the Tax Reform Act requires that certain minimum distributions be made in accordance with a specified formula. At December 31, 19X1, the foundation had distributed approximately $200,000 more than the required minimum.

Note 4—Commitments

Trustees of the foundation had approved, as of December 31, 19X1, and 19X0, grants amounting to $750,000 and $700,000, respectively. Such grants are subject to the satisfaction by the intended recipients of prior conditions before payment. The commitments outstanding at December 31, 19X1, are scheduled for payment as follows.

Year	*Amount*
19X2	$600,000
19X3	100,000
19X4	50,000
	$750,000

Note 5—Pension and Other Postretirement Benefit Plans

Note 6—Functional Allocation of Expenses

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 8—PUBLIC BROADCASTING STATION

Exhibit 8A

Sample Public Broadcasting Station

Balance Sheet

December 31, 19X1, and 19X0

	19X1			19X0
	Unrestricted	*Restricted*	*Total*	*Total*
Assets				
Current assets				
Cash	$ 78,000	$ 24,000	$ 102,000	$ 71,000
Accounts receivable, principally grants, net of allowance for doubtful accounts of $4,000 in 19X1, and $9,000 in 19X0 (Note 2)	192,000	80,000	272,000	245,000
Costs incurred for programs not yet telecast (Note 1)	117,000	74,000	191,000	176,000
Other assets	105,000	—	105,000	89,000
Total current assets	492,000	178,000	670,000	581,000
Property and equipment (Notes 1 and 3)				
Leasehold improvements, net of accumulated amortization of $154,000 in 19X1, and $94,000 in 19X0	359,000	—	359,000	374,000
Television and other equipment, net of accumulated depreciation of $672,000 in 19X1, and $407,000 in 19X0	1,568,000	—	1,568,000	1,676,000
	1,927,000	—	1,927,000	2,050,000
Total assets	$2,419,000	$178,000	$2,597,000	$2,631,000
Liabilities and Fund Balance				
Current liabilities				
Accounts payable and accrued expenses	$ 113,000	—	$ 113,000	$ 186,000
Deferred revenue for programs not yet telecast (Notes 1 and 7)	—	$178,000	178,000	270,000
Current portion of long-term debt (Note 4)	50,000	—	50,000	—
Total current liabilities	163,000	178,000	341,000	456,000
Long-term debt (Note 4)	250,000	—	250,000	300,000
Total liabilities	413,000	178,000	591,000	756,000
Fund balance	2,006,000	—	2,006,000	1,875,000
Total liabilities and fund balance	$2,419,000	$178,000	$2,597,000	$2,631,000

Exhibit 8B

Sample Public Broadcasting Station
Statement of Revenue, Expenses, and Changes in Fund Balance
Years Ended December 31, 19X1, and 19X0

	19X1			19X0
	Unrestricted	*Restricted*	*Total*	*Total*
Revenue (Note 2)				
Contributions	$ 946,000	—	$ 946,000	$ 790,000
Community service grants	—	$327,000	327,000	287,000
Other grants	—	189,000	189,000	155,000
Telecasting and production	286,000	—	286,000	302,000
Facilities rental	36,000	—	36,000	31,000
Total revenue	1,268,000	516,000	1,784,000	1,565,000
Expenses				
Program services				
Programming production, including designated projects (Note 1)	274,000	335,000	609,000	563,000
Broadcasting and technical	385,000	—	385,000	279,000
Public information	162,000	—	162,000	134,000
Total program expenses	821,000	335,000	1,156,000	976,000
Supporting services				
General administration	372,000	136,000	508,000	421,000
Fund raising	146,000	45,000	191,000	154,000
Total supporting expenses	518,000	181,000	699,000	575,000
Total expenses	1,339,000	516,000	1,855,000	1,551,000
Excess (deficiency) of revenue over expenses before special grants	(71,000)	—	(71,000)	14,000
Special grants	202,000		202,000	107,000
Excess for the year	131,000		131,000	121,000
Fund balance, beginning of year	1,875,000		1,875,000	1,754,000
Fund balance, end of year	$2,006,000		$2,006,000	$1,875,000

Exhibit 8C

Sample Public Broadcasting Station

Statement of Changes in Financial Position

Years Ended December 31, 19X1, and 19X0

	19X1			*19X0*
	Unrestricted	*Restricted*	*Total*	*Total*
Financial resources were provided by				
Excess (deficiency) of revenue over expenses before special grants	$(71,000)	—	$(71,000)	$ 14,000
Special grants	202,000	—	202,000	107,000
Excess for the year	131,000	—	131,000	121,000
Add items not requiring working capital — amortization and depreciation	325,000	—	325,000	281,000
Working capital provided by operations	456,000	—	456,000	402,000
Increase in long-term debt	—	—	—	300,000
Total resources provided	456,000	—	456,000	702,000
Financial resources were used for				
Leasehold improvements	45,000	—	45,000	30,000
Purchases of property and equipment	157,000	—	157,000	457,000
Reduction of long-term debt	50,000	—	50,000	—
Total resources used	252,000	—	252,000	487,000
Increase in working capital	$204,000	—	$204,000	$215,000
Analysis of changes in working capital				
Increase (decrease) in current assets				
Cash	$ 57,000	$(26,000)	$ 31,000	$ 25,000
Accounts receivable	62,000	(35,000)	27,000	49,000
Costs incurred for programs not yet telecast	46,000	(31,000)	15,000	45,000
Other assets	16,000	—	16,000	21,000
	181,000	(92,000)	89,000	140,000
Decrease (increase) in current liabilities				
Accounts payable and accrued expenses	73,000	—	73,000	32,000
Deferred revenue for programs not yet telecast	—	92,000	92,000	43,000
Current portion of long-term debt	(50,000)	—	(50,000)	—
	23,000	92,000	115,000	75,000
	$204,000	—	$204,000	$215,000

Exhibit 8D

Sample Public Broadcasting Station

Notes to Financial Statements *

December 31, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Programs Not Yet Telecast

Costs incurred for programs not yet telecast relate to programs that will be aired principally in the next fiscal year. Grants and contributions relating to programs not yet telecast are included as deferred revenue. As the programs are telecast, the costs incurred will be included in operating expenses and the deferred revenue will be included in revenue.

Note 2—Grants

Note 3—Property and Equipment

Note 4—Long-Term Debt

Note 5—Lease Commitments

Note 6—Pension and Other Postretirement Benefit Plans

Note 7—Changes in Restricted Deferred Revenue

Note 8—Functional Allocation of Expenses

In 19X1 the station incurred joint costs of $278,000 for informational materials and activities that included fund-raising appeals. Those costs were allocated as follows:

	19X1
Public information	$ 72,000
Fund raising	63,000
	$135,000

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 9A

Sample Religious Organization

Balance Sheet

December 31, 19X1

	Expendable Funds				*Nonexpendable Funds*		
Assets	*Operating*	*Deposit and Loan*	*Total*	*Plant Fund*	*Endowment*	*Annuity and Life Income*	*Total All Funds*
Cash	$1,750,000	$ 10,000	$ 1,760,000	$ 408,000	$ 20,000	$ 2,000	$ 2,190,000
Accounts receivable, less allowance for doubtful receivables of $12,000	520,000	—	520,000	—	—	—	520,000
Pledges receivable, less allowance for doubtful pledges of $25,000	500,000	—	500,000	80,000	—	—	580,000
Investments (Note 2)	3,800,000	300,000	4,100,000	260,000	1,300,000	178,000	5,838,000
Loans receivable, less allowance for doubtful loans of $350,000	—	2,600,000	2,600,000	—	—	—	2,600,000
Advances to plant funds	—	3,500,000	3,500,000	—	—	—	—*
Land, buildings, and equipment at cost, less accumulated depreciation of $23,500,000 (Note 3)	—	—	—	44,800,000	—	—	44,800,000
Other assets	150,000	—	150,000	—	—	—	150,000
Total assets	$6,720,000	$6,410,000	$13,130,000	$45,548,000	$1,320,000	$180,000	$56,678,000

* Interfund borrowings eliminated in combination.

Liabilities and Fund Balances							
Accounts payable and accrued expenses	$ 600,000	—	$ 600,000	$ 20,000	—	$120,000	$ 740,000
Deferred amounts (Note 6)							
Unrestricted	160,000	—	160,000	—	—	—	160,000
Restricted	870,000	—	870,000	328,000	—	60,000	1,258,000
Advances from expendable funds	—	—	—	3,500,000	—	—	—*
Deposits payable	—	$7,310,000	7,310,000	—	—	—	7,310,000
Long-term debt (Note 4)	—	—	—	2,800,000	—	—	2,800,000
Total liabilities	1,630,000	7,310,000	8,940,000	6,648,000	—	180,000	12,268,000
Fund balances (deficit)							
Unrestricted							
Designated for long-term investment	3,800,000	—	3,800,000	—	—	—	3,800,000
Undesignated	1,290,000	(900,000)	390,000	—	—	—	390,000
	5,090,000	(900,000)	4,190,000	—	—	—	4,190,000
Restricted	—	—	—	—	$1,320,000	—	1,320,000
Net investment in plant	—	—	—	38,900,000	—	—	38,900,000
Total fund balances (deficit)	5,090,000	(900,000)	4,190,000	38,900,000	1,320,000	—	44,410,000
Total liabilities and fund balances	$6,720,000	$6,410,000	$13,130,000	$45,548,000	$1,320,000	$180,000	$56,678,000

* Interfund borrowings eliminated in combination.

Exhibit 9B

Sample Religious Organization

Statement of Support and Revenue, Expenses, Capital Additions, and Changes in Fund Balances

Year Ended December 31, 19X1

	Expendable Funds						
	Operating					*Nonexpendable*	
	Unrestricted	*Restricted*	*Deposit and Loan*	*Total*	*Plant Fund*	*Endowment Funds*	*Total All Funds*
Support and revenue							
Contributions and bequests	$ 6,800,000	$180,000	–	$ 6,980,000	–	–	$ 6,980,000
Fees for services	4,000,000	–	–	4,000,000	–	–	4,000,000
Endowment and other investment income	200,000	40,000	–	240,000	–	–	240,000
Net gain on investment transactions	250,000	–	–	250,000	–	–	250,000
Contributed services	950,000	–	–	950,000	–	–	950,000
Auxiliary activities	205,000	–	$ 535,000	740,000	–	–	740,000
Total support and revenue	12,405,000	220,000	535,000	13,160,000	–	–	13,160,000
Expenses							
Program services							
Pastoral	3,300,000	45,000	–	3,345,000	$ 300,000	–	3,645,000
Education	4,000,000	80,000	–	4,080,000	460,000	–	4,540,000
Health care	2,800,000	25,000	–	2,825,000	250,000	–	3,075,000
Social services	900,000	50,000	–	950,000	85,000	–	1,035,000
Cemeteries	220,000	20,000	–	240,000	20,000	–	260,000
Religious personnel development	600,000	–	–	600,000	55,000	–	655,000
Auxiliary activities	160,000	–	685,000	845,000	5,000	–	850,000
Total program services	11,980,000	220,000	685,000	12,885,000	1,175,000	–	14,060,000

Supporting services							
General administration	180,000	–	–	180,000	15,000	–	195,000
Fund raising	120,000	–	–	120,000	10,000	–	130,000
Total supporting services	300,000	–	–	300,000	25,000	–	325,000
Total expenses	12,280,000	220,000	685,000	13,185,000	1,200,000	–	14,385,000
Excess (deficiency) of support and revenue over expenses before capital additions	125,000	–	(150,000)	(25,000)	(1,200,000)	–	(1,225,000)
Capital additions							
Contributions and bequests	–	–	–	–	310,000	$ 200,000	510,000
Investment income	–	–	–	–	15,000	–	15,000
Net gain on investment transactions	–	–	–	–	–	80,000	80,000
Total capital additions	–	–	–	–	325,000	280,000	605,000
Excess (deficiency) of support and revenue over expenses after capital additions	125,000	–	(150,000)	(25,000)	(875,000)	280,000	(620,000)
Fund balances (deficit) at beginning of year	5,315,000	–	(750,000)	4,565,000	39,425,000	1,040,000	45,030,000
Transfers to plant funds for plant acquisitions and principal debt service payments financed from operating funds	(350,000)	–	–	(350,000)	350,000	–	–
Fund balances (deficit) at end of year	$ 5,090,000	–	$ (900,000)	$ 4,190,000	$38,900,000	$ 1,320,000	$ 44,410,000

Exhibit 9C

Sample Religious Organization

Statement of Changes in Financial Position

Year Ended December 31, 19X1

	Expendable Funds				*Nonexpendable Funds*		
	Operating	*Deposit and Loan*	*Total*	*Plant Fund*	*Endowment*	*Annuity and Life Income*	*Total All Funds*
Resources provided							
Excess (deficiency) of support and revenue over expenses before capital additions	$ 125,000	$(150,000)	$ (25,000)	$(1,200,000)	–	–	$(1,225,000)
Capital additions							
Contributions and bequests	–	–	–	310,000	$ 200,000	–	510,000
Investment income	–	–	–	15,000	–	–	15,000
Net gain on investment transactions	–	–	–	–	80,000	–	80,000
Excess (deficiency) of support and revenue over expenses after capital additions	125,000	(150,000)	(25,000)	(875,000)	280,000	–	(620,000)
Items that do not use (provide) resources							
Provision for depreciation	–	–	–	1,200,000	–	–	1,200,000
Net gain on investment transactions	(250,000)	(15,000)	(265,000)	–	(80,000)	$ (12,000)	(357,000)
Issuance of long-term debt	–	–	–	400,000	–	–	400,000
Increase in deferred amounts	650,000	–	650,000	3,000	–	2,000	655,000
Proceeds from sale of investments	1,800,000	210,000	2,010,000	332,000	590,000	49,000	2,981,000
Total resources provided	2,325,000	45,000	2,370,000	1,060,000	790,000	39,000	4,259,000

Resources used							
Purchases of building and equipment	–	–	–	755,000	–	–	755,000
Reduction of long-term debt	–	–	–	320,000	–	–	320,000
Purchases of investments	1,830,000	70,000	1,900,000	–	784,000	36,000	2,720,000
Increase in accounts and pledges receivable	400,000	–	400,000	5,000	–	–	405,000
Increase in loans receivable	–	45,000	45,000	–	–	–	45,000
Decrease in accounts payable and accrued expenses	70,000	–	70,000	10,000	–	2,000	82,000
Decrease in deposits payable	–	10,000	10,000	–	–	–	10,000
Total resources used	2,300,000	125,000	2,425,000	1,090,000	784,000	38,000	4,337,000
Transfers to plant funds for plant acquisitions and principal debt service payments financed from operating funds	(350,000)	–	(350,000)	350,000	–	–	–
Increase (decrease) in cash	$ (325,000)	$ (80,000)	$ (405,000)	$ 320,000	$ 6,000	$ 1,000	$ (78,000)

Exhibit 9D

Sample Religious Organization

Notes to Financial Statements *

December 31, 19X1

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Basis of Presentation

The accompanying financial statements include the assets, liabilities, fund balances, and financial activities of all institutions and organizations providing services at the level of administration above the individual congregation. All significant balances and transactions among the organizations included in the financial statements have been eliminated.

Other Matters

Support arising from contributed services of certain religious personnel has been recognized in the accompanying financial statements. The computation of the value of the contribution of those services represents the difference between the stipends and other amounts paid to or on behalf of the religious personnel and the comparable compensation that would be paid to lay persons if lay persons were to occupy those positions. No computation is made for positions that can be held only by religious personnel.

Note 2—Investments

Note 3—Plant Assets and Depreciation

Note 4—Long-Term Debt

Note 5—Pension and Other Postretirement Benefit Plans

Note 6—Changes in Deferred Restricted Amounts

Note 7—Functional Allocation of Expenses

Note 8—Commitment

The organization has a lease for certain office facilities that expires December 31, 19X9. The lease contains operating expense and real estate tax escalation clauses. The minimum rental commitment on the lease as of December 31, 19X1, aggregates approximately $210,000 with annual payments ranging from $25,000 to $35,000. Rent expense for the year ended December 31, 19X1, amounted to $28,000.

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* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 10—RESEARCH AND SCIENTIFIC ORGANIZATION

Exhibit 10A

Sample Research and Scientific Organization

Balance Sheet

June 30, 19X1, and 19X0

Assets	*19X1*	*19X0*
Current assets		
Cash	$ 125,000	$ 115,000
Certificates of deposit	200,000	210,000
Accounts receivable	372,000	346,000
Unbilled contract revenues reimbursable grant expenses	488,000	390,000
Prepaid expenses and other current assets	40,000	38,000
Total current assets	1,225,000	1,099,000
Property, plant, and equipment (Notes 1 and 4)		
Land and building	220,000	220,000
Furniture and equipment	167,000	156,000
Leased property under capital leases	479,000	479,000
	866,000	855,000
Less—accumulated depreciation and amortization	259,000	185,000
	607,000	670,000
	$1,832,000	$1,769,000

Liabilities and Fund Balance	*19X1*	*19X0*
Current liabilities		
Accounts payable and accrued expenses	$ 418,000	$ 388,000
Restricted grant advances (Note 2)	261,000	210,000
Obligations under capital leases (Note 4)	88,000	82,000
Total current liabilities	767,000	680,000
Noncurrent capital lease obligations (Note 4)	309,000	397,000
	1,076,000	1,077,000
Fund balance		
Unrestricted	458,000	419,000
Net equity in fixed assets	298,000	273,000
Total fund balance	756,000	692,000
	$1,832,000	$1,769,000

Exhibit 10B

Sample Research and Scientific Organization

Statement of Revenues, Expenses, and Changes in Fund Balance

Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Revenues (Notes 1, 2, and 3)		
Contract revenues—U.S. government	$ 5,958,000	$5,578,000
Restricted grants—foundations and individuals	4,752,000	4,172,000
Other, including interest	43,000	41,000
	10,753,000	9,791,000
Expenses		
Research and development		
Environmental	5,263,000	4,997,000
Health	2,992,000	2,766,000
National defense	1,166,000	938,000
Management and general	1,103,000	985,000
Contract and grant procurement	165,000	151,000
	10,689,000	9,837,000
Excess (deficiency) of revenues over expenses	64,000	(46,000)
Fund balance, beginning of year	692,000	738,000
Fund balance, end of year	$ 756,000	$ 692,000

Exhibit 10C

Sample Research and Scientific Organization
Statement of Changes in Financial Position
Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Financial resources were provided by		
Excess (deficiency) of revenues over expenses	$ 64,000	$ (46,000)
Add—expenses not requiring current outlay of working capital—depreciation and amortization	74,000	26,000
Working capital provided by (used in) operations	138,000	(20,000)
Financing of fixed asset additions through capital leases	—	397,000
Total resources provided	138,000	377,000
Financial resources were used for		
Acquisition of property, plant, and equipment	11,000	481,000
Reduction of noncurrent capital lease obligations	88,000	—
Total resources used	99,000	481,000
Increase (decrease) in working capital	$ 39,000	$(104,000)
Changes in working capital were represented by		
Increase (decrease) in current assets—		
Cash	$ 10,000	$ (14,000)
Certificates of deposit	(10,000)	(40,000)
Accounts receivable	26,000	10,000
Unbilled contract revenues and reimbursable grant expenses	98,000	42,000
Other	2,000	(1,000)
	126,000	(3,000)
(Increase) decrease in current liabilities—		
Accounts payable and accrued expenses	(30,000)	(23,000)
Restricted grant advances	(51,000)	4,000
Obligations under capital leases	(6,000)	(82,000)
	(87,000)	(101,000)
Increase (decrease) in working capital	$ 39,000	$(104,000)

Exhibit 10D

Sample Research and Scientific Organization

Notes to Financial Statements *

June 30, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

(In addition to the policy disclosures illustrated in Note 1 of exhibit 1, the following are typical of additional disclosures to be considered for this type of organization.)

Revenue Recognition

Substantially all of the organization's revenue is derived from restricted grants and cost-plus-fixed-fee contracts. Revenue is recognized based on the proportion of project expenses incurred to total anticipated project expenses (percentage-of-completion method). Losses on contracts are recognized when identified.

Note 2—Restricted Grants

Note 3—Government Contracts

Certain contract costs billed to the U.S. government are subject to audit by the Defense Contract Audit Agency. The agency has audited costs billed before July 1, 19X0.

Note 4—Lease Commitments

The organization uses data processing equipment under capital leases expiring in 19X7 which provide for the transfer of ownership of the equipment at the end of the lease term. The related future minimum lease payments as of June 30, 19X1, are as follows:

19X2	$ 94,000
19X3	94,000
19X4	94,000
19X5	94,000
19X6	94,000
19X7	10,000
	480,000
Less—amount representing interest	(83,000)
Present value of minimum lease payments	$397,000

Note 5—Functional Allocation of Expenses

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 11—TRADE ASSOCIATION

Exhibit 11A

Sample Trade Association

Balance Sheet

June 30, 19X1, and 19X0

	19X1	*19X0*
Assets		
Current assets		
Cash	$ 15,000	$ 24,000
Marketable securities, at market (Note 2)	433,000	330,000
Accounts receivable, net of allowance for doubtful accounts of $6,000 in 19X1 and $8,000 in 19X0	51,000	67,000
Publications inventory, at lower of cost (FIFO) or market	122,000	80,000
Total current assets	621,000	501,000
Long-term investments, at market (Note 2)	240,000	250,000
Fixed assets, at cost, net of accumulated depreciation of $45,000 in 19X1 and $26,000 in 19X0 (Note 1)	66,000	60,000
Other assets	56,000	46,000
Total assets	$983,000	$857,000
Liabilities and Fund Balance		
Current liabilities		
Accounts payable and accrued expenses	$ 96,000	$ 41,000
Deferred membership dues (Note 1)	262,000	245,000
Total current liabilities	358,000	286,000
Fund balance	625,000	571,000
Total liabilities and fund balance	$983,000	$857,000

Exhibit 11B

Sample Trade Association

Statement of Revenue, Expenses, and Changes in Fund Balance

Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Revenue		
Membership dues (Note 1)	$ 369,000	$ 279,000
Conferences and meetings	642,000	601,000
Publication sales and advertising	285,000	275,000
Special assessments	101,000	95,000
Investment income including net gains on investments	21,000	23,000
Total revenue	1,418,000	1,273,000
Expenses (Note 5)		
Member services	113,000	109,000
Conferences and meetings	335,000	334,000
Technical services	437,000	472,000
Communications, including publication of magazine	122,000	72,000
Total program expenses	1,007,000	987,000
General administration	308,000	219,000
Membership development	49,000	38,000
Total expenses	1,364,000	1,244,000
Excess of revenue over expenses	54,000	29,000
Fund balance, beginning of year	571,000	542,000
Fund balance, end of year	$ 625,000	$ 571,000

Exhibit 11C

Sample Trade Association

Statement of Changes in Financial Position

Years Ended June 30, 19X1, and 19X0

	19X1	*19X0*
Funds were provided by		
Excess of revenue over expenses	$ 54,000	$29,000
Add item not requiring funds—depreciation	19,000	12,000
Funds provided by operations	73,000	41,000
Sale of long-term investments	10,000	—
Total funds provided	83,000	41,000
Funds were used for		
Purchase of fixed assets	(25,000)	—
Increase in other assets	(10,000)	(25,000)
Total funds used	(35,000)	(25,000)
Increase in working capital	$ 48,000	$16,000
Analysis of changes in working capital		
Increase (decrease) in current assets		
Cash	$ (9,000)	$17,000
Marketable securities	103,000	21,000
Accounts receivable	(16,000)	(8,000)
Publications inventory	42,000	16,000
	120,000	46,000
Decrease (increase) in current liabilities		
Accounts payable and accrued expenses	(55,000)	(17,000)
Deferred membership dues	(17,000)	(13,000)
	(72,000)	(30,000)
	$ 48,000	$16,000

Exhibit 11D

Sample Trade Association

Notes to Financial Statements *

June 30, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

Note 2—Investments

Note 3—Pension and Other Postretirement Benefit Plans

Note 4—Lease Agreements/Commitments

Note 5—Functional Allocation of Expenses

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 12—UNION

Exhibit 12A

Sample Union

Balance Sheet

December 31, 19X1

(With Comparative Totals for 19X0)

Assets	*General Fund (Undesignated)*	*Strike Insurance Fund (Designated)*	*December 31, 19X1 Total*	*December 31, 19X0 Total*
Current assets				
Cash (including savings accounts of $2,100,000 and $1,050,000) (Note 3)	$ 650,800	$ 1,710,000	$ 2,360,000	$ 1,238,100
Investments at market	491,800	9,054,200	9,546,000	9,640,400
Per capita dues receivable	51,800	133,200	185,000	189,500
Accrued interest receivable	1,800	210,700	212,500	214,600
Loans to affiliated organizations (Note 4)	21,400	—	21,400	27,300
Accounts receivable (less allowance for doubtful accounts of $2,300 and $2,500)	67,900	—	67,900	68,900
Prepaid expenses	74,900	—	74,900	71,500
Total current assets	1,360,400	11,108,100	12,468,500	11,450,300

Property, furniture, and equipment at cost (Note 1)				
Land	678,400	—	678,400	678,400
Buildings (net of accumulated depreciation of $743,500 and $675,600)	1,973,400	—	1,973,400	1,515,500
Furniture and equipment (net of accumulated depreciation of $314,800 and $278,200)	50,800	—	50,800	87,400
Total property, furniture, and equipment	2,702,600	—	2,702,600	2,281,300
Total assets	$4,063,000	$11,108,100	$15,171,100	$13,731,600
Liabilities and Fund Balances				
Current liabilities				
Accounts payable	$ 337,600	—	$ 337,600	$ 423,100
Notes payable	13,100	—	13,100	19,600
Affiliation dues payable	48,800	—	48,800	49,600
Accrued salaries	31,500	—	31,500	33,000
Payroll taxes and employee deductions payable	89,300	—	89,300	90,400
Total current liabilities	520,300	—	520,300	615,700
Fund balances	3,542,700	$11,108,100	14,650,800	13,115,900
Total liabilities and fund balances	$4,063,000	$11,108,100	$15,171,100	$13,731,600

Exhibit 12B

Sample Union

Statement of Revenue, Expense, and Changes in Fund Balances

Year Ended December 31, 19X1

(With Comparative Totals for 19X0)

	General Fund (Undesignated)	*Strike Insurance Fund (Designated)*	*December 31, 19X1 Total*	*December 31, 19X0 Total*
Revenue				
Per capita dues (Note 2)	$9,385,500	$ 3,532,300	$12,917,800	$13,219,800
Initiation fees	24,100	—	24,100	22,800
Sales of organizational supplies	26,700	—	26,700	17,900
Rental income	216,300	—	216,300	216,100
Administrative fees—apprentice training	11,800	—	11,800	12,100
Interest income	28,100	609,000	637,100	644,100
Total revenue	9,692,500	4,141,300	13,833,800	14,132,800

Expense (Note 6)				
Program services				
Strike assistance to local unions	877,900	2,630,500	3,508,400	3,345,600
Constitutional convention	154,600	—	154,600	132,800
Field office services				
Organization	2,054,000	—	2,054,000	2,106,500
Negotiation	2,156,700	—	2,156,700	2,212,000
Grievance	924,300	—	924,300	947,900
Total program services	6,167,500	2,630,500	8,798,000	8,744,800
Administrative and general	3,537,700	57,600	3,595,300	1,425,200
Net (gains) losses on investments	(94,400)	—	(94,400)	2,062,800
Total expense	9,610,800	2,688,100	12,298,900	12,232,800
Excess of revenue over expense	81,700	1,453,200	1,534,900	1,900,000
Fund balances, beginning of year	3,461,000	9,654,900	13,115,900	11,215,900
Fund balances, end of year	$3,542,700	$11,108,100	$14,650,800	$13,115,900

Exhibit 12C

Sample Union

Statement of Changes in Financial Position

Year Ended December 31, 19X1

(With Comparative Totals for 19X0)

	General Fund (Undesignated)	*Strike Insurance Fund (Designated)*	*December 31, 19X1 Total*	*December 31, 19X0 Total*
Sources of working capital				
Excess of revenue over expense	$ 81,700	$1,453,200	$1,534,900	$1,900,000
Add charges not affecting working capital				
Depreciation	104,500	—	104,500	100,300
Working capital provided	186.200	1,453,200	1,639,400	2,000,300
Use of working capital				
Purchase of property, furniture, and equipment	525,800	—	525,800	352,000
Increase (decrease) in working capital	$ (339,600)	$1,453,200	$1,113,600	$1,648,300

Changes in working capital				
Increase (decrease) in current assets				
Cash	$ (413,900)	$1,536,600	$1,122,700	$ 186,300
Investments	(15,900)	(78,500)	(94,400)	1,425,200
Per capita dues receivable	(1,300)	(3,200)	(4,500)	(2,300)
Accrued interest receivable	(400)	(1,700)	(2,100)	(1,200)
Loans to affiliated organizations	(5,900)	—	(5,900)	(2,600)
Accounts receivable	(1,000)	—	(1,000)	(100)
Prepaid expenses	3,400	—	3,400	2,900
	(435,000)	1,453,200	1,018,200	1,608,200
Increase (decrease) in current liabilities				
Accounts payable	(85,500)	—	(85,500)	(32,200)
Notes payable	(6,500)	—	(6,500)	(6,500)
Affiliation dues payable	(800)	—	(800)	(200)
Accrued salaries	(1,500)	—	(1,500)	(800)
Payroll taxes and employee deductions payable	(1,100)	—	(1,100)	(400)
	(95,400)	—	(95,400)	(40,100)
Increase (decrease) in working capital	$ (339,600)	$1,453,200	$1,113,600	$1,648,300

Exhibit 12D

Sample Union

Notes to Financial Statements*

December 31, 19X1, and 19X0

Note 1—Summary of Significant Accounting Policies

Note 2—Strike Insurance Fund

In accordance with the provisions of the Union Constitution, 27 percent of the per capita dues paid to the Union are designated for the Strike Insurance Fund. The fund may be distributed for strike relief at the discretion of the Union Executive Board. No charges may be made against the fund for administrative expenses.

Note 3—Pledged Assets and Contingent Liabilities

The Union is contingently liable as guarantor of a loan of $15,000 to an affiliated local. In connection with the guarantee, a savings account, having a balance of $20,000, is pledged as collateral for the loan.

Note 4—Loans to Affiliated Organizations

The loans to affiliated organizations represent short-term loans to local unions at current interest rates. All such loans are expected to be collected within one year.

Note 5—Pension and Other Postretirement Benefit Plans

Note 6—Functional Allocation of Expenses

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* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Exhibit 13—ZOOLOGICAL AND BOTANICAL SOCIETY

Exhibit 13A

Sample Zoological and Botanical Society

Balance Sheet

December 31, 19X1

	Operating Funds	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Assets				
Cash	$ 257,000	$ 20,000	$ 50,000	$ 327,000
Accounts receivable, less allowance for doubtful receivables of $18,000	125,000	—	—	125,000
Pledges receivable, less allowance for doubtful pledges of $95,000	520,000	120,000	—	640,000
Inventories, at lower of cost (FIFO) or market	330,000	—	—	330,000
Investments (Note 2)	7,800,000	3,000,000	2,800,000	13,600,000
Land, buildings, and equipment, at cost or fair value at date of gift, less accumulated depreciation of $10,500,000 (Note 3)	—	23,000,000	—	23,000,000
Other assets	180,000	—	—	180,000
Collections (Note 9)	—	—	—	—
Total assets	$9,212,000	$26,140,000	$ 2,850,000	$38,202,000
Liabilities and Fund Balances				
Accounts payable and accrued expenses	$ 350,000	$ 225,000	—	$ 575,000
Deferred amounts (Note 6)				
Unrestricted	50,000	—	—	50,000
Restricted	1,600,000	2,915,000	—	4,515,000
Long-term debt (Note 4)	—	900,000	—	900,000
Total liabilities	2,000,000	4,040,000	—	6,040,000
Fund balances				
Unrestricted				
Designated by the governing board for long-term investment	6,200,000	—	—	6,200,000
Undesignated	1,012,000	—	—	1,012,000
	7,212,000	—	—	7,212,000
Restricted—nonexpendable	—	—	$ 2,850,000	2,850,000
Net investment in plant	—	22,100,000	—	22,100,000
Total fund balances	7,212,000	22,100,000	2,850,000	32,162,000
Total liabilities and fund balances	$9,212,000	$26,140,000	$ 2,850,000	$38,202,000

Exhibit 13B

Sample Zoological and Botanical Society

Statement of Support and Revenue, Expenses, Capital Additions, and Changes in Fund Balances

Year Ended December 31, 19X1

	Operating Funds					
	Unrestricted	*Restricted*	*Total*	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Support and revenue						
Contributions and bequests	$ 550,000	$1,045,000	$1,595,000	—	—	$ 1,595,000
Fees and grants from governmental agencies	—	1,200,000	1,200,000	—	—	1,200,000
Admission charges	1,300,000	—	1,300,000	—	—	1,300,000
Membership dues	350,000	—	350,000	—	—	350,000
Endowment and other investment income	420,000	90,000	510,000	—	—	510,000
Net gain realized on investments	180,000	15,000	195,000	—	—	195,000
Auxiliary activities	3,000,000	—	3,000,000	—	—	3,000,000
Total support and revenue	5,800,000	2,350,000	8,150,000	—	—	8,150,000
Expenses						
Program services						
Animal collections and exhibits	2,742,000	1,825,000	4,567,000	$ 440,000	—	5,007,000
Educational activities	350,000	135,000	485,000	42,000	—	527,000
Conservation and public service	60,000	90,000	150,000	14,000	—	164,000
Research activities	220,000	300,000	520,000	50,000	—	570,000
Membership activities	78,000	—	78,000	6,000	—	84,000
Auxiliary activities	1,800,000	—	1,800,000	216,000	—	2,016,000
Total program services	5,250,000	2,350,000	7,600,000	768,000	—	8,368,000

Supporting services						
General administration	530,000	—	530,000	24,000	—	554,000
Fund raising	80,000	—	80,000	8,000	—	88,000
Total supporting services	610,000	—	610,000	32,000	—	642,000
Total expenses	5,860,000	2,350,000	8,210,000	800,000	—	9,010,000
Excess (deficiency) of support and revenue over expenses before capital additions	(60,000)	—	(60,000)	(800,000)	—	(860,000)
Capital additions						
Contributions and bequests	—	—	—	1,030,000	$ 20,000	1,050,000
Investment income	—	—	—	150,000	—	150,000
Net gain realized on investments	—	—	—	100,000	110,000	210,000
Total capital additions	—	—	—	1,280,000	130,000	1,410,000
Excess (deficiency) of support and revenue over expenses after capital additions	(60,000)	—	(60,000)	480,000	130,000	550,000
Fund balances at beginning of year	7,428,000	—	7,428,000	21,384,000	2,800,000	31,612,000
Transfers						
Equipment acquisitions and principal debt service payments	(236,000)	—	(236,000)	236,000	—	—
Realized gains on endowment funds utilized	80,000	—	80,000	—	(80,000)	—
Fund balances at end of year	$7,212,000	—	$7,212,000	$22,100,000	$ 2,850,000	$32,162,000

Exhibit 13C

Sample Zoological and Botanical Society
Statement of Changes in Financial Position
Year Ended December 31, 19X1

	Operating Funds	*Plant Funds*	*Endowment Funds*	*Total All Funds*
Resources provided				
Excess (deficiency) of support and revenue over expenses before capital additions	$ (60,000)	$ (800,000)	—	$ (860,000)
Capital additions				
Contributions and bequests	—	1,030,000	$ 20,000	1,050,000
Investment income	—	150,000	—	150,000
Net gain realized on investments	—	100,000	110,000	210,000
Excess (deficiency) of support and revenue over expenses after capital additions	(60,000)	480,000	130,000	550,000
Items that do not use (provide) resources				
Provision for depreciation	—	800,000	—	800,000
Net gain realized on investments	(195,000)	(100,000)	(110,000)	(405,000)
Issuance of long-term debt	—	900,000	—	900,000
Increase in deferred amounts	200,000	350,000	—	550,000
Proceeds from sales of investments	3,200,000	1,270,000	900,000	5,370,000
Total resources provided	3,145,000	3,700,000	920,000	7,765,000
Resources used				
Purchases of building and equipment	—	1,480,000	—	1,480,000
Reduction of long-term debt	—	36,000	—	36,000
Purchases of investments	2,861,000	2,372,000	848,000	6,081,000
Increase in accounts and pledges receivable	80,000	30,000	—	110,000
Increase in inventories	8,000	—	—	8,000
Decrease in accounts payable and accrued expenses	10,000	20,000	—	30,000
Total resources used	2,959,000	3,938,000	848,000	7,745,000
Transfers				
Equipment acquisitions and principal debt service payments	(236,000)	236,000	—	—
Realized gains on endowment funds utilized	80,000	—	(80,000)	—
Total transfers	(156,000)	236,000	(80,000)	—
Increase (decrease) in cash	$ 30,000	$ (2,000)	$ (8,000)	$ 20,000

Exhibit 13D

Sample Zoological and Botanical Society

Notes to Financial Statements*

December 31, 19X1

Note 1—Summary of Significant Accounting Policies

Note 2—Investments

Note 3—Plant Assets and Depreciation

Note 4—Long-Term Debt

Note 5—Pension and Other Postretirement Benefit Plans

Note 6—Changes in Deferred Restricted Amounts

Note 7—Functional Allocation of Expenses

Note 8—Commitments

Note 9—Collections

The note should disclose the following:

a. Capitalization basis or a statement that collections are not capitalized.

b. Policy on accounting for current year's purchased and donated collections.

c. The nature and the cost, or contributed value, of current year accessions and the nature of and proceeds from deaccessions.

* For suggested comments in each area of note disclosure above, see exhibit 1D, the example included in comprehensive set of Notes to Financial Statements for exhibit 1.

Appendix B

Statement of Position 87-2

Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal

August 21, 1987

Issued by
Accounting Standards Division

American Institute of
Certified Public Accountants

AICPA

NOTICE TO READERS

Statements of Position of the Accounting Standards Division present the conclusions of at least a majority of the Accounting Standards Executive Committee, which is the senior technical body of the AICPA authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report,* identifies AICPA Statements of Position as sources of established accounting principles that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this Statement of Position should be used or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances. However, an entity need not change an accounting treatment followed as of March 15, 1992 to the accounting treatment specified in this Statement of Position.

Table of Contents

SUMMARY

This statement of position recommends the following: If it can be demonstrated that a bona fide program or management and general function has been conducted in conjunction with an appeal for funds, joint costs of informational materials or activities that include a fund-raising appeal should be allocated between fund-raising and the appropriate program or management and general function. All joint costs of informational materials or activities that include a fund-raising appeal should be reported as fund-raising expense if it cannot be demonstrated that a program or management and general function has been conducted in conjunction with the appeal for funds.

Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal

Introduction

1. Many not-for-profit organizations solicit financial support from the public through a variety of fund-raising activities, including direct mail, door-to-door canvassing, telephone solicitation, telethons, and special events. Some of the costs incurred by such organizations are clearly identifiable with fund-raising, such as the cost of fund-raising consulting services. However, organizations often incur joint costs, such as postage and other communication costs, in distributing materials or performing activities that relate to several functions, including program activities, fund-raising, or other supporting services. It is often difficult to distinguish the amounts of joint costs that relate to each function.

2. This statement of position applies only to joint costs of informational materials and activities that include a fund-raising appeal. Allocations of other joint costs are permitted under existing authoritative literature. Also, this statement of position does not address the issue of how to allocate joint costs. A number of cost accounting techniques are available for that purpose.

3. The American Institute of Certified Public Accountants' Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations* (Audit Guide) and Statement of Position 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations* (SOP 78-10), now included in the AICPA Audit and Accounting Guide, *Audits of Certain Nonprofit Organizations,* and in *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations* (industry's Standards) [1] provide some guidance on accounting for joint costs of informational materials and activities that include fund-raising appeals. Numerous requests have been received for further guidance.

Background

4. External users of financial statements, including contributors, creditors, accreditation agencies, and regulators, are concerned with the amounts not-for-profit organizations spend to solicit contributions, as well as with the amounts spent for their program purposes and management and general activities.

5. Not-for-profit organizations subject to the Audit Guide and organizations that follow the recommendations in SOP 78-10 and receive significant amounts of contributions from the public are required, in preparing their financial statements, to report separately the costs of program services, management and general activities, and fund-raising efforts.

6. Though some costs are wholly identifiable with one of those basic functions, others are allocated because they are incurred for more than one function. The allocation usually involves no special accounting problems because cost accounting techniques are available. However, special problems are encountered in allocating joint costs of informational materials and activities that include fund-raising appeals.

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[1] National Health Council, Inc., National Assembly of National Voluntary Health and Social Welfare Organizations, Inc., and United Way of America, *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations,* rev. ed. 1974.

7. The industry's Standards provides guidance for voluntary health and welfare organizations. As part of its discussion of joint mailings and other "multiple part" information efforts, the industry's Standards requires a concept called *primary purpose,* in which all joint costs involving fund-raising are charged to fund-raising expense except for those incremental costs directly attributable to a separate educational or other informational material or activity. For example, only the incremental costs of joint mailings, such as the direct costs of an educational pamphlet, are charged to functions other than fund-raising; all other costs, such as postage, are charged to fund-raising expense.

8. The primary-purpose concept was originally adopted in 1964 by the voluntary health and welfare industry in the industry's Standards as a practical solution to a credibility problem that existed then. The industry responded to public criticism by not permitting the reported costs of fund-raising to be less than they would otherwise be solely because public education efforts were structured in a way that would absorb fund-raising costs. Many believe, however, that the primary-purpose concept may cause fund-raising expense to be misstated.

9. Although less specific than the industry's Standards, paragraphs 6.05 and 6.06 of the Audit Guide indicate that costs of public education should not include costs "that may have some relationship to the function but are primarily directed toward other purposes." Specifically mentioned as a cost normally not charged to public education expense is postage for mass mailing in connection with fund-raising solicitations.

10. Some have interpreted the Audit Guide and SOP 78-10 to be less restrictive than the industry's Standards in the method of allocation of the costs of joint fund-raising and educational programs. The Audit Guide indicates, as part of a discussion of fund-raising costs in paragraph 6.11, that—

> The cost of printed material used should be charged to program service, management and general, or fund-raising on the basis of the use made of the material, determined from the content, the reasons for distribution, and the audience to whom it is addressed.

Paragraph 97 of SOP 78-10 states—

> If an organization combines the fund-raising function with a program function (for example, a piece of educational literature with a request for funds), the costs should be allocated to the program and fund-raising categories on the basis of the use made of the literature, as determined from its content, the reasons for its distribution, and the audience to whom it is addressed.

Present Practice

11. Present practice is diverse because of the diverse guidance. Some not-for-profit organizations (for example, organizations that follow the industry's Standards) do not allocate joint costs of informational materials and activities that include fund-raising appeals. They charge only the incremental cost of educational activities and publications to program expenses or management and general expenses and charge joint costs to fund-raising expense.

12. The activities of some not-for-profit organizations raise consciousness and stimulate action or are primarily educational. Many of them allocate joint costs primarily to expenses for educational programs based on intent as determined from the content of the materials distributed or the activities conducted. They argue that primary programs of the organizations are to educate the public and that the actions by the recipients of such materials or activities are essential elements of the organization's program goals.

13. Other organizations allocate joint costs to program expenses, fund-raising expenses, or management and general expenses based on the intended purpose of the material or activity, determined from its content, the reason for its distribution, and the audience to whom it is addressed.

Division's Conclusions

14. The following paragraphs present the Accounting Standards Division's conclusions, which amend chapter 6 of the Audit Guide and paragraph 97 of SOP 78-10.

15. All joint costs of informational materials or activities that include a fund-raising appeal should be reported as fund-raising expense if it cannot be demonstrated that a program or management and general function has been conducted in conjunction with the appeal for funds. However, if it can be demonstrated that a bona fide program or management and general function has been conducted in conjunction with the appeal for funds, joint costs should be allocated between fund-raising and the appropriate program or management and general function.

16. Demonstrating that a bona fide program or management and general function has been conducted in conjunction with an appeal for funds requires verifiable indications of the reasons for conducting the activity. Such indications include the content of the non-fund-raising portion of the activity; the audience targeted; the action, if any, requested of the recipients; and other corroborating evidence, such as written instructions to parties outside the organization who produce the activity, or documentation in minutes of the organization's board of the organization's reasons for the activity.

17. Most fund-raising appeals include descriptions of the causes for which the entities exist and the planned uses of the funds, to inform prospective donors why funds are needed and how they will be used. Unless an appeal is designed to motivate its audience to action other than providing financial support to the organization, all costs of the appeal should be charged to fund-raising.

18. In order to accomplish their basic missions, some organizations educate the public and seek the involvement of the public in the attainment of their missions by telling people what they can or should do about particular issues. Those organizations should allocate joint costs to program activities if the informational materials or activities further those program goals.

19. Two examples of situations in which it may be appropriate to allocate such joint costs to program activities follow:

a. A voluntary health and welfare organization describes the symptoms of a disease and the action an individual should take if those symptoms occur.

b. An organization whose purpose is to raise public awareness alerts individuals to a social or community problem and urges their action in seeking changes.

20. The content of the message is an important factor, but content alone may not be a conclusive indication of the reason for the activity. For example, if an audience is selected principally because of the organization's perception of its need for or interest in the educational information and not for its capacity to support the organization financially, any accompanying fund-raising appeal would appear to be incidental and the joint costs of the educational activity would not be required to be allocated. Conversely, if the audience is selected based on its presumed ability to provide financial support

without consideration of its need for the educational information, the purpose would appear to be entirely fund-raising, and all joint costs should be considered fund-raising costs regardless of any accompanying educational message.

21. All circumstances surrounding informational materials and activities that include a fund-raising appeal should be examined, and the criteria in paragraphs 15 through 20 of this statement of position should be applied together rather than separately.

22. Not-for-profit organizations incurring joint costs of informational materials and activities that include fund-raising appeals should disclose in their financial statements that such costs have been allocated, the total amount allocated during the period, and the portion allocated to each functional expense category. The following illustrates such disclosure.

Note X. Allocation of Joint Costs

In 19XX, the organization incurred joint costs of ________ for informational materials and activities that included fund-raising appeals. Of those costs, ________ was allocated to fund-raising expense, ________ was allocated to Program A expense, ________ was allocated to Program B expense, and ________ and was allocated to management and general expense.

Effective Date and Transition

23. The conclusions in this statement of position should be applied to financial statements for fiscal years beginning after December 31, 1987. The adoption of this statement of position is considered to be a change in the application of generally accepted accounting principles. In the year that this statement of position is first applied, the financial statements should disclose the fact of the change and the effect of the change on the financial statements. Financial statements of prior periods may be, but need not be, restated.

Appendix C

Statement of Position 92-9

Audits of Not-for-Profit Organizations Receiving Federal Awards

December 28, 1992

Amendment to AICPA Audit and Accounting Guides
Audits of Providers of Health Care Services,
Audits of Voluntary Health and Welfare Organizations,
Audits of Colleges and Universities,
and *Audits of Certain Nonprofit Organizations*

Prepared by the
Not-for-Profit Organizations Committee

American Institute of
Certified Public Accountants

AICPA

NOTICE TO READERS

This Statement of Position presents the recommendations of the AICPA Not-for-Profit Organizations Committee regarding the performance of audits in accordance with generally accepted auditing standards, *Government Auditing Standards,* and OMB Circular A-133. Members of the AICPA Auditing Standards Board have found the recommendations in this Statement of Position to be consistent with existing standards covered by Rule 202 of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from the recommendations in this Statement of Position.

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Paragraph

SUMMARY

This statement of position (SOP) provides guidance on the auditor's responsibilities when conducting an audit in accordance with Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions.* This SOP amends the following AICPA audit and accounting guides:

- *Audits of Providers of Health Care Services*
- *Audits of Voluntary Health and Welfare Organizations*
- *Audits of Colleges and Universities*
- *Audits of Certain Nonprofit Organizations*

In addition to providing an overview of the auditor's responsibilities in an audit of federal awards, this SOP—

- Describes the applicability of OMB Circular A-133.
- Summarizes the differences between Circular A-133 and OMB Circular A-128, *Audits of State and Local Governments.*
- Describes the auditor's responsibility for considering the internal control structure and performing tests of compliance with certain laws and regulations.
- Describes the auditor's responsibility for reporting and provides examples of the reports required by Circular A-133.

This SOP incorporates guidance on the following:

- Statement on Auditing Standards No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance.*
- AICPA Statement of Position 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance.*
- The OMB's October 1991 *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions.*
- The President's Council on Integrity and Efficiency Standards Subcommittee's Position Statement No. 6 [A-133 Questions & Answers].

Chapter 1

INTRODUCTION AND OVERVIEW

Introduction

Purpose and Applicability

1.1. The purpose of this statement of position (SOP) is to provide auditors of not-for-profit organizations (NPOs) with a basic understanding of the work they should do and the reports they should issue for audits under—

a. The 1988 revision of *Government Auditing Standards* (also referred to as GAS and the Yellow Book), issued by the Comptroller General of the United States.

b. Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions.*[1]

1.2. This SOP provides guidance about financial and compliance auditing requirements and requirements to consider the internal control structure promulgated by the American Institute of Certified Public Accountants (AICPA), the General Accounting Office (GAO), and the OMB; and the application of these requirements to NPOs. This SOP, instead of establishing new requirements, consolidates applicable audit requirements established by these organizations in order to facilitate efficient and effective compliance. In addition, this SOP provides guidance for implementing these requirements and includes illustrative audit reports.

1.3. This SOP is not a complete manual of procedures, nor should it supplant the auditor's judgment about the audit work required in particular situations. Because of the variety of federal, state, and local financial assistance programs and the complexity of the regulations that govern them, the procedures included in this SOP cannot cover all the circumstances or conditions that would be encountered in audits of every organization. The auditor should use professional judgment to tailor his or her procedures to meet the conditions of the particular engagement so that the audit objectives may be achieved.[2]

1.4. The provisions of this SOP are effective for audits in accordance with OMB Circular A-133 for periods ending on or after December 31, 1992. Early application of this SOP is encouraged.

Relationship of GAAS, Government Auditing Standards, *and OMB Circular A-133*

1.5. Exhibit 1 presents the relationship among the compliance testing requirements of GAAS, *Government Auditing Standards,* and OMB Circular A-133.[3] (Chapter 2 of this SOP discusses the requirements of Circular A-133.)

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[1] Some of the guidance in this statement of position may be helpful for (A) program-specific audits (see paragraph 2.28) and (B) compliance testing in audits of NPOs that are performed in accordance with generally accepted auditing standards (GAAS). Paragraphs 6 through 19 of AICPA Statement on Auditing Standards No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance,* describe the auditor's responsibility for testing compliance with laws and regulations in an audit conducted in accordance with GAAS. Appendix B of this SOP explains how to obtain these and other relevant publications.

[2] The auditor should refer to relevant AICPA audit and accounting guides, such as *Audits of Voluntary Health and Welfare Organizations, Audits of Colleges and Universities, Audits of Certain Nonprofit Organizations* and *Audits of Providers of Health Care Services.*

[3] OMB Circular A-133 is reprinted in appendix A of this SOP.

SAS No. 68 defines the auditor's responsibility to understand and assess audit risk related to compliance, and to design audit procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts resulting from violations of laws and regulations that have a direct and material effect on financial statement amounts in an audit of financial statements under GAAS. It also discusses the auditor's responsibility when conducting audits under *Government Auditing Standards* and OMB Circular A-133.

Exhibit 1

Auditing Compliance With Laws and Regulations

ORGANIZATION-WIDE AUDITS[4] IN ACCORDANCE WITH CIRCULAR A-133

Procedures Performed

General Requirements: Testing of compliance with general requirements applicable to federal awards

Specific Requirements:

Major programs: Audit of compliance with specific requirements applicable to major federal programs

Nonmajor programs: Testing of compliance with laws and regulations applicable to nonmajor program transactions selected in connection with the audit of the financial statements or the consideration of the internal control structure over federal awards

GOVERNMENT AUDITING STANDARDS

Procedures Performed

Same testing of compliance with laws and regulations as required by GAAS. However, GAS requires a written report on compliance with laws and regulations.

GENERALLY ACCEPTED AUDITING STANDARDS

Procedures Performed

Testing of compliance with laws and regulations in accordance with SAS No. 54, *Illegal Acts by Clients,* and SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities,* as described in SAS No. 68

1.6. Exhibit 2 presents the relationship among the requirements to consider the internal control structure under GAAS, *Government Auditing Standards,* and OMB Circular A-133. SAS No. 68 distinguishes the requirements of reporting on the internal control structure under GAAS and *Government Auditing Standards.* Guidance on the additional internal control structure testing requirements of OMB Circular A-133 is in chapter 5 of this SOP.

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[4] Audits performed in accordance with Circular A-133 are often referred to as organization-wide audits.

Exhibit 2

Consideration of the Internal Control Structure

ORGANIZATION-WIDE AUDITS IN ACCORDANCE WITH CIRCULAR A-133

Procedures Performed

Testing of control policies and procedures in the internal control structure over federal awards

Reporting

Requires a report on the internal control structure used in administering federal awards

GOVERNMENT AUDITING STANDARDS

Procedures Performed

The same procedures as required by GAAS

Reporting

Requires a written report on the auditor's understanding of the internal control structure over financial reporting and assessment of control risk under SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit.* Also requires the identification of the internal control structure categories considered and separate identification of those reportable conditions that are significant enough to be material weaknesses.

GENERALLY ACCEPTED AUDITING STANDARDS

Procedures Performed

Obtaining an understanding of the internal control structure over financial reporting sufficient to plan the audit and assess control risk in accordance with SAS No. 55

CONSIDERATION OF THE INTERNAL CONTROL STRUCTURE IN A FINANCIAL STATEMENT AUDIT

Reporting

Requires an oral or written report when reportable conditions are noted in accordance with SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit*

1.7. *Government Auditing Standards* should be followed when required by law, regulation, agreement or contract, or policy. In performing audits in accordance with *Government Auditing Standards,*[5] the auditor assumes certain reporting responsibilities beyond those of audits performed in accordance with GAAS.[6] Thus, *Government Auditing Standards* incorporates fieldwork and reporting under GAAS and expands upon certain reporting requirements of GAAS. The additional reporting responsibilities focus on compliance with laws and regulations and the internal control structure over financial reporting. In addition to requirements for written reports on compliance and the internal control structure over financial reporting in all audits, *Government Auditing Standards* includes quality-control, continuing professional education, specific working-paper, and audit follow-up requirements.

Nature and Purpose of an Organization-Wide Audit

1.8. America's hundreds of thousands of NPOs receive billions of dollars of financial assistance every year. The sources of this funding include both governmental and private entities. Much of this funding—even matching support for general program purposes—is given subject to an NPO's compliance with certain laws and regulations. In the past, each sponsor audited its individual program to determine whether the NPO had complied with the applicable laws and regulations. Such compliance audits proliferated, however, and grantees were often tied up for weeks with many sets of auditors. In the late 1970s, the federal government began to develop the single-audit concept. In accordance with this concept, one auditor, most often the independent auditor, would integrate the various sponsors' compliance auditing requirements and their requirements to consider the organization's internal control structure with an audit of the financial statements.

1.9. The single-audit concept became United States law for state and local governmental grantees with the enactment of the Single Audit Act of 1984. (For a more detailed history of key events in the history of auditing federal programs, see SOP 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance.*) Circular A-128 is the policy that implements the Single Audit Act. Circular A-133,[7] which was patterned after Circular A-128, was issued in 1990. Both Circulars A-128 and A-133 provide

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[5] *Government Auditing Standards* includes standards for financial audits as well as for performance audits. The references to *Government Auditing Standards* in this SOP encompass only the standards for financial audits and not the performance audit standards. However, *Government Auditing Standards* states that the "report 'Contents' and 'Presentation' standards, which are included in the section describing performance audit reporting standards, also apply for financial audits."

[6] Paragraphs 4 and 5 of SAS No. 68 describe the auditor's responsibility when he or she has been engaged to perform an audit in accordance with GAAS and becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement. In such a situation, SAS No. 68 requires that the auditor communicate to management and the audit committee, or to others with equivalent authority or responsibility, that an audit in accordance with GAAS alone will not satisfy the relevant legal, regulatory, or contractual requirements. That communication may be oral or written. However, if the communication is oral, the auditor should document that in the audit workpapers. The auditor should consider how the client's actions in response to such communication relate to other aspects of the audit, including the potential effect on the financial statements and on the auditor's report on those financial statements. Specifically, the auditor should consider management's actions in relation to the guidance in SAS No. 54.

[7] The audit requirements of Circular A-133 supersede those for certain entities described in attachment F, subparagraph 2h, of Circular A-110, *Uniform Administrative Requirements—Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations.* Institutions subject to Circular A-110 should continue to follow the audit provisions of attachment F to Circular A-110 either until the institutions implement Circular A-133 or (in the case of organizations that are not subject to Circular A-133) as a matter of course. It should be noted that other requirements of A-110 discussed in paragraph 1.27 of this SOP remain in effect for all nonprofit grantees.

guidance on implementing the single-audit concept, although the Single Audit Act itself does not apply to NPOs. Rather, the single-audit concept is described in Circular A-133 as an "organization-wide audit."

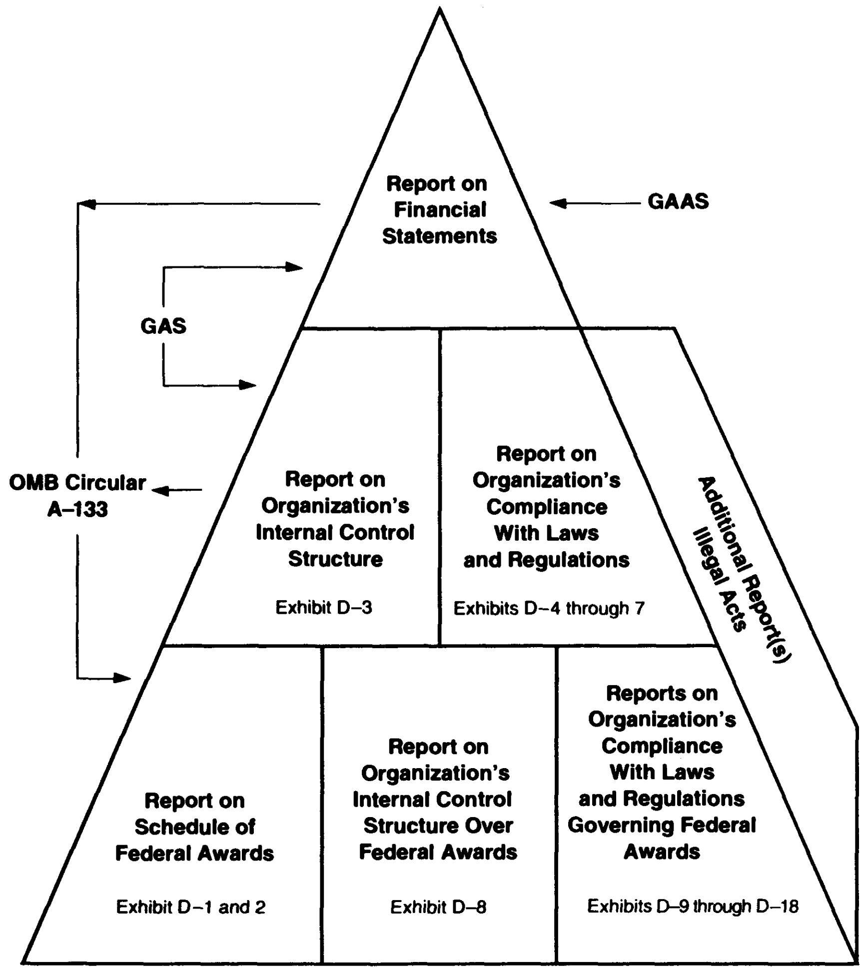
Components of an Organization-Wide Audit

1.10. With certain exceptions, NPOs that receive over $25,000 per year in federal awards are subject to Circular A-133.[8] NPOs receiving less than $25,000 per year in federal awards are exempt from federal audit requirements, but records are to be available for review by appropriate officials of the granting entity or subgranting entity. An organization-wide audit under Circular A-133 has two main components—an audit of the financial statements (paragraph 1.11 of this SOP) and an audit of federal awards (paragraphs 1.12 and 1.13 of this SOP). Each component results in a variety of audit reports. An overview of the various reports issued in an organization-wide audit is presented in exhibit 3.

[8] Organizations receiving awards of $100,000 or more under only one program have the option of having a program-specific audit. Organizations receiving total awards of at least $25,000 but not more than $100,000 per year have the option of having an audit performed in accordance with Circular A-133 or having an audit made of each award. Paragraphs 2.28 through 2.35 of this SOP provide guidance on program-specific audits.

Exhibit 3

Levels of Reporting in Organization-Wide Audits



1.11. *Financial Statement Audit.* The financial statement audit required by Circular A-133 is performed in accordance with GAAS and GAS, and results in reports on the financial statements, compliance, and the internal control structure over financial reporting. The primary sources of guidance and standards regarding the auditing of the financial statements of NPOs are the AICPA Statements on Auditing Standards, particularly SAS No. 68; *Government Auditing Standards;* and the AICPA audit and accounting guides *Audits of Voluntary Health and Welfare Organizations, Audits of Colleges and Universities, Audits of Certain Nonprofit Organizations,* and *Audits of Providers of Health Care Services.*

1.12. *Audit of Federal Awards.* In performing an audit in accordance with Circular A-133, the auditor assumes certain testing and reporting responsibilities beyond those of an audit performed in accordance with GAAS and GAS. Thus, an audit in accordance with Circular A-133 incorporates GAAS and GAS and expands on certain of their testing and reporting requirements. The additional responsibilities focus on compliance with laws and regulations applicable to federal awards and on the internal control structure over federal awards. The terms *single audit, organization-wide audit,* and *entity-wide audit* are frequently used interchangeably by practitioners when they refer to the more extensive form of an audit of federal awards required by Circular A-133.

1.13. The audit of federal awards specified in Circular A-133 provides a basis for issuing additional reports on the internal control structure and on compliance. The remainder of this chapter introduces concepts that are important to establishing the scope of an audit of federal awards, summarizes the auditor's responsibilities in such an audit, and previews the other sections of this SOP.

Determining the Scope of an Audit of Federal Awards

1.14. Two factors, the relative size of federal award programs and the compliance requirements applicable to these programs, determine the scope of the auditor's work and the reports to be issued in an audit of federal awards under Circular A-133.

1.15. *Size—Major versus Nonmajor Programs.* Before an audit begins, the NPO should identify the programs under which it receives federal awards, to prepare the required schedule of federal awards (see chapter 4 of this SOP) and to identify which programs are "major" and which programs are "nonmajor" for audit purposes. For purposes of Circular A-133, a program is an award or group of awards for a similar purpose or general line of inquiry. Federal sponsors have classified awards into program categories in the *Catalog of Federal Domestic Assistance* (CFDA), published by the Government Printing Office. However, the CFDA may not include all programs. For example, contracts and foreign assistance programs may not be listed in the CFDA. In general, awards that are assigned the same CFDA number constitute a program. The President's Council on Integrity and Efficiency (PCIE) Standards Subcommittee's Position Statement No. 6, Question 24, states that "an exception to the statement that all awards under the same CFDA number constitute a program is when a State government combines different Federal awards into a combined program which is passed through to a not-for-profit recipient. In this case, the State government *may* require the subrecipient to treat the combined program as a single program for both major program determination and to determine whether a program-specific audit may be elected . . ." In addition, single-program treatment is appropriate under Circular A-133. However, Circular A-133 specifies that awards in two defined categories—student financial assistance and research and development—be classified as separate programs.

1.16. PCIE Position Statement No. 6, Question 24, also states that "for awards not assigned a CFDA number, all awards made for the same purpose would be combined as one program similar to how grants under the same CFDA number from multiple funding years are combined as one program." For example, if funds were expended during the audit period from both an original agreement and a separate award that renewed the original agreement, the two awards would be combined and considered as one program.

1.17. PCIE Position Statement No. 6, Question 40, states that, if the CFDA numbers are not available for awards, the NPO should include the awarding agency name and program name or some other identifier obtained from the award documents in the Schedule of Federal Awards.

1.18. The type of reports issued and, therefore, the audit work required in an audit performed in accordance with Circular A-133 depend on whether financial awards received by the NPO constitute major or nonmajor programs. Circular A-133 states that each of the following categories constitutes a major program if total federal expenditures are the larger of 3 percent of total federal funds expended or $100,000:

a. Research and development

b. Student financial aid

c. Individual programs not in the research-and-development or student financial-aid category

1.19. Any federal program without sufficient expenditures to be considered a major program is a nonmajor program. As will be discussed, the auditor's responsibilities for major programs generally are greater than those for nonmajor programs.

1.20. *Compliance Requirements.* Paragraph 13(c)(1) of Circular A-133 requires that "[t]he auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major federal programs." The term *compliance requirements* refers to the laws, regulations, and other requirements that an auditor should consider in making this determination.

1.21. The principal compliance requirements and suggested audit procedures for the largest federal programs are included in the *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions* (Circular A-133 Compliance Supplement), issued by the OMB and available from the Government Printing Office. For testing general requirements (see paragraph 1.26 of this SOP), the auditor should follow the guidance contained in the Circular A-133 Compliance Supplement. For testing specific requirements (see paragraph 1.24 of this SOP), the auditor should follow the guidance provided for that program, which may be included in either the Circular A-133 Compliance Supplement or the *Compliance Supplement for Single Audits of State and Local Governments.* For programs not listed in the compliance supplements, compliance requirements may be determined by researching the statutes, regulations, grant agreements governing individual programs or the *Catalog of Federal Domestic Assistance.* Additionally, some agencies have developed audit guides for programs not included in the Compliance Supplement. This guidance, where applicable, may be obtained from the Office of the Inspector General of the appropriate federal agency.

1.22. The auditor should be aware that compliance requirements may change over time. Thus, the auditor should also review grant agreements to determine whether specific requirements reflected in the Compliance Supplements have changed. If there have been changes, the auditor should follow the provisions of the Compliance Supplement as modified by the changes.

1.23. Paragraphs 13(c)(4) and (5) of Circular A-133 list the compliance requirements on which the auditor should express an opinion. Some of these requirements (e.g., federal financial reports and allowability of expenses) are listed as "general" requirements in the OMB Compliance Supplements; others (e.g., matching and level of effort) are set forth as "specific" requirements of each of the various programs described in the Compliance Supplements.

1.24. *Specific Requirements.* These requirements include—

- *Types of services allowed or not allowed,* which specifies the types of goods or services that entities may purchase with financial assistance and the types of costs that may be claimed.
- *Eligibility,* which specifies the characteristics of individuals or groups to whom entities may give financial assistance.
- *Matching, level of effort, or earmarking,* which specifies amounts entities should contribute from their own resources toward projects for which financial assistance is provided.
- *Reporting,* which specifies reports that entities must file in addition to those required by the general requirements.
- *Special tests and provisions,* which identifies other provisions for which federal agencies have determined that noncompliance could materially affect the program. (For example, some programs specify limits on salaries paid under research grants; other programs prohibit the use of foreign carriers for overseas travel; still other programs set a deadline for the expenditure of federal awards.)

The auditor should note that the following are also considered to be specific requirements:

- Federal financial reports and claims for advances and reimbursements include information that is supported by books and records from which the basic financial statements have been prepared.
- Amounts claimed for reimbursement or used for matching were determined in accordance with the cost principles and matching or cost-sharing requirements set forth in (*a*) OMB Circular A-21, *Cost Principles for Educational Institutions;* (*b*) OMB Circular A-110, *Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations;* (*c*) OMB Circular A-122, *Cost Principles for Nonprofit Organizations;* (*d*) Federal Acquisition Requirements, subpart 31, cost principles; and (*e*) other applicable cost principles or regulations.

These two requirements—federal financial reports and allowable costs—are considered both general and specific by OMB. Thus, the same audit procedures can be used to test compliance with those requirements.

1.25. Although the auditor should test compliance with the requirements specified in the Compliance Supplements, performance of the suggested audit procedures is not mandatory. However, federal Inspectors General recommend their use. The auditor may refer to the statute or Code of Federal Regulations (CFR) identified in the appropriate Compliance Supplement to obtain a complete understanding of the compliance requirements. The auditor may also review award documents and procedure manuals to gain familiarity with the federal compliance requirements. The auditor may also contact the appropriate Inspectors General office, grantor, or agency to determine the availability of agency-prepared supplements or audit guides for programs not included in the Compliance Supplements.

1.26. *General Requirements.* In addition to the specific requirements, the Circular A-133 Compliance Supplement also identifies eight general compliance requirements that apply to all federal award programs. These requirements are:

- Political activity (Hatch Act and Intergovernmental Personnel Act of 1970, as amended)
- Construction contracts (Davis-Bacon Act)
- Civil rights
- Cash management
- Federal financial reports
- Drug-free workplace[9]
- Allowable costs and cost principles
- Administrative requirements (Circular A-110)

1.27. Three administrative requirements set forth in Circular A-110—those regarding cash management, financial reporting, and cost principles—are explicitly included among the general requirements. Other administrative requirements included in the Compliance Supplement affect the following matters:

- Interest earned on advances
- Period of availability of funds
- Program income
- Real property
- Equipment
- Supplies
- Subawards to debarred and suspended parties
- Procurement
- Subawards
- Revolving fund repayments

The Circular A-133 Compliance Supplement sets forth audit procedures for testing compliance with three of these requirements: program income, property management, and procurement. The auditor should exercise professional judgment in determining appropriate audit procedures for testing compliance with the other requirements and whether there are other administrative requirements that are relevant in an organization-wide audit of federal awards of an NPO.

1.28. The auditor should perform tests of compliance for all of the general requirements applicable to federal awards. Thus, the auditor should test and report on compliance with general requirements regardless of whether or not the NPO being audited has major programs. SAS No. 68 states that it has become generally accepted that the nature of the procedures suggested in the compliance supplements is sufficient to satisfy the requirements of Circular

[9] Per PCIE Position Statement No. 6, Question 68, the Drug-Free Workplace Act applies to recipients who receive grants directly from federal agencies. The Drug-Free Workplace Act does not apply to subrecipients. However, if a subrecipient is also a prime recipient, the auditor must test for compliance with the Drug-Free Workplace Act. Also, in some cases the prime recipient may by contract pass the Drug-Free Workplace requirements on to a subrecipient.

A-133 with respect to the general requirements. However, the Compliance Supplement does not specify the extent of such procedures. The auditor should exercise professional judgment in determining the extent of compliance testing of general requirements. Additionally, the auditor should evaluate his or her understanding and assessment of the internal control policies and procedures used in administering programs, and should exercise professional judgment in determining the extent of procedures for testing compliance with the general requirements. Typically, many of these procedures would be performed in conjunction with tests of controls over federal awards.

The Auditor's Responsibilities in Audits of Federal Awards—An Overview

1.29. The extent of the auditor's tests of internal control structure policies and procedures used in administering federal awards and the organization's compliance with laws and regulations is determined by the size of federal award programs and the compliance requirements applicable to them. The following sections briefly describe how program size and compliance requirements determine the scope of each component of the audit of federal awards.

The Internal Control Structure Used in Administering Federal Awards

1.30. In audits of federal awards conducted as part of an organization-wide audit in accordance with Circular A-133, the auditor is concerned with the design and operation of the internal control structure policies and procedures relevant to ensuring compliance with both specific and general requirements. The auditor's work in this area is in addition to the consideration of the internal control structure—specifically, obtaining an understanding of the structure and assessing control risk—that is a part of a financial statement audit.

1.31. For all major programs, the auditor should document this understanding and assessment, and he or she should test the operating effectiveness of the design and operation of the internal control structure policies and procedures ("test controls") relevant to ensuring compliance with both general and specific requirements. Evidence gained from tests of controls relevant to compliance with specific requirements would likely provide evidence that the auditor could use to determine the nature and extent of testing required to express an opinion on compliance with specific requirements applicable to major programs.

1.32. If the total amount of major program expenditures represents less than half of total federal expenditures, or if there are no major program expenditures, the auditor should gain an understanding, assess control risk, and perform a test of controls of the internal control structure for nonmajor programs, until such procedures (including those performed on major programs) encompass programs constituting 50 percent of total federal expenditures. The auditor may select nonmajor programs on a rotating basis so that the control structure over all programs is understood, assessed, and tested over a number of years. The PCIE suggests that these procedures be performed at least once every three years. An alternative to selecting nonmajor programs on a rotating basis (to reach 50 percent of total federal expenditures) is to test controls over the largest nonmajor programs, starting with the largest, until at least half of the total federal expenditures have been subjected to tests of controls.

1.33. With regard to the internal control structure of the remaining nonmajor programs, the auditor should understand the related internal control structure and determine that the controls are in place. The auditor may achieve this understanding and determination on a cyclical basis. In the first year, the auditor should gain an understanding of internal controls and assess risk for all but clearly insignificant nonmajor programs. This process may include inquiries, observations or walk-throughs. Thereafter, the auditor would obtain an understanding of internal controls and assess control risk for all but clearly insignificant nonmajor programs once every three years. Any new nonmajor programs, other than those that are clearly insignificant, should be reviewed the first year the program is active. If two-year (biennial) audits are performed, all programs should be covered by every second audit.

Compliance With Laws and Regulations

1.34. The interaction between the relative size of the federal awards program and the type of applicable compliance requirements results in three distinct levels of responsibility for testing and reporting on compliance with laws and regulations in an audit of federal awards. Chapter 6 of this SOP discusses these responsibilities. Chapters 6 and 7 discuss the schedule of findings and questioned costs.

1.35. *Failure to Follow Standards.* The auditor should be aware that AICPA Ethics Interpretation 501-3, *Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits,* states that when an auditor undertakes an audit of government grants or recipients of government monies and agrees to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, he or she is obligated to follow these standards or guidelines in addition to GAAS. Failure to do so is an act discreditable to the profession and a violation of rule 501 of the AICPA Code of Professional Conduct, unless it is disclosed in the auditor's report that these rules were not followed and the reasons are given.

1.36. *Overview of This SOP.* Chapter 2 of this SOP discusses the requirements of Circular A-133. Chapter 3 discusses planning the organization-wide audit. Chapter 4 describes the Schedule of Federal Awards. Chapter 5 describes the auditor's consideration of the internal control structure in audits performed in accordance with *Government Auditing Standards* and in those performed in accordance with Circular A-133. Chapter 6 discusses compliance auditing requirements. Chapter 7 discusses reporting considerations.

Chapter 2

REQUIREMENTS OF OMB CIRCULAR A-133

Applicability

2.1. The applicability of OMB Circular A-133 to an NPO depends on (*a*) the status of its adoption by individual federal and other sponsors, (*b*) the type of NPO, and (*c*) the amount of federal awards it receives.

Status of Adoption

2.2. Circular A-133 is directed to federal agencies with an effective date for fiscal years beginning on or after January 1, 1990. Federal agencies may implement Circular A-133 by regulation or contract. The effective date of implementation by the federal grantor agency will determine the effective date for the recipient.

2.3. As of the date of this SOP, most major federal agencies have taken steps to implement Circular A-133, either by incorporating it into the Code of Federal Regulations or by issuing internal policy directives and instructions to grantees.

2.4. Nine federal agencies (the departments of Commerce, Defense, Education, Energy, Health and Human Services, Housing and Urban Development, the Interior, Labor, and the Environmental Protection Agency) have issued final regulations to formally implement Circular A-133. The Department of Agriculture is actively working to finalize regulations to incorporate Circular A-133.

2.5. Other smaller federal agencies have chosen to implement Circular A-133 by issuing internal directives and amending grant administration handbooks and individual award agreements. Agencies using this approach include the Federal Emergency Management Agency, the National Science Foundation, the National Endowments for the Arts and Humanities, the Agency for International Development (AID), ACTION, and the Departments of Justice and Transportation.

2.6. In some cases, states or other recipients have implemented Circular A-133 for their subrecipients under federal awards or for programs funded by their own appropriations.

2.7. Question 2 of PCIE Position Statement No. 6 states that if a not-for-profit organization receives federal awards from two federal agencies, one that has implemented Circular A-133 in regulation and one that has not, the "not-for-profit should have an audit in accordance with [Circular] A-133 and include the federal awards from both agencies. An audit done in accordance with Circular A-133 will meet the requirements of A-110."

Type of NPO

2.8. Circular A-133 defines a not-for-profit institution as any corporation, trust, association, cooperative, or other organization that—

a. Is operated in the public interest primarily for scientific, educational, service, charitable, or similar purposes.

b. Is not organized primarily for profit.

c. Uses its net proceeds to maintain, improve, or expand its operations.

2.9. Accordingly, the NPOs covered by Circular A-133 include colleges and universities (and their affiliated hospitals[10] and community-based organizations such as voluntary health and welfare organizations). Circular A-133 does not apply to—

- Colleges and universities covered by Circular A-128. According to paragraph 6c of OMB Circular A-128, a state or local government can elect to include institutions of higher education in its Circular A-128 audit. State and local government institutions of higher education excluded from the government's Circular A-128 audit can be audited separately under Circular A-128 or Circular A-133.
- Hospitals not affiliated with a college or university.[11]
- State and local governments and Indian tribes covered by Circular A-128.

2.10. Except for the public hospitals and universities cited above, Circular A-128 does not apply to NPOs. Before the promulgation of Circular A-133, however, it was not uncommon for state and local government recipients to contractually require Circular A-128 audits of their not-for-profit subrecipients.[12] With the promulgation of Circular A-133, an organization will no longer need an audit in accordance with Circular A-128 and one in accordance with Circular A-133. The subrecipient should clarify the matter with the recipient requiring an A-128 audit. In most cases, the contract can be changed to specify a Circular A-133 audit. Not-for-profit organizations with new contracts should consider making reference to Circular A-133 audit requirements in such contracts.

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[10] According to 42 Code of Federal Regulations (CFR) Ch. IV (10-1-91 Edition), Part 409—Hospital Insurance Benefits, Section 409.3 (Definitions), a hospital is a facility that meets the following criteria:

— Is primarily engaged in providing by or under the supervision of doctors of medicine or osteopathy, inpatient services for the diagnosis, treatment, and care or rehabilitation of persons who are sick, injured, or disabled;

— Is *not* primarily engaged in providing skilled nursing care and related services for inpatients who require medical or nursing care;

— Provides 24-hour nursing service; and

— Is licensed or approved as meeting the standards for licensing by the State or local licensing agency as a hospital.

[11] Hospitals (e.g., community hospitals) not affiliated with a college or university that are subject to OMB Circular A-110's audit requirement, are subject to statutory audit requirements of Medicaid, Medicare, or other programs in which they participate.

Circular A-133 applies to hospitals "affiliated" with an institution of higher education but not audited as part of a state or local government under Circular A-128. Since Circular A-133 does not define affiliated, the Department of Health and Human Services (HHS) has developed a definition to include hospitals with significant research and training funds. The HHS definition (HHS interim final rule, published *Federal Register,* Friday, March 1, 1991, starting at page 8712) of affiliated includes all situations where—

— Either a hospital or an institution of higher education has an ownership interest in the other entity, or some other party (other than a state or local unit of government) has an ownership interest in each of them

— An affiliation agreement exists

— Federal research or training awards to a hospital or institution of higher education are performed in whole or in part in the facilities of, or involve the staff of, the other entity.

[12] Paragraphs 3.20-3.41 of this SOP discuss the responsibilities of the recipient and subrecipient and their auditors.

Amount of Federal Awards

2.11. OMB Circular A-133 applies to NPOs that directly or indirectly receive federal awards above a certain threshold, as discussed in paragraph 1.10. The term *federal awards* is defined broadly in Circular A-133 to include federal financial assistance and federal cost-type contracts used to buy services or goods for the use of the federal government. *Federal financial assistance* is defined as assistance provided by a federal agency to a recipient or subrecipient in the form of grants, contracts, loans, cooperative agreements, loan guarantees, property, interest subsidies, insurance, direct appropriations, and other noncash assistance. For purposes of determining the amount of federal awards, loans and guarantees are afforded a specific treatment.

2.12. The following guidelines should be used to calculate the value of assistance expended under loan or loan guarantee programs for determining major programs:

Types of Noncash Assistance	*Basis Used to Determine Major Programs*
Loans (including guaranteed student loans made by an institution of higher education and loan guarantees)	Value of new loans processed during the fiscal year, plus the balance of loans made in the prior years for which the federal government is at risk, plus any interest subsidy, cash, or administrative cost allowance received
Commodities	Value of the commodities issued during the year
Insurance	Value of the insurance contract
Guaranteed student loans that were not made by an institution of higher education	Value of the guaranteed loans made during the year
Food stamps	Value of food stamps distributed during the year

Note: Value as used in this table is to be determined by methods or prices prescribed by the federal departments making the award.

2.13. At institutions of higher education and other organizations having student financial assistance (SFA) programs, the value of guaranteed student loans processed during the year, if available, is considered as an expenditure for major program determination. Guaranteed student loans are then combined with other student financial assistance to form the category of SFA. The SFA category total is then compared to the larger of 3 percent of total federal funds expended or $100,000 to determine whether SFA is a major program.

2.14. When determining major programs, the inclusion of noncash programs should not result in the exclusion of other programs from the definition of major programs. PCIE Position Statement No. 6, Question 26, provides guidance for inclusion of loan and loan guarantee programs in the determination of major programs as follows: "When including a loan program significantly affects the number or size of other major programs, the loan program should be considered a major program, and the value attributed to the loan program should be excluded in determining other major programs."

2.15. An organization may receive program assistance in various forms. The classification of cash-supported programs as major or nonmajor depends, as shown in the following table, on whether or not the noncash programs (i.e., commodities and loans) are considered to be part of the entity's total federal awards when the 3 percent test is applied:

Program/Federal Grantor	*Federal Awards Received*
Cash Program A—Labor	$ 1,335,000
Cash Program B—DHHS	3,000,000
Cash Program C-1—Education	175,000
Cash Program C-2—Education	280,000
Cash Program D-HUD (subaward from county)	310,000
Subtotal Cash Expenditures	5,100,000
Commodities Program E—U.S. Dept. of Agriculture (subaward from state)	2,000,000
Subtotal—expenditures—cash and commodities	7,100,000
Loan Program F—Perkins	3,500,000*
Loan Guarantee Program G—HUD	7,000,000*
Total Federal Awards Expenditures	$17,600,000

DHHS = Department of Health and Human Services; HUD = Department of Housing and Urban Development; USDA = United States Department of Agriculture; FFA = Federal Financial Assistance.
* Total of new loans made during the year plus prior-year loans for which the federal government is at risk.

- Major programs are based on the larger of (*a*) 3 percent of $7,100,000 or $213,000 (total cash and noncash federal awards, except for loans and loan guarantees) or (*b*) $100,000. Major programs are those in excess of the higher of these figures, or $213,000.
- Therefore, according to Circular A-133, all programs above, except Program C-1, are major, *including* Programs F and G.
- Programs F and G do *not* count in the total for the test. If Programs F and G were included, major programs would be 3 percent of $17,600,000 or $528,000, making Programs C-1, C-2, and D *nonmajor*.

2.16. Once management has prepared the schedule of federal awards and identified each major program, the auditor should assess the reasonableness and completeness of the schedule, as well as management's determination of major programs.

2.17. Federal awards shown on the schedule should include pass-through assistance (subawards of federal assistance from nonfederal sponsors) but should not include direct federal cash assistance to individuals.[13]

[13] Medicare funds paid to a not-for-profit provider for health care services to Medicare-eligible individuals are not considered to be federal financial awards subject to Circular A-133 audits.
Medicaid funds paid to a not-for-profit provider of health care services under a fixed-price arrangement generally are not subject to Circular A-133 audits.
However, under certain circumstances, Medicaid funds may be subject to Circular A-133 audits. The following are the most likely circumstances:

- Because state and local funds are also part of the Medicaid program, the state may require the NPO to have an audit in accordance with Circular A-133 (or any other requirements) and/or may require expanded coverage for a number of reasons.

Receipts

2.18. Question 7 of PCIE Position Statement No. 6 states that the definition of a receipt, which determines which entities are subject to Circular A-133, is based on how a recipient recognizes and reports its revenue. It states that "receipt of an award is *not* tied to when the contract or grant agreement is signed or awarded to the NPO." Generally, a recipient has received awards when it has obtained cash or noncash assistance, or when it has incurred expenditures that will be reimbursed under a federal program. Receipt of federal awards occurs when revenues are recorded in the financial statements.

2.19. For programs that involve the receipt of tangible assets (such as food stamps, food commodities, and donated surplus property), "receipts" should be based on the point at which the revenue is recognized according to generally accepted accounting principles. For programs that do not involve the transfer of tangible assets (such as guarantee and insurance programs), "receives" should be based on the transaction or event that gives rise to the award.

2.20. Determining the year in which an award is received is particularly important when an NPO is not required to have an audit each year. For example, an NPO may meet the dollar threshold requiring an audit in one year, but not in the next. In this case, the fiscal year audited should match the fiscal year in which the related award activity (expenditures or noncash transactions) occurs.

2.21. The following table sets forth the requirements of Circular A-133 for the types of NPOs described in paragraphs 2.8 and 2.9 of this SOP, based on the amount of awards received.

What Is the Total Amount of Federal Awards Received in a Year?	*Is the Organization Required to Follow Circular A-133?*
$100,000 or more	Yes. However, if the awards are under only one program, the organization has the option of following Circular A-133 or having an audit of the program based on the requirements governing the program in which the organization participates (see paragraph 2a(2) of the Attachment to A-133).
At least $25,000, but less than $100,000	The organization has the option of following Circular A-133 or having an audit of each award based on that program's requirements. The requirements for individual program audits are set forth in the respective regulations and audit guides (see appendix B of this SOP).
Less than $25,000	No. However, records must be available for review by appropriate officials.

(Footnote Continued)

- When Medicaid funds are paid to an NPO to assist the state or local government in administering the Medicaid program, a Circular A-133 organization-wide or program-specific audit would be required. The following are examples:

— The state contracts with a not-for-profit peer review organization to administer the Medicaid utilization review function.

— The state contracts with an NPO to handle the claims-processing function.

2.22. PCIE Position Statement No. 6, Question 29, states that noncash assistance such as free rent, interest subsidy, food stamps, food commodities, Women/Infant/Children (WIC) program vouchers, or donated property should be valued at fair market value at the time of receipt to determine the amount of federal award. WIC program vouchers may be valued either at maximum allowed redemption value or average redeemed value.

2.23. PCIE Position Statement No. 6 states that receipt of *only* free rent would not be considered a federal award to carry out a program and therefore would not require an audit under Circular A-133. However, the not-for-profit may be subject to monitoring, audit, or other requirements imposed by the federal agency providing free rent.

2.24. In some cases, the free rent may be received as part of a federal award or other assistance to "carry out a program." In these cases, the free rent would fall under the definition of "other noncash assistance" and would be included in the total amount awarded for the program, under Circular A-133, paragraph 1e(1).

2.25. PCIE Position Statement No. 6, Question 12, states that nonfederal matching is not considered a federal award when determining whether or not an audit is required. For example, a $25,000 match to a $75,000 Federal award would not be considered federal financial assistance; only the $75,000 would be added to any other federal awards to determine whether an audit is required. Once it is determined that an audit is required, however, the auditor should consider whether it is necessary to apply any tests of compliance with requirements applicable to the matching funds.

Treatment of Loans

2.26. PCIE Position Statement No. 6, Question 7, states that, "since the federal government is at risk for loans and loan guarantees, ("Loans") until the debt is repaid, the balance of prior year loans is considered current year financial assistance in each year they are outstanding." PCIE Question 6 notes that if the only federal assistance is prior year loans, then the NPO may have an audit in accordance with the laws and regulations governing the Loans, according to paragraph 2a(1) of the Attachment to Circular A-133.

2.27. Further, PCIE Question 6 states: "however, the Loans may be one time financing with no continuing audit or other compliance requirements except to make repayment. In cases such as this, when the only Federal awards are Loans and the Federal agencies providing the loans do not require an audit, then Circular A-133 would not require an audit."

Program-Specific Audits

2.28. There are instances where recipients may elect to have a program-specific audit rather than an audit based on the organization-wide requirements of Circular A-133 based on the option described in paragraph 2.21 of this SOP. A program-specific audit is an audit of one federal program in accordance with federal laws, regulations, or audit guides relative to that particular program and does not require a financial statement audit of the not-for-profit entity. By comparison, a Circular A-133 audit is an organization-wide audit that covers all federal awards and requires an audit of the financial statements of the not-for-profit entity. In general, in meeting program-specific requirements, the audit would follow GAS and any specific requirements set forth in the applicable regulations and related audit guides issued by the federal sponsor.

2.29. In many cases, a program-specific audit guide will be available to provide guidance on compliance testing, other audit procedures, and reporting. When engaged to conduct a program-specific audit, the auditor should obtain an understanding of the audit requirements for that particular program from the agreement with the grantor agency, from an audit guide published by the grantor agency, or through contact with the grantor agency. The PCIE Standards Subcommittee has prepared a *Program Audit Guide Survey* (October 1991), which is referred to in appendix B of this SOP. Paragraphs 7.51 through 7.54 of this SOP discuss program audit reporting.

2.30. PCIE Position Statement No. 6, Question 22 requires that program-specific audits for which no current federal agency guide is available should follow the standards for financial audits in GAS. The reporting should normally include an opinion on the financial statements of the program, a report on the internal controls over the program, and a report on program compliance with laws and regulations. A schedule of findings and questioned costs, a management letter, or a report on illegal acts may also be required when applicable.

2.31. PCIE Position Statement No. 6, Question 23, states that—

> When a current program-specific audit guide is not available, the auditor should use the following guidance for general and specific compliance requirements:
>
> > *General Requirements.* The general requirements listed in the *Compliance Supplements* should be included as part of every audit that involves Federal financial assistance. The auditor should review the Circular A-133 *Compliance Supplement* general requirements and consider these in planning the audit. In particular, federal financial reporting, cash management, allowable costs/cost principles, and administrative requirements will usually apply to all programs.
> >
> > *Specific Requirements.* The specific requirements may be obtained from the compliance supplements, program laws and regulations, or from the sponsoring agency. The auditor may also look to the *Compliance Supplements* or other sources for guidance on suggested audit procedures and the types of compliance requirements to be tested.

Program-Specific Audits—R&D

2.32. The sum of expenditures from awards for research and development (as defined in Circular A-133) received is considered a program and the sum of expenditures from SFA awards is considered a program. Under a Circular A-133 audit, expenditures for all R&D awards are tested as if they were a single program with possible different compliance requirements within the program. SFA is treated similarly.

2.33. A Circular A-133 organization-wide audit is required when there are multiple R&D awards totaling $100,000 or more. A program-specific audit is not acceptable for multiple R&D awards because R&D can be received from many federal agencies and R&D often involves multiple offices or accounting systems within the NPO.

2.34. An exception is that a program-specific audit of R&D is permitted when *all* of the following conditions are met:

a. There are only R&D awards and all awards are received from a single federal agency, or from a single prime recipient, in the case of a subrecipient.

b. The federal agency, or prime recipient in the case of a subrecipient, approves a program audit in advance. The approval should be based upon a determination that the program audit will provide at least the same level of audit coverage over federal funds as the Circular A-133 single audit.

c. The program audit is performed in accordance with *Government Auditing Standards* and guidance provided by the federal agency, or by the prime recipient in the case of a subrecipient.

Program-Specific Audits—SFA

2.35. The U.S. Department of Education (ED) and U.S. Department of Health and Human Services (HHS) have agreed to accept an SFA program audit when there are multiple awards but the awards are for SFA. The auditor may consider using the current ED audit guide, *Audits of Student Financial Assistance Programs,* which may be supplemented as necessary with the program requirements for SFA programs of other federal agencies. For purposes of an audit conducted in accordance with Circular A-133, all SFA programs are considered to be a single major program, while the ED audit guide requires that the auditor consider *each* SFA program to be a major program.

Associated Organizations

2.36. As noted in PCIE Position Statement No. 6, Question 13—

> Not-for-profit organizations often create Associated Organizations to perform certain functions for the not-for-profit (e.g., a university athletic foundation, a university association to provide dormitory housing, a not-for-profit creating a separate not-for-profit organization to hold real estate, or a national not-for-profit organization that sponsors local chapters). Common reasons for forming these Associated Organizations are for exemption from restrictions on the NPO to raise funds or to further the purpose of the not-for-profit. In many cases, the same individuals may hold offices in both organizations or the NPO may otherwise exercise control over the Associated Organization.

2.37. PCIE Position Statement No. 6, Question 13, also states that the application of the audit requirements under Circular A-133 to such Associated Organizations will depend on the circumstances. The auditor should use the following guidelines:

- When an Associated Organization receives federal awards, either as a recipient or subrecipient, it would be subject to Circular A-133 audit requirements.
- When an Associated Organization is included in the NPO's indirect cost allocation plan, the auditor of the NPO may need to test transactions of the Associated Organization in procedures performed relative to indirect costs. The auditor should also consider whether any transactions between the NPO and Associated Organization that affect federal awards or otherwise need to be tested as part of the NPOs Circular A-133 audit. If the transactions with the Associ-

ated Organization are clearly immaterial, then additional procedures may not be necessary.

- An Associated Organization which meets *all* of the following conditions does not need to be audited under Circular A-133:
  - — It receives no direct or indirect federal awards;
  - — It is not included in the NPO's indirect cost allocation plan; *and*
  - — Otherwise it does not receive payments or benefits from the NPO which are paid out of federal funds.

Basic Requirements of Circular A-133

2.38. Circular A-133 requires an audit of the NPO's basic financial statements, additional audit tests for compliance with applicable laws and regulations, and consideration of the NPO's internal control structure over federal awards.

2.39. The audit requirements of Circular A-133 are administered on behalf of the federal government by cognizant agency representatives who are designated or agree to represent the collective interests of the federal government.

2.40. Circular A-133 requires the auditor to determine whether—

- The financial statements of an NPO present fairly its financial position and the results of its operations in conformity with generally accepted accounting principles (GAAP).[14]
- The NPO has an internal control structure to (*a*) provide reasonable assurance that it is managing federal awards in compliance with applicable laws and regulations and (*b*) ensure compliance with laws and regulations that could have a material effect on the financial statements.
- The organization has complied with laws and regulations that may have a direct and material effect on its financial statement amounts or on each major federal program.

Differences Between Circulars A-110 and A-133

2.41. Attachment F, subparagraph 2(h), of Circular A-110 includes a broad requirement for an organization-wide financial audit, to be carried out at least biennially. Since the attachment to Circular A-110 included no specific reporting requirements, its application was diverse in practice. Circular A-133 sets forth the audit requirements described in chapter 1 and above.

2.42. In 1989, the Standards Subcommittee of the PCIE, which represents the federal Inspectors General, directed in its Statement No. 5 that accountants conducting audits of federal recipients under Circular A-110 should use the audit procedures and reports set forth in a 1989 audit guide promulgated by HHS. In summary, its reporting requirements include the internal control structure and compliance reports of GAS, but do not include the separate internal control structure and compliance reports required by Circular A-133. Circular A-133 supersedes Circular A-110 audit requirements and expands the audit and reporting guidance beyond those contained in the HHS guide. As stated in PCIE Position Statement No. 6, Question 3, "Because an audit conducted in accordance with the HHS Guide would not meet the requirements of Circular A-133, PCIE No. 5 does not apply to Circular A-133

[14] Bases of accounting other than GAAP are acceptable. See paragraph 7.4 of this SOP.

audits. However, PCIE No. 5 remains in effect for Circular A-110 audits performed prior to implementation of Circular A-133."

Differences Between Circulars A-128 and A-133

2.43. Although Circular A-133 was patterned after Circular A-128, there are differences between the two. The following paragraphs highlight the major differences.

Defining Major Programs

2.44. Major programs are defined differently in Circular A-133 than in Circular A-128. For entities that have $100 million or less in expenditures, Circular A-128 defines a major program as any program for which federal expenditures exceed the larger of $300,000 or 3 percent of such total expenditures. For entities that spend more than $100 million, Circular A-128 includes a chart that specifies the amounts used to define major programs. Paragraph 1.18 of this SOP discusses how Circular A-133 defines a major program.

2.45. Per Circulars A-128 and A-133, a program can also include several grants, but they should be grouped by their listing in the CFDA; for student financial aid and research and development programs, Circular A-133 allows broader groupings whereas Circular A-128 does not.

Disclosure of Immaterial Findings

2.46. Circular A-128 requires the auditor to include a description of all findings of noncompliance, including immaterial findings in the audit reports, but Circular A-133 does not. However, under Circular A-133, immaterial findings of noncompliance may be reported either in the report or in a separate written communication to the NPO. This separate communication is referred to in the Circular A-133 compliance reports.

Frequency of Audit

2.47. Circular A-128 requires an annual audit, unless the appropriate state or local government established a constitutional or statutory requirement for biennial audits prior to January 1, 1987.[15] Circular A-133 permits audits to be conducted every two years, but only if the recipient does not have an annual financial statement audit, in which case the PCIE has interpreted OMB Circular A-133 to require annual audits as well. If circumstances permit a biennial audit, the entire two-year period must be audited, and the determination for major programs should be based on expenditures for the two-year period. An audit performed in accordance with OMB Circular A-133 should cover the reporting entity's transactions for its fiscal year, which is not necessarily the period of the program being funded.

2.48. According to the PCIE Position Statement No. 6, Question 71, the Circular A-133 audit must be annual when the not-for-profit organization has annual financial audits. Since some not-for-profit organizations and their auditors have interpreted Circular A-133 to allow a Circular A-133 audit every two years in all cases, the Inspectors General may use judgment in accepting two-year audits in the first cycle of audits under Circular A-133.

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[15] Circular A-133 Attachment, paragraph 7, states, "Audits shall usually be performed annually but not less frequently then every two years." However, if the statute for the program requires an annual audit, then an annual audit must be performed.
For example, Section 330 of the Public Health Act, which covers community health centers, requires an annual audit. Circular A-133 guidance should be followed in performing an annual audit.

Coordinated Audit

2.49. Circular A-128 does not contain a provision for a coordinated audit approach. In recognition of the potential economies gained through mutual reliance among auditors, Circular A-133 permits a coordinated audit approach. A coordinated audit is one in which the independent auditor and federal and other auditors consider each other's work in determining the nature, timing, and extent of auditing procedures.

2.50. In most cases, the objectives of GAAS and Circular A-133 can be achieved most effectively by a single auditor, whose work and reports meet the objectives and reporting requirements described in paragraphs 12(b) and 15 of Circular A-133. In other cases, however, internal, state, local, or federal auditors or other federal representatives may be involved as well. In these cases, the auditor should consult with the other auditors to determine whether the other auditors have any work planned, in process, or completed that may be used to satisfy some or all of the other auditor's needs in performing planned work, to avoid duplication of effort. Such work includes work performed by internal auditors, other independent accountants, or specialists such as program reviewers or contracting officers. Circular A-133 states that the coordinated audit approach is not intended to limit the scope of the audit work to preclude the independent auditor from meeting the objectives and reporting requirements described in paragraphs 12(b) and 15 of that Circular. For the coordinated audit to succeed, there should be a clear understanding with the recipient, as well as among all auditors involved, as to the specific audit and reporting responsibilities of each.

2.51. If the coordinated audit approach is used, the auditor should follow, as appropriate, SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*; SAS No. 11, *Using the Work of a Specialist*;* and SAS No. 1, section 543, *Part of Audit Performed by Other Independent Auditors.*[16]

2.52. A coordinated audit contemplates that different auditors will provide various reports required by paragraph 15 of Circular A-133. For example, a separate financial statement and compliance audit may be conducted by an auditor, other than the principal auditor, of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements of the parent NPO. Typically, the auditor of the parent will not have performed the procedures necessary to issue the required Circular A-133 reports on compliance and internal control relative to the component unit. When another auditor is involved, the other participating auditors should indicate the division of responsibility in the scope paragraph of their reports on the financial statements, compliance, and the internal control structure, rather than disclaiming an opinion on the work of the other auditor. For professional guidance, the auditor may need to refer to SAS No. 1, section 543. An auditor participating in coordinated audits should carefully evaluate the interrelationships of the work performed by others and the nature of his or her reliance on them in meeting his or her reporting responsibilities.

* The AICPA's Auditing Standards Board has voted to issue a Statement on Auditing Standards that will supersede SAS No. 11. The new SAS is expected to be issued in July 1994 and to be effective for audits of financial statements for periods ending on or after December 15, 1994.

[16] In some cases the work of a program reviewer would qualify as that of a "specialist" under SAS No. 11.* If so, the auditor would be required to satisfy himself or herself concerning the reviewer's professional qualifications and understand the purpose and nature of work performed by the specialist. In most cases, a program reviewer cannot satisfy all the work required by and planned under Circular A-133, but it can be a substitute for some of it. The auditor is still required to gain a satisfactory understanding of the internal control structure, assess control risk, and perform some testing of the specific requirements.

2.53. In overseeing "coordinated" audits, federal agencies may, in certain cases, request special reports prepared in accordance with SAS No. 62, *Special* Reports, or reports on the internal control structure or compliance with certain laws and regulations, in addition to the reports required in accordance with paragraph 15 of Circular A-133. When participating in a coordinated audit, the auditor should understand his or her responsibilities for any additional reporting requirements, and consider documenting this understanding in an engagement letter signed by all parties, before beginning fieldwork.

Additional Audit Work

2.54. Circular A-73, *Audits of Federal Operations and Programs,* provides guidance to federal agencies responsible for processing and assessing the adequacy of audit reports prepared by nonfederal auditors who have been engaged in audits of federal programs. Circular A-73 states in part:

> Federal agencies will rely on recipient audits, provided they are made in accordance with the audit standards issued by the Comptroller General and otherwise meet the requirements of the federal agencies. Federal agencies may perform additional audit work building on the audit work already performed.

2.55. The provisions of Circular A-73 do not limit the authority of a federal agency to conduct or contract for additional audits of recipient organizations. However, under Circulars A-73 and A-133, any additional audit work should not duplicate the work already performed. Further, Circular A-133 states that federal agencies contracting for additional audit work are responsible for the additional costs involved.

Contracting for Audits

2.56. Paragraph 10 of Circular A-133 refers to the procurement standards set forth in Circular A-110. These standards provide for cost or price analysis in connection with all of a recipient's purchases, and require that this analysis be documented for procurement over a certain threshold. A responsible procurement is particularly important for audits. Among others, the Mid-America Intergovernmental Audit Forum (see appendix B) has produced sample procurement guidelines that may be useful to recipients and their auditors. Circular A-133 provides guidelines for recipients of federal awards to ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals will have the opportunity to participate in the performance of contracts awarded to fulfill the audit requirements of Circular A-133.

Working Papers

2.57. Circular A-133 requires auditors to retain working papers and audit reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Working papers are required to be made available on request to the cognizant agency, its designee, or the GAO.

Other Literature on Organization-Wide Audits

2.58. Additional guidance on organization-wide audits has been provided by the Standards Subcommittee of the PCIE and by the AICPA. Appendix B of this SOP lists this guidance and explains how to obtain it. In the planning stage of the audit, auditors should become familiar with the applicable documents presented in appendix B, many of which are discussed in this SOP.

Chapter 3

PLANNING AND OTHER SPECIAL AUDIT CONSIDERATIONS OF OMB CIRCULAR A-133

Planning Considerations

3.1. In planning an audit in accordance with OMB Circular A-133, the auditor considers several matters in addition to those ordinarily connected with an audit of financial statements in accordance with generally accepted auditing standards and *Government Auditing Standards.* This chapter discusses overall planning considerations in an organization-wide audit in accordance with Circular A-133.

Overall Organization-Wide Audit—Planning Considerations

3.2. Matters that are relevant to planning both components of an organization-wide audit—the financial statement audit and the audit of federal financial assistance—include the following:

- Preliminary assessment of audit risk
- Materiality
- The cognizant agency
- *Government Auditing Standards,* including continuing education and quality-control requirements
- Foreign NPOs
- Subrecipients
- For-profit subrecipients
- Third-party contractors
- Additional responsibilities of the auditor
- Audit follow-up
- State award compliance
- Determination of the audit period
- Initial-year audit considerations
- Joint-audit considerations
- Quality-assessment programs
- The engagement letter
- Other audit services
- The exit conference

Preliminary Assessment of Audit Risk

3.3. SAS No. 68 requires that the auditor obtain an understanding of the possible effect of laws and regulations that are generally recognized by auditors to have a direct and material effect on the financial statements (under GAAS and GAS) and on federal financial assistance programs (under OMB Circular A-133). The auditor should consider risk factors related to these laws and regulations and to the related policies and procedures in the internal control structure.

Materiality

3.4. Materiality is a significant matter that should be considered in planning the organization-wide audit. SAS No. 47, *Audit Risk and Materiality* *in Conducting an Audit,* provides guidance on the auditor's consideration of materiality when planning and performing an audit of financial statements in accordance with GAAS. (See paragraphs 6.30—6.35 of this SOP for a detailed discussion of materiality.)

3.5. *Compliance Requirements.* In planning the control structure and compliance aspects of the audit, the auditor should obtain from management the principal compliance requirements from the sponsor or the organization at the start of the audit. The entity and auditor may also ascertain the principal compliance requirements for the largest federal programs by referring to the OMB's *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions.* For programs not listed, the auditor may refer to the OMB's *Compliance Supplement for Single Audits of State and Local Governments* or to the regulations and agreements governing individual programs.

3.6. Circular A-133 defines the cognizant agency as a federal agency assigned by the OMB to carry out the responsibilities with regard to an organization-wide audit as defined in paragraph 3 of the Attachment to the Circular. For some organizations subject to OMB Circular A-133, the OMB has assigned a cognizant agency. For other entities, there is an oversight agency with somewhat lesser responsibilities. Paragraph 4 of the Attachment to the Circular describes them.

Responsibilities of the Cognizant and Oversight Agencies

3.7. The OMB has designated cognizant agencies for larger not-for-profit organizations. Smaller NPOs not assigned a cognizant agency are under the general oversight of the federal agency that provides them with the most direct funding. (Where there is no direct funding, the prime recipient providing the most pass-through funding to the NPO will generally assume oversight responsibility.) For assistance in planning, conducting, and reporting on an audit conducted in accordance with Circular A-133, the recipient and auditor may wish to consider this oversight agency in the role played by the cognizant agency, described above.

3.8. Paragraph 3 of Circular A-133 states that a cognizant agency has the responsibility to—

a. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of Circular A-133.

b. Provide technical advice and liaison to organizations and independent auditors.

c. Obtain or make quality-control reviews of selected audits made by nonfederal audit organizations and provide the results, when appropriate, to other interested organizations.

d. Promptly inform other affected federal agencies and appropriate federal, state, and local law enforcement officials of any reported illegal acts or irregularities.

e. Advise the recipient of audits that have been found not to have met the requirements set forth in Circular A-133. In such instances, the recipients are expected to work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency will notify the recipient and federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repeated substandard performance of independent auditors will be referred to appropriate professional bodies for disciplinary action.

f. Coordinate, to the extent practicable, audits made for federal agencies that are in addition to the audits made pursuant to Circular A-133, so that the additional audits build upon such audits.

g. Oversee the resolution of audit findings that affect the programs of more than one agency.

h. Coordinate audit work and reporting among all auditors in order to achieve the most cost-effective audit. Seek the views of other interested agencies before completing a coordinated audit.

3.9. Additional information on the responsibility of a cognizant agency is contained in the *Federal Cognizant Agency Audit Organization Guidelines,* issued by the PCIE. It provides guidance for promoting quality audits, processing audit reports, and providing notification of irregularities.

3.10. The OMB has stated that the responsibilities of an oversight agency are not as broad as those of a cognizant agency. An oversight agency's primary responsibility is to provide advice and counsel to recipients and their auditors when requested. An oversight agency may take on additional responsibilities if deemed necessary, such as ensuring that audits are conducted and transmitted to appropriate federal officials.

3.11. In addition, OMB has designated the Bureau of the Census to act as the overall clearinghouse for Circular A-133 reports.

3.12. *Communication With the Cognizant or Oversight Agency.* Although not required by Circular A-133, the auditor may, when professional judgment indicates it is appropriate, communicate with the cognizant agency. If a planning meeting is held with the cognizant agency and the recipient organization, matters such as the following may be discussed:

- The audit plan
- The scope of compliance testing of programs for specific requirements
- The intended use of the Circular A-133 Compliance Supplement
- The identification of federal awards, including those that are considered to be major programs
- The form and content of the supplemental schedule of federal awards
- Testing the monitoring of subrecipients
- The scope of consideration of internal control structure
- Testing of compliance requirements
- Status of prior-year findings and questioned costs

3.13. If the cognizant agency disagrees with significant elements of the audit plan, these matters should be resolved among the recipient, the cognizant or oversight agency (or major funder), and the auditor before fieldwork commences. Communication with and decisions rendered by the cognizant agency should be documented.

Government Auditing Standards

3.14. OMB Circular A-133 requires that the audit be performed by an independent auditor in accordance with *Government Auditing Standards.* The auditor should be aware of AICPA Ethics Interpretation 501-3, *Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits.* Two of the general standards included in *Government Auditing Standards* relate to continuing professional education and quality control.

3.15. *Continuing Professional Education Requirements. Government Auditing Standards* requires auditors to participate in a program of continuing professional education (CPE) and training. Every two years, certain auditors performing audits in accordance with GAS should complete at least eighty credit hours of training that contribute directly to their professional proficiency. At least twenty of these hours should be completed in each year of the two-year period and at least twenty-four hours should be in topics directly related to the specific or unique environment in which the entity operates. For example, if the auditor performs audits of an entity that is a not-for-profit organization, the twenty-four hours should be in topics related to the not-for-profit accounting and auditing environment. These could include compliance and government-related courses or those broadly related to the sort of not-for-profit organization being audited.

3.16. This requirement applies to auditors responsible for planning, directing, and reporting on audits conducted in accordance with GAS and to those "conducting substantial portions[17] of field work." A detailed interpretation of the CPE standards, *Interpretation of Continuing Education and Training Requirements,* is available from the Government Printing Office (stock number 020-000-00250-6). During engagement planning, auditors and audit organizations should ensure that members of the audit team have met or will meet the appropriate CPE requirement.

3.17. *Quality Control. Government Auditing Standards* also states that the audit organization should have in place an internal quality-control system and participate in an external quality-review program (for example, peer review). An external quality review should be conducted at least once every three years.

Foreign NPOs

3.18. Auditors performing Circular A-133 audits of U.S. grantees and their subrecipients (U.S. and/or foreign based) are required to meet *Government Auditing Standards.* No specific exception is provided for foreign auditors. When a subrecipient is a foreign NPO, it may be necessary to use independent auditors who may not fully meet *Government Auditing Standards* such as the continuing education or quality control standards. In these cases, the auditor should disclose the applicable audit standards that were not met. PCIE Statement No. 6, Question 89, states that the Inspectors General, or recipients in the case of a subrecipient, are expected to use their judgment on whether to accept the reports.

3.19. A foreign NPO that is a sub-office of or otherwise included in the financial statements of a U.S.-based NPO, is generally included as part of the audit of the U.S.-based operation and not considered a subrecipient. A foreign NPO that is a subrecipient of a U.S.-based NPO would be subject to Circular A-133.[18] A foreign not-for-profit organization receiving a federal award directly from the U.S. government would be subject to the audit requirements of the terms and conditions of the award. The auditor should be aware that certain federal agencies have issued guidelines for these types of audits. For example, the AID has issued *Guidelines for Audits of AID Assistance Contracted by Foreign Recipients.*

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[17] Per the GAO *Interpretation of Continuing Education and Training Requirements,* individuals are considered responsible for "conducting substantial portions of the field work" when, in a given CPE year, their time chargeable to audits conducted under GAS amounts to 20 percent or more of their total chargeable time.

[18] General requirements may not apply to a foreign NPO. The auditor should refer to the terms of the award or discuss the matter with the granting agency.

Subrecipient Versus Vendor Responsibilities

3.20. Many NPOs and governmental units make subcontract or subaward awards and disburse their own funds as well as federal funds to subrecipients. In many instances, the amount of these payments or provisions of goods to subrecipients or vendors is material to the primary recipient's financial statements.

3.21. The difference between vendors and subrecipients is significant for purposes of the Circular A-133 audit. If an entity that receives pass-through federal funds is classified as a vendor, that vendor's responsibility is to meet the requirements of the procurement contract. If, however, the entity is classified as a subrecipient, then the primary recipient NPO must make certain that the pass-through funds are utilized in accordance with applicable laws and regulations. Examples of a typical recipient-subrecipient relationship include the following:

- A state university receives federal assistance that it disburses to other organizations throughout the state according to a formula or some other basis.
- A regional commission receives federal funds for the feeding of elderly and low-income individuals that are disbursed to not-for-profit organizations to support their feeding programs.
- A state department of social services receives federal funds that are disbursed to NPOs within the state.

3.22. The type of entity the subrecipient is determines which circular is applicable. Circular A-128 applies to state or local government subrecipients. Circular A-133 applies to institutions of higher education or other not-for-profit subrecipients.

3.23. *Subrecipient.* A subrecipient is defined in OMB Circular A-133 as "any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other subrecipient but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a direct recipient of Federal awards under other agreements." According to PCIE Position Statement No. 6, Question 46, "a subrecipient may have some or all of the following characteristics: responsibility for applicable program compliance requirements, performance measured against meeting the objectives of the program, responsibility for program decisions, and determining eligibility for assistance."

3.24. *Vendor.* A vendor is an entity generally responsible for providing required goods or services related to the administrative support of the federal award. These goods or services may be for the recipient or subrecipient's own use or for the use of beneficiaries of the program. The vendor's only responsibility is to satisfy the terms of this contract.

3.25. Per PCIE Position Statement No. 6, Question 57, "Compliance requirements normally do not pass through to vendors. However, some transactions may be structured such that the vendor should also be responsible for compliance or the vendor's records must be reviewed to determine compliance. In these cases, the NPO is responsible to ensure compliance for applicable transactions by vendors. Methods to ensure this compliance are pre-award audits, monitoring during the contract, and post-award audits. Audits may be done or procured by the NPO or the terms and conditions of the contract may require the vendor to procure the audit."

3.26. PCIE Position Statement No. 6, Question 58, states that "when the auditor cannot obtain compliance assurances from reviewing the not-for-profit's records and monitoring procedures, the auditor will need to perform additional procedures to determine compliance. These procedures may include testing the vendor's records or relying on work performed by the vendor's independent auditor." PCIE Position Statement No. 6, Question 46, notes that the distinguishing characteristics of a vendor include:

- Providing the goods or services within normal business operations
- Providing similar goods or services to many different purchasers
- Operating in a competitive environment
- Program compliance requirements that do not pertain to the goods or services provided

3.27. The following considerations may help the organization and its auditor decide whether the entity is a subrecipient or a vendor. In some cases, it may be difficult to determine whether the relationship with the NPO is that of a subrecipient or of a vendor. In those cases, the organization and the auditor should make a decision based on the preponderance of answers.

	Yes	*No*
1. Are the funds being disbursed directly or indirectly from a federal source?	Indicative of subrecipient	Cannot be subrecipient
2. Is the receiving entity a not-for-profit or a governmental entity?	No distinction made	Indicative of vendor
3. Does the entity that receives the funds have the authority for administrative and programmatic decision-making responsibility and/or eligibility determination?	Indicative of subrecipient	Indicative of vendor
4. Are the services provided by the entity ongoing as opposed to occasional?	Indicative of subrecipient	Indicative of vendor
5. Do contracts with the entity state that they are to comply with all applicable laws and regulations? Are there performance requirements that must be met and reported?	Indicative of subrecipient	Indicative of vendor

3.28. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. The federal cognizant, oversight, or sponsoring agency may be of help in making these determinations.

3.29. Federal awards normally are redistributed to subrecipients only on the basis of properly completed and approved awards. These written agreements require subrecipients to comply with the requirements of the federal agency and additional requirements established by the pass-through organization. Hence, the auditor may be required to test compliance, for example, with state as well as federal reporting requirements.

Subrecipient Audits

3.30. Under the requirements of Circular A-133, if in a single fiscal year a recipient of a federal award passes through $25,000 or more of that federal award to a subrecipient, the primary recipient is responsible for determining that the subrecipient expends that award in accordance with applicable laws and regulations.[19] Further, Circular A-133 provides that in such instances, the primary recipient should—

- Determine whether not-for-profit subrecipients and, if applicable, governmental subrecipients covered by Circular A-128, have met the audit requirements of Circulars A-133 and A-128, respectively.[20]
- Determine whether the subrecipient spent federal funds provided in accordance with applicable laws and regulations.
- Ensure that appropriate corrective action on reported instances of noncompliance with federal laws and regulations is taken within six months after receipt of the subrecipient audit report.
- Consider whether subrecipient audits necessitate adjustment of the recipient's own records.
- Require each subrecipient to permit independent auditors to have access to their records and financial statements as necessary to comply with Circular A-133.

3.31. Prime recipients are responsible for identifying federal awards to subrecipients. However, when the not-for-profit subrecipient is unable to identify the amount of the award which is federal, the full amount should be considered a federal award of the NPO. The full amount should also be reported on the schedule of federal awards with a footnote that the federal amount cannot be determined.

3.32. Although the threshold per Circular A-133 for monitoring subrecipients is $25,000 provided to a subrecipient, Circular A-110 includes certain responsibilities for recipients to monitor subrecipients, regardless of the amount of the subaward.

3.33. Those responsibilities may be discharged by relying on the subrecipients' Circular A-133 audits, relying on appropriate procedures performed by the primary recipient's internal audit or program management personnel, expanding the scope of the independent financial and compliance audit of the primary recipient to encompass testing of subrecipients' charges, or a combination of these procedures.

3.34. The primary recipient is also responsible for reviewing audit and other reports submitted by subrecipients, identifying questioned costs and other findings pertaining to the federal awards passed through to the subrecipients, properly accounting for and pursuing resolution of questioned costs,

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[19] Per PCIE Position Statement No. 6, Question 54:

If the prime recipient does not inform the subrecipient that a Federal award is being passed through, and the subrecipient otherwise is not aware that the award is Federal or that an audit is required, then the prime recipient is responsible to make arrangements with the subrecipient for the proper audit. The prime recipient is ultimately responsible for Federal awards passed through to a subrecipient.

The determining factor for A-133 audit requirements is the dollar amount of Federal awards received, not whether the audit is requested. All not-for-profit subrecipients whose total Federal awards received meet the dollar thresholds are required to have an A-133 audit. However it is essential that the prime recipient identify Federal awards to the subrecipient.

If the prime recipient fails to advise the subrecipient that the award is Federal, this should be considered a weakness in the prime recipient's internal control system for monitoring subrecipients.

[20] In some cases, the award passing through the prime recipient to the subgrantee is the only such award the subrecipient receives. If the subrecipient qualifies for a program-specific audit under such circumstances (see paragraph 2.28), then it would be appropriate for either the prime recipient or the subrecipient to engage an auditor to perform the program-specific audit. When an organization-wide audit is required under Circular A-133, separate program-specific audits of this type will not meet the requirements of the Circular.

and ensuring that prompt and appropriate corrective action is taken in instances of material noncompliance with laws and regulations.

3.35. In establishing its control policies and procedures to monitor subrecipients, the primary recipient should design procedures sufficient to determine a subrecipient's noncompliance with applicable federal rules and regulations that could be material to the subaward. Financial operations of subrecipients related to the federal awards may be subjected to timely and periodic audits. If not, the primary recipient should develop alternative procedures for monitoring their subrecipients, The primary recipient may perform monitoring procedures such as the following:

- Review grant applications submitted by subrecipients to determine that—
  - Applications are approved by subgrantor management before any funds are awarded.
  - Applications are filed in a timely manner.
  - Each application contains the condition that the subrecipient comply with the federal requirements set by the initial federal grantor agency.
- Establish control policies and procedures to provide reasonable assurance that funds are disbursed to subrecipients only on an as-needed basis.
- Disburse funds to subrecipients only on the basis of approved, properly completed reports submitted on a timely basis.
- Bill and collect refunds due from subrecipients in a timely manner.
- Establish control policies and procedures to provide reasonable assurance that subrecipients and those using the funds meet eligibility requirements.
- Review financial and technical reports received from subrecipients on a timely basis and investigate all unusual items.
- Review submitted audit reports to evaluate for completeness and for compliance with applicable laws and regulations to determine whether the appropriate reporting standards were followed.
- Evaluate audit findings, issue appropriate management decisions, if necessary, and determine if an acceptable plan for corrective action has been prepared and implemented. If considered necessary, review the working papers of the auditors.
- Review evidence of previously detected deficiencies and determine that corrective action was taken.

3.36. The auditor of the primary recipient should develop an understanding of the design of the recipient's policies and procedures used to monitor subrecipients and determine whether they have been placed in operation. The auditor should also assess the level of control risk by evaluating the effectiveness of the primary recipient's control policies and procedures in preventing or detecting subrecipients' noncompliance with the applicable laws and regulations.

3.37. When awards to subrecipients are part of a major program (or a nonmajor program used to meet the 50-percent rule described in paragraph 1.32 of this SOP), the auditor should test the NPO's control policies and procedures used to monitor subrecipients. The tests of controls may include inquiry, observation and inspection of documentation, or a reperformance by the auditor of some or all of the monitoring procedures identified above as the primary recipient's responsibilities. The nature and extent of the tests performed will vary depending on the auditor's assessment of inherent risk, understanding of the control structure policies and procedures, and professional judgment.

3.38. The instances of noncompliance reported in a subrecipient's audit report are not required to be included in the primary recipient's audit report. However, as noted above, the recipient has a responsibility to resolve subrecipients' audit findings directly related to the primary recipient's programs. Thus, the auditor should consider the effects on a major program (or a nonmajor program used to meet the 50-percent rule described in paragraph 1.32 of this SOP) of instances of noncompliance reported in subrecipient audit reports, or reportable conditions, including material weaknesses, in the primary recipient's control policies and procedures used for monitoring the subrecipient.

3.39. In many cases, the primary recipient will not have received all subrecipient audit reports in time to incorporate the results into its own audit. Circular A-133 does not require that the reports for prime and subrecipient be issued simultaneously, but that the primary recipient have control policies and procedures to determine that subrecipient audit reports have been received and that corrective action is taken within six months after receipt of the subrecipient's audit report. A subrecipient's audit report may cover a previous period; in choosing whether to use such a report to meet the requirements described previously, the auditor should consider the period covered by the report and its date of issuance. As long as the audit report of the subrecipient is current, it need not cover the same period as the prime recipient's audit. If the subawards are not material to the financial statements and the major programs of the primary recipient, the primary recipient and its auditor should be able to rely on the grantee's subrecipient audit cycle, even if it is not coterminous with the primary recipient's fiscal year.

3.40. If subrecipient audits have not been made and the grant awards are material to the financial statements or programs administered by the primary recipient, the scope of the primary recipient's audit can be expanded by management to include testing of the subrecipient records for compliance with the applicable provisions of the general and specific requirements. If the scope of the audit is not expanded, the auditor should consider disclosing the amount of the subaward as a questioned cost and modifying the auditor's report on compliance with laws and regulations. Additionally, the auditor should consider whether deficiencies in the primary recipient's control policies and procedures used to monitor subrecipients may exist.

3.41. Per PCIE Position Statement No. 6, Question 53, a prime recipient government's internal auditor who is independent and otherwise meets the qualifications and standards prescribed by Circular A-133 and *Government Auditing Standards* may perform the audit required by Circular A-133 for a subrecipient. However, nongovernmental internal auditors could not perform and report upon subrecipients' audits under Circular A-133 because they are not included in the Circular A-133 definition of independent auditor. A prime recipient's internal auditor, either governmental or nongovernmental, may be used, however, to monitor the subrecipient or assist the independent auditor.

For-Profit Subrecipients

3.42. Circular A-133 does not require audits of for-profit entities. However, an NPO is responsible for ensuring that expenditures from all federal awards are made in accordance with applicable laws and regulations. Methods to ensure compliance for funds passed through to for-profit subrecipients are pre-award audits, monitoring during the contract, and post-award audits.

3.43. A prime recipient has the same responsibilities for funds passed through to for-profit subrecipients as it has for not-for-profit subrecipients *except* that Circular A-133 does not establish for-profit subrecipient audit requirements. Since audit requirements are not specified, the contract with the for-profit subrecipient should include applicable administrative, general, and specific compliance requirements.

3.44. PCIE Position Statement No. 6, Question 49, states that NPOs should consider establishing appropriate audit requirements and including them in contracts with for-profit subrecipients. Audit requirements a prime recipient may consider including in contracts with a for-profit subrecipient are—

- An audit in accordance with the requirements of Circular A-128 or Circular A-133.
- A program-specific audit.
- Audits and monitoring similar to circumstances involving vendors, as described in paragraphs 3.25 and 3.26 of this SOP.

3.45. When a for-profit subrecipient has not had an audit, the prime recipient's auditor is responsible for determining compliance with applicable program requirements. The auditor may meet this responsibility either by reviewing relevant records at the NPO and considering the NPO's control policies and procedures used to monitor the subrecipients, or by performing tests of compliance of the for-profit's records.

Additional Responsibilities of the Auditor

3.46. The auditor may also be engaged to test and report on compliance with state and local laws and regulations in addition to those set forth in *Government Auditing Standards* and OMB Circular A-133.

Audit Follow-Up

3.47. The section entitled "Audit Follow-Up" in chapter 3 of *Government Auditing Standards* states:

> Due professional care also includes follow-up on known findings and recommendations from previous audits that could have an effect on the current audit objectives to determine whether prompt and appropriate corrective actions have been taken by entity officials or other appropriate organizations. . . . The auditor's report should disclose the status of known but uncorrected significant or material findings and recommendations. . . .

3.48. The auditor should review the status of action taken on findings reported in prior audits or program reviews, whether they were conducted by independent auditors or by the grantor agency's personnel. When corrective action has not been taken, the deficiency remains unresolved and could be significant or material in the current audit period, the auditor should briefly describe the prior finding and refer to the page on which it appears in the current report. If there were no prior findings and recommendations, a note stating that may be included in the audit report.

State and Local Award Requirements

3.49. In addition to the requirements imposed on recipients by OMB Circular A-133, there may be state award requirements imposed by states that make grants to their political subdivisions and NPOs. In connection with the financial statement audit, the auditor should obtain an understanding of applicable state reporting and compliance requirements that have a direct and material effect on the financial statements being audited. If engaged to audit state grant activity, the auditor should consider performing the following procedures:

- Inquire of management about additional compliance auditing requirements applicable to the entity.
- Inquire of the office of the state or local auditor or other appropriate audit oversight organizations about audit requirements applicable to the entity.
- Review information about governmental audit requirements available from state societies of CPAs or associations of governments.

3.50. When the engagement includes auditing compliance with a state or local award, the auditor should consider performing the following steps:

- Read the grant agreements and any amendments.
- Obtain any applicable audit guidance from the state grantor agency (including any audit guides, amendments, administrative rulings, and the like) pertaining to the grant.
- When appropriate, discuss the scope of testing that is expected to be performed with the state grantor agency.

3.51. Nonfederal awards received by an NPO from a state or other organization should be distinguished from the federal pass-through funds received. These nonfederal pass-through funds are not considered part of the total federal awards received by an NPO and are not subject to audit in accordance with OMB Circular A-133. The recipient of federal awards that provides pass-through funds to a subrecipient has the responsibility of notifying the subrecipient of *(a)* the amount of federal awards included in the pass-through and *(b)* the federal program name and CFDA number from which such awards were derived.

3.52. To become familiar with any additional requirements of state and local grantors, the auditor of a not-for-profit organization should consider performing planning procedures such as the following:

- Inquire about sources of revenue received by the organization and about restrictions, limitations, terms, and conditions under which such revenue is received. Review any agreements directly related to revenue (for example, loans and grants) and inquire about the applicability of any overall regulations of governmental sponsors that apply to the revenue or accounting for the revenue.
- Inquire about compliance and reporting requirements. The audit divisions of sponsoring agencies usually can be helpful in identifying these requirements, which may be identified separately for each recipient or published in an audit guide.

Determination of the Audit Period

3.53. An audit performed in accordance with OMB Circular A-133 should cover the reporting entity's financial transactions for its fiscal year (or a two-year period, if there is no annual audit of the financial statements), which is not necessarily the same as the period of the program being funded. Thus, the audit might include only a part of the transactions of a federal award program because some transactions may not occur within the period covered by the audit.

Initial-Year Audit Considerations

3.54. An auditor accepting, or contemplating accepting, an engagement in which the federal awards of the preceding period were audited by another auditor is guided by SAS No. 7, *Communications Between Predecessor and Successor Auditors.* If the awards have not been previously audited, the auditor should discuss with the recipient and the cognizant agency the need to perform any additional audit work for the prior unaudited periods. If additional work is not required, testing for the prior unaudited period would be limited to balances as of the end of that unaudited period.

Joint Audits and Reliance on Other Auditors

3.55. In order to comply with Circular A-133's provisions with regard to small and minority firms, certain NPOs may engage small, minority, or socially or economically disadvantaged independent accounting firms on a joint-venture or subcontract basis. In these instances it will be necessary to refer to the work of other auditors.

3.56. Prior to entering into an agreement to perform an audit or to subcontract with another firm, the auditor should consider SAS No. 1, section 543, and, for audits of applicable foreign subrecipients, the AID audit guidelines.

3.57. At a minimum, the auditor should—

- Ensure his or her own independence of the oversight entity and of each component unit in reporting entity.
- Confirm the other auditor's independence under Ethics Interpretation 101-10.
- Obtain separate audited financial statements and schedule of federal awards of each component unit.
- Ascertain that an appropriate subsequent-event review was performed for the reporting entity, including all component units and federal programs. This review should include a review of correspondence the entity received after the audit date.
- Obtain representation that the other audit organization and its personnel have met the requirements of *Government Auditing Standards,* including CPE, internal quality control, and external triennial quality control review.

3.58. In some circumstances, each of the auditors participating in the organization-wide audit will have jointly signed an audit report. Signing a report is appropriate only if the auditor is in a position that would justify his or her being the only signatory of the report.

3.59. If part of the organization-wide audit is performed by governmental auditors,[21] the auditors should be satisfied that the government auditors meet the independence standards in chapter 3 of *Government Auditing Standards* as well as the CPE and quality control. These standards require that government auditors be free from organizational, personal, and external impairments to independence and that they maintain an independent attitude and appearance.

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[21] See paragraphs 2.49 through 2.53 of this SOP, which describe the coordinated audit.

Quality Control Reviews

3.60. In addition to the quality control requirements set forth in *Government Auditing Standards,* cognizant agencies have implemented procedures for evaluating the quality of audits. These procedures include both desk reviews and on-site reviews. As a part of the cognizant agencies' evaluation of completed reports of such engagements and, as required by Circular A-133, the supporting audit working papers must be made available upon request of the representative of the inspector general. Audit working papers are typically reviewed at a location agreed upon by the cognizant agency and the independent auditor. SAS No. 41, *Working Papers,* discusses certain matters related to the ownership and custody of working papers. SAS No. 41 states that "[working papers are the property of the auditor, and some states have statutes that designate the auditor as the owner of the working papers.]." Circular A-133 states that workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency, its designee, or the General Accounting Office at the completion of the audit.

3.61. Whenever a review of the audit report or the working papers discloses an inadequacy, the audit firm is contacted for corrective action. Where major inadequacies are identified and the representative of the local cognizant agency determines that the audit report and the working papers are substandard, cognizant agencies may take further steps. In those instances where the audit was performed by a certified public accountant and the work was determined to be substandard by the Office of Inspectors General, the matter may be submitted to state boards of public accountancy.

Engagement Letters

3.62. It is in the best interest of both the auditor and the organization to document the planning and scope of the audit in an engagement letter. This may minimize confusion and help ensure a proper understanding of the responsibilities of each party. Although not required, the auditor may wish to discuss the engagement letter with the cognizant agency. Appendix G of this SOP presents an example engagement letter. Auditors should consider describing items such as the following:

- The requirements of *Government Auditing Standards*
- The additional reports required by OMB Circular A-133
- The auditor's and organization's responsibility with respect to reporting illegal acts noted during the audit (see pages 5-4 to 5-6 of *Government Auditing Standards*)
- The period covered
- The financial statements and/or programs to be audited
- The reports to be prepared

Auditors should also consider ensuring—

- That representatives of the cognizant agency will have access to the workpapers.
- That these workpapers will be retained for at least three years after the date of the report, or longer if so requested by the cognizant agency.

Other Audit Services

3.63. Footnote 6 of this SOP notes that if auditors are engaged to perform an audit in accordance with GAAS and discover during the course of the audit that the entity should be obtaining an audit in accordance with *Government Auditing Standards* or Circular A-133, the auditor has an obligation to notify the entity of the requirement for a higher-level engagement (see paragraphs 4 and 5 of SAS No. 68). Circumstances that may indicate higher-level audit requirements include—

- A review of laws, contracts, policies, or grant agreements that contain audit requirements.
- The discovery that the NPO received over $25,000 in federal awards in the year under audit.

Exit Conference

3.64. Upon completion of the fieldwork, the auditor may hold a closing or exit conference with senior officials of the organization. In the case of decentralized operations, as at a university, the federal government encourages preliminary meetings with deans, department heads, and other operating personnel who have direct responsibility for financial management systems and administration of sponsored projects.

3.65. The exit conference gives the auditor an opportunity to obtain management's comments on the accuracy and completeness of his or her facts and conclusions. This conference also serves to provide the organization with advance information so that it may initiate corrective action without waiting for a final audit report. Whenever possible, the concurrence or the reasons for nonconcurrence by the organization should be obtained and incorporated in the auditor's report. Information on any corrective measures taken or promised to be taken by the organization should also be included in appropriate sections of the report under a caption such as "Organization's Comments."

3.66. The auditor may consider documenting the auditors who conducted the exit conference, the names and positions of the organizational representatives with whom exit conferences were held, details of the discussions, and the comments of the organizational officials.

Chapter 4

SCHEDULE OF FEDERAL AWARDS

Types of Awards and Payment Methods

4.1. There are over 1,000 individual grant programs and several distinct types of federal awards payment methods. Many of these programs are described in the CFDA.

4.2. Programs in the CFDA are classified into fifteen types of assistance. Benefits and services are provided through seven financial and eight nonfinancial types of assistance. The following list describes the eight principal types of assistance that are available.

- *Formula grants.* Allocations of money to NPOs in accordance with a distribution formula prescribed by law or administrative regulation, for activities of a continuing nature not confined to a specific project. One example is the Department of Agriculture's award to land-grant universities for cooperative extension services.
- *Project grants.* The funding, for fixed or known periods, of specific projects, or the delivery of specific services or products without liability for damages resulting from a failure to perform. Project grants include fellowships, scholarships, research grants, training grants, traineeships, experimental and demonstration grants, evaluation grants, construction grants, and unsolicited contractual agreements.
- *Direct payments for specific use.* Financial assistance provided by the federal government directly to individuals, private firms, and other private institutions to encourage or subsidize a particular activity by conditioning the receipt of the assistance upon the recipient's performance. These do not include solicited contracts for the procurement of goods and services for the federal government.
- *Direct payments with unrestricted use.* Financial assistance provided by the federal government directly to beneficiaries who satisfy federal eligibility requirements with no restrictions imposed on how the money is spent. Included are payments under retirement, pension, and compensation programs.
- *Direct loans.* Financial assistance provided through the lending of federal monies for a specific period of time, with a reasonable expectation of repayment. Such loans may or may not require the payment of interest.
- *Guaranteed insured loans.* Programs in which the federal government makes an arrangement to indemnify a lender against part of any defaults by those responsible for repayment of loans.
- *Insurance.* Financial assistance provided to assure reimbursement for losses sustained under specified conditions. Coverage may be provided directly by the federal government or through a private carrier, and may or may not involve the payment of premiums.
- *Sale, exchange, or donation of property and goods.* Programs that provide for the sale, exchange, or donation of federal real property, personal property, commodities, and other goods including land,

buildings, equipment, food, and drugs. This does not include the loan of, use of, or access to federal facilities or property.

Payment Methods

4.3. Awards may be paid to NPOs directly or indirectly through reimbursement arrangements in which recipient organizations bill grantors for costs as incurred. Some programs provide for advance payments. Other programs permit organizations to draw against letters of credit as grant expenditures are incurred. Certain grants have matching requirements in which participating NPOs must contribute a proportionate share of the total program costs.

Noncash Awards

4.4. Most federal awards are in the form of cash awards. However, some federal programs do not involve cash transactions with NPOs. These programs usually involve commodities received, loan guarantees, loans, or insurance. The value of both cash and noncash awards should be reported as part of the schedule of federal awards or included in a footnote to the schedule. For example, the value of commodities distributed is generally included on the schedule of federal awards either as an expenditure or in a note. The existence and value of federal guarantee, loan, or insurance programs at the end of the fiscal year should be disclosed in a footnote to the schedule. Also, the value of commodities in inventory should be shown in the organization's financial statement or in a footnote to the financial statements. Any interest, subsidy, or administrative cost allowance received during the fiscal year under a loan or loan guarantee program should be included on the schedule.

4.5. The individual sources of financial assistance may not be separately identifiable, because of commingled assistance from different levels of government. If commingled assistance is identified, auditors should consider the requirements prescribed by each individual source. For example, a department of state government may receive financial assistance from the federal government and then pass the federal funding through to an NPO, supplemented with its own funds. If this occurs, the subrecipient NPO may be responsible for complying with both federal and state requirements governing that assistance. (See paragraphs 3.30 through 3.41 of this SOP for discussion of subrecipient considerations.) If management or the auditor believes that federal awards may represent combined assistance from various levels of government, management should review contracts or other documents to determine the source of the assistance. If the documentation indicates that awards received from various sources may have been commingled, the subrecipient should make inquiries of the granting agency to determine (*a*) whether the assistance provided includes assistance from other sources, (*b*) the sources and amounts of that additional assistance, if any, and (*c*) the program through which that assistance was provided. PCIE Position Statement No. 6, Question 55, states that, if the commingled portion cannot be separated to specifically identify the individual funding sources, the total amount should be included in the schedule with a footnote describing the commingled nature of the funds. The PCIE suggests that the auditor consider the total amount as federal funds in order to determine the nature and extent of tests.

Identification of Major Programs

4.6. Once all sources of federal awards have been identified, federally sponsored programs should be ranked as major and nonmajor according to the amount of expenditures. Noncash assistance should be valued to complete the ranking process, which is described further in paragraphs 2.12 through 2.15 of this SOP.

General Presentation Guidance

4.7. Paragraph 15(c)(1) of the Attachment to Circular A-133 requires that the auditor report on a schedule of federal awards.

4.8. The information that should be presented on the schedule includes—

- An identification of each major program (except student financial-aid and research-and-development programs) as it is identified in the CFDA (normally by program or grant title, and by federal agency and CFDA number).
- An identification of totals for student financial aid and research and development.
- Other federal awards (those federal programs that have not been assigned a catalog number).
- Total expenditures for each federal award program by grantor, department, or agency.
- Total federal awards.

4.9. PCIE Position Statement No. 6, Question *29*, discusses schedule presentation and includes the following guidance:

- The entity and period covered by the Schedule should be the same as those covered by the financial statements.
- The same program (i.e., same CFDA number) from different program years may be combined on one line, though where feasible, presenting program years separately may make the schedule more useful to federal sponsors.
- Major programs should be specifically identified as such.
- Funds passed through from other recipients should be identified as pass-through funds and include the name of the awarding organization, the program identifying number, and the CFDA number.
- The existence and value of federal loans, loan guarantees, or insurance programs at the end of the fiscal year should be disclosed in a note to the schedule.
- Noncash assistance should be shown either in the schedule or in footnotes and valued at fair market value at the time of receipt. Women/Infants/Children program vouchers may be valued either at maximum allowed redemption value or average redeemed value.
- Interest subsidies or administrative cost allowances received under a loan or loan guarantee program should be included in the schedule.
- While not required, it is recommended that where feasible, the NPO provide additional requested information that will make the schedule easier for federal agencies to use. Examples are identification of matching funds, funds passed through to a subrecipient, individual grant numbers or amounts, and grant revenue.

4.10. Circular A-133 describes three categories of awards: (*a*) research and development (R&D), (*b*) student financial aid (SFA), and (*c*) individual awards not in an R&D or SFA category (Individual Awards—Other). Paragraphs 4.12 through 4.15 of this SOP summarize guidance provided by Question *29* of PCIE Position Statement No. 6.

4.11. Although Circular A-133 permits the total of R&D or SFA categories to be listed as one line item on the schedule, more specific identification, such as the following, is generally expected by federal agencies.

R&D

4.12. Where practicable, each individual R&D award should be listed as a separate line in the schedule. However, in some cases, such as a large NPO with many R&D awards, it may not be practical to list each award. In this case, total expenditures may be listed by each federal agency and major subdivision within each federal agency. For example, in the Department of Health and Human Services, a major subdivision would be the National Institutes of Health.

SFA

4.13. Where practicable, each individual SFA program should be listed as a separate line in the schedule by CFDA number. In any case, programs supported by different federal agencies should be listed separately. The existence and value of SFA loans made during the audit period should be shown as a footnote. For institutions of higher education that are not lenders, the footnote amount would be new loans made during the fiscal year. For other not-for-profit organizations, the footnote amount would be the total of new loans made during the fiscal year plus the balance of loans for previous years for which the government is still at risk.

Individual Award—Other (Major)

4.14. Each Individual Award—Other, that is a major program should be listed as a separate line in the schedule by CFDA number.

Individual Awards—Other (Nonmajor)

4.15. Each individual nonmajor award should be listed as a separate line in the schedule by CFDA number under the caption "Other Federal Assistance." Where individual listing is not practicable, the awards should be grouped by awarding agency.

4.16. PCIE Position Statement No. 6, Question 36, notes that expenditures may exceed the amount of the award when additional nonfederal sources provide support for a program. The Schedule may present nonfederal expenditures but should separately identify federally funded expenditures.

4.17. Paragraph 13(c)(2) of Circular A-133 requires NPOs to "identify, in their accounts, all federal funds received and expended and the programs under which they were received." Therefore, when federally funded expenditures cannot be separately identified, the auditor should include a finding in the report on compliance recommending that the NPO separately identify federal funds in subsequent periods.

4.18. PCIE Position Statement No. 6, Question 36, states that, "when expenditures in excess of current awards represent additional amounts the NPO intends to bill a Federal program, the amount and circumstances concerning the excess should be disclosed in a footnote."

4.19. Depending on the circumstances of the engagement and the requirements of federal program managers, the schedule may also include other information for each program, such as the following:

- Matching contributions
- Amount of the program award
- Receipts or revenue recognized

- Beginning and ending balances, such as unexpended amounts or accrued (deferred) amounts

4.20. The financial information included in the schedule should be derived from the organization's books and records from which the basic financial statements were prepared. It should be prepared to the greatest extent practical on a basis consistent with other federal grant reports. However, the information included in the schedule may not fully agree with the grant reports because, among other reasons, the grant reports—

- May be prepared on a different fiscal period.
- May include cumulative (from prior years) rather than only current-year data.

4.21. Because the information should be presented in the schedule on a basis consistent with other federal grant reports, it may not agree with the basis of accounting used to prepare the NPO's financial statements. Although a reconciliation should be possible, it is not expected that the schedule's data will be directly traceable to the NPO's financial statements, because grant activity is usually not separately identifiable in the fund presentation used in the basic financial statements. The basis of accounting should be discussed in a footnote.

4.22. Subrecipients of federal awards should identify program funds that are received directly from the federal government and those that are received as pass-throughs from another NPO or governmental unit. For those funds received from another NPO, the program's identifying number(s) from the CFDA should be included.

4.23. PCIE Position Statement No. 6, Question 40, states that "the CFDA number should be available for most domestic Federal financial assistance. Federal agencies and prime recipients are required to provide the CFDA number to recipients and subrecipients when awarding assistance. Not-for-profit organizations are required to identify in their accounts the programs under which funds are received."

4.24. International programs and cost-type contracts will normally not have a CFDA number. When the CFDA number is not available, the not-for-profit organization should include in the schedule the program name or other identifier obtained from the award documents.

4.25. Because federal agencies are the primary users of the supplementary schedule, financial data for state and other nonfederal assistance are not usually presented in it. If such nonfederal data is presented, it should be segregated and clearly designated as nonfederal.

4.26. In assessing the completeness of the schedule of federal awards programs, the auditor should consider, among other things, evidence obtained from procedures performed in the audit of financial statements, such as evaluating the completeness and classification of recorded revenues and expenditures. This may include sending confirmations to granting federal agencies or prime recipients when conducting an audit of a subrecipient.

4.27. Appendix E of this SOP provides an illustration of a schedule of federal awards that incorporates the described levels of disclosures.

4.28. Other supplemental information may be provided by the NPO if it is considered necessary to meet requirements for full disclosure of grants or other agreements from federal funding sources. The supplemental information may consist of the reconciliation of financial status reports (FSRs) with the schedule of federal award, or other information that the auditor believes is necessary for full disclosure of federal programs.

Chapter 5

CONSIDERATION OF THE INTERNAL CONTROL STRUCTURE

5.1. As noted in chapter 1, in an organization-wide audit, the auditor must consider the requirements of generally accepted auditing standards and *Government Auditing Standards,* as well as those of OMB Circular A-133. In most cases, these will be met as part of the single organization-wide effort.

Consideration of the Internal Control Structure in an Audit Conducted in Accordance With GAAS

5.2. SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit,* requires the auditor to obtain an understanding of the internal control structure that is sufficient to plan the audit and to assess control risk for the assertions embodied in the financial statements. In all audits of financial statements, including those of an NPO, this understanding incorporates knowledge about the design of internal control structure policies and procedures relevant to compliance with laws and regulations that have a direct and material effect on the determination of financial statement amounts, and about whether those policies and procedures are in operation.

5.3. In planning the audit, such knowledge should be used to—

a. Identify types of potential misstatements.

b. Consider factors that affect the risk of material misstatements.

c. Design substantive tests.

5.4. Policies and procedures for all three elements of the internal control structure (control environment, accounting system, and control procedures) may influence the auditor's assessment of control risk for assertions affected by compliance with laws and regulations. For example, the elements of a control environment that may influence the auditor's assessment of control risk include—

- Significant pass-through of funds to subrecipients.
- Requirement to include only allowable and allocable costs in amounts claimed for reimbursement.
- Management's awareness, or lack of awareness, of relevant laws and regulations.
- Organization policy regarding such matters as acceptable operating practices and codes of conduct.
- Assignment of responsibility and delegation of authority for dealing with such matters as organizational goals and objectives, operating functions, and regulatory requirements.
- A mixture of volunteers and employees participating in operations. Depending on the size and other features of an organization, day-to-day operations sometimes are conducted by volunteers instead of employees. The manner in which responsibility and authority are delegated varies among organizations, which may affect the control over financial transactions, particularly with respect to authorization.
- A limited number of staff personnel, which sometimes may be too small to provide for appropriate segregation of duties.

- A volunteer governing board, many of whose members serve for limited terms.
- A budget approved by the governing board. The budget may serve as authorization for management to carry out activities in order to achieve an organization's program objectives. Many NPOs prepare budgets for both operating and capital expenditures.

Procedures to Obtain the Required Understanding

5.5. Procedures to obtain an understanding of the organization's internal control structure include the following:

- Obtain background data on the nature of the organization's control environment, including its key staff members. Documents such as the organization's charter, bylaws, and organizational chart may prove helpful.
- Obtain an understanding of the system and control procedures through inquiry, narratives, flowcharts, and other means.
- Obtain a schedule of federal awards and understand what major and nonmajor programs exist and the related general and specific requirements.
- Obtain a copy of the most recent audited financial statements of the organization and review them to determine the nature and volume of sponsored activity (that is, activity for which the organization receives financial assistance) and for indications of problems that relate to sponsored programs.
- Obtain copies of the most recent audit reports on sponsored programs issued by the cognizant agency, other federal or state agencies, or independent auditors. Follow up on the most recent audit findings to determine whether the organization has taken corrective action. This follow-up should include any additional findings or recommendations presented by the cognizant agency in its letter transmitting the report to financial officers.
- Tour the organization and meet its key employees.
- Obtain management identification of applicable laws and regulations and assess it for completeness.
- Obtain an understanding of the internal control structure related to the federal awards.

5.6. The auditor should consider whether deficiencies in such internal control structure policies and procedures should be reported in accordance with SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit.*

Consideration of the Internal Control Structure in an Audit Conducted in Accordance With *Government Auditing Standards*

5.7. Except for certain reporting requirements, *Government Auditing Standards* does not require the auditor to perform any additional work on the internal control structure beyond that required in an audit conducted in accordance with GAAS. Chapter 5 of *Government Auditing Standards* includes requirements beyond those set forth in SAS No. 60 concerning the communication of internal control structure deficiencies, which are described in paragraph 7.6 of this SOP. *Government Auditing Standards* requires auditors to prepare a written report on their understanding of an entity's internal control structure, and whether the controls have been placed in operation, and on their assessment of control risk. A description of the report, which is based on the results of procedures performed as part of an audit of the financial statements in accordance with GAAS, is described in paragraph 7.5 of this SOP and paragraphs 40 through 42 of SAS No. 68. The report is illustrated in exhibit D-3 of appendix D to this SOP.

Consideration of the Internal Control Structure in an Audit Conducted in Accordance With Circular A-133

5.8. Circular A-133 establishes additional audit procedures and reporting relative to the auditor's consideration of the internal control structure beyond those of a financial-statement audit conducted in accordance with GAAS and *Government Auditing Standards.* These requirements are discussed in the following paragraphs.

The Internal Control Structure Used in Administering Federal Awards

5.9. Circular A-133 requires the auditor to obtain an understanding of, assess control risk for, and perform tests of controls on the policies and procedures designed to provide reasonable assurance that an organization is managing federal awards in compliance with applicable laws, regulations, and contract terms and that it safeguards federal funds. The auditor's internal control structure responsibility under Circular A-133 also includes testing a recipient's system for monitoring subrecipients and the controls in effect to ensure that direct and indirect costs are properly computed and billed. These internal controls will be referred to throughout the remainder of this SOP as the *internal control structure over federal awards,* to distinguish them from the larger internal control structure of which they are a part.

5.10. Circular A-133 defines the internal control structure used in administering federal awards as the policies and procedures established to provide reasonable assurance that—

a. Use of resources is consistent with laws, regulations, and award terms.

b. Resources are safeguarded against waste, loss, and misuse.

c. Reliable data are obtained, maintained, and fairly disclosed in reports.

5.11. In addition to these basic control policies and procedures, Circular A-110 and other federal pronouncements (such as program handbooks and guides) specify uniform administrative requirements for grants and agreements with NPOs. Among the administrative requirements are those regarding cash depositories, bonding and insurance, record-retention procedures, program income, cost sharing, matching, financial reporting, monitoring and reporting of program performance, payment requirements, revisions of financial plans, closeout procedures, suspensions and terminations, applications for federal assistance, and standards for property management and procurement.

5.12. Although some of these control policies and procedures may have been considered by the auditor in the audit of the financial statements, particularly where federal awards are significant to the financial statements, others go beyond those an auditor may have considered in the audit of the financial statements, as they relate to distribution of salaries, invoice clearance, account reporting, cost transfers, and other matters. In certain cases, deficiencies in administrative procedures (such as those regarding cash receipts, cost sharing, procurement, property management, and financial reporting) may not be significant to the financial statement audit, but may be significant to the operation of federally sponsored programs. Consequently, the OMB has considered these administrative requirements to be a general requirement in the Compliance Supplements.

5.13. Although Circular A-133 requires a *report* on the internal control structure, it does not require the auditor to express an *opinion* on the effectiveness of the internal control structure used in administering federal awards. Exhibit D-8 of appendix D of this SOP illustrates the report on program-related controls.

5.14. In addition to his or her responsibilities under SAS No. 55, the auditor should perform the following procedures regarding the internal control structure used in administering federal awards:

- Test the effectiveness of the design and operation of the internal control structure policies and procedures for preventing or detecting material noncompliance.
- Review the recipient's system for monitoring subrecipients and obtaining and acting on subrecipients' audit reports.
- Determine whether controls to ensure that direct and indirect costs were computed and billed in accordance with the general requirements are in place.
- Document procedures employed to assess and test the internal control structure.

5.15. A literal interpretation of Circular A-133 would require the auditor to perform tests of controls relevant to each federal program regardless of the dollar amount of the program expenditures. However, a somewhat different approach for considering the internal control structure, a description of which follows, has been developed in consultation with representatives of the OMB, the GAO, and the PCIE. The approach was originally developed for audits of state and local governmental units under Circular A-128, but it is considered acceptable under Circular A-133.

Major Programs

5.16. For each major program as defined in Circular A-133, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that he or she considers relevant to preventing or detecting material noncompliance with—

a. Specific requirements that are applicable to those programs, addressing the types of services allowed or not allowed; eligibility; matching, level of effort, or earmarking; reporting; and special tests and provisions, as discussed in paragraphs 58 through 62 of SAS No. 68.

b. General requirements addressing civil rights, political activity, cash management, the Davis-Bacon Act, federal financial reports, allowable costs and cost principles, the Drug-Free Workplace Act, and certain administrative requirements. Paragraphs 46 through 49 of SAS No. 68 discuss these eight general requirements.

c. Requirements governing claims for advances and reimbursements, and amounts claimed for reimbursement or used for matching, as discussed in paragraph 59 of SAS No. 68.

d. Cost allocation and subrecipient monitoring, specifically identified in section 13(b)(2) of the Circular A-133 Attachment.

5.17. The auditor should consider the results of these tests of controls when evaluating control risk and developing substantive tests to provide a basis for expressing an opinion on compliance with laws and regulations applicable to major programs.

5.18. Tests of controls should include the types of procedures described in paragraphs 34 and 35 of SAS No. 55. Tests of controls, which provide evidence of the design and operation of the controls and procedures, may include steps such as (*a*) inquiries of appropriate personnel, including grant and contract managers; (*b*) inspection of documents and reports; (*c*) observation of the application of the specific control policies and procedures; and (*d*) reperformance of the application of the policy or procedure by the auditor. The auditor should perform such procedures regardless of whether he or she would otherwise choose to obtain evidence to support an assessment of control risk below the maximum level.

5.19. Tests of controls may be omitted only in those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance (in which case a reportable condition or material weakness should be reported) or in those areas that are not relevant to the compliance determinations discussed in paragraph 5.16.

5.20. For purposes of SAS No. 55, a reportable condition is a matter coming to the auditor's attention that, in his or her judgment, should be communicated to the audit committee (or its equivalent) because it represents a significant deficiency in the design or operation of the internal control structure that could adversely affect an organization's ability to record, process, summarize, and report financial data in a manner consistent with the assertions of management in the financial statements or to administer federal programs in accordance with applicable laws and regulations.

5.21. There may be separate control policies and procedures related to student financial assistance and research and development, which are treated as one program under a Circular A-133 audit. In this case, when evaluating whether an identified deficiency is a reportable condition, the auditor should consider the deficiency in relation to the program administered by the control policies and procedures being reviewed as well as the overall program. Some examples are as follows: (*a*) a significant deficiency in specific controls over a single SFA program with significant expenditures, time cards of college work study students, for example, would be considered a reportable condition when considered in relation to the college work study program; (*b*) significant deficiencies in controls over a single campus or department of a university where a significant amount of research was administered would be a reportable condition when considered in relation to total expenditures of R&D programs; (*c*) a deficiency in an SFA or R&D program that was clearly insignificant to SFA or R&D, respectively, as a whole would not necessarily be considered a reportable condition, and the auditor would report a finding in a separate letter.

5.22. A material weakness in the internal control structure is a reportable condition in which the design or operation of one or more elements of the internal control structure does not reduce, to a relatively low level, the risk that either errors or irregularities in amounts that would be material to the financial statements being audited, or noncompliance with laws and regulations that would be material to a major federal program,[22] may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Nonmajor Programs

5.23. The auditor may find that the total amount of major program expenditures is less than 50 percent of a recipient organization's total federal cash and noncash award expenditures. In such circumstances, the auditor should select nonmajor programs (to reach 50 percent of federal expenditures) on a rotating basis so that all but clearly insignificant programs are covered at least once every three years. As an alternative, the auditor may perform tests of controls over all the major programs and the largest nonmajor programs until at least 50 percent of federal program expenditures have been subjected to tests of controls performed in accordance with paragraph 1.32 of this SOP.

5.24. For all other nonmajor programs, the auditor should, at a minimum, obtain an understanding of each of the three elements of the organization's internal control structure—the control environment, the accounting system, and control procedures—that he or she considers relevant in preventing or detecting material noncompliance with the requirements listed in paragraph 1.26 of this SOP. That understanding should include the design of relevant policies, procedures, and records, and whether the organization has placed them in operation. In obtaining this understanding, the auditor is not required to obtain knowledge about operating effectiveness.

5.25. If the recipient organization has no major programs, the scope of the auditor's consideration of the internal control structure used in administering federal award programs should be comparable to the scope applicable to major programs, as described in paragraphs 5.16 through 5.22 of this SOP, for the selected nonmajor programs that, in the aggregate, are equal to or greater than 50 percent of total federal program expenditures. The auditor's consideration of the internal control structure relating to the remainder of the federal programs need not exceed that described in paragraph 5.24 of this SOP.

Documentation Requirements

5.26. The auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control structure policies and procedures related to general and specific compliance requirements. The steps performed and conclusions reached should be clearly evidenced in the auditor's working papers. The working papers should clearly demonstrate the auditor's understanding and assessment of control risk related to the internal control policies and procedures established for federal awards. If the auditor has not performed tests of controls relevant to certain requirements or programs, as discussed in paragraph 5.19 of this SOP, then the rationale for omitting such tests should be documented.

Cyclical Approach

5.27. In some circumstances, such as when multiple operating components of an NPO administer a large number of nonmajor programs, the auditor may obtain the required understanding of internal control structure policies and procedures applicable to nonmajor programs on a cyclical basis over a number of years. For a cyclical approach to be acceptable, each nonmajor

[22] For this purpose, a material weakness would include such a condition that related to a major program or a program tested under the 50-percent rule set forth in paragraph 1.32 of this SOP.

program for which the cyclical approach is used should be covered at least once every three years. In the first year of the review cycle, the auditor should obtain an understanding of the internal control structure policies and procedures for all programs, except those that are clearly insignificant, about which he or she has not obtained an understanding. Also, the auditor should obtain an understanding of policies and procedures for all new nonmajor programs, except those that are clearly insignificant in the first year that the programs are active. The decision to use the cyclical approach should be discussed with the cognizant agency. If a cyclical approach is used, the auditor's report on the internal control structure should be modified to clearly describe the coverage provided for nonmajor programs.

5.28. These steps provide the basis for the report on program-related controls, which is illustrated in exhibit D-8 of appendix D to this SOP.

Chapter 6

COMPLIANCE AUDITING

Compliance Auditing Environment

6.1. The auditor should be aware of the unique characteristics of the compliance auditing environment. NPOs differ from commercial enterprises in that they may be subject to the diverse charitable intentions of their donors, who often restrict the use of their funds. Further, federal, state, and local governments have established various laws and regulations that affect NPOs' operations.

6.2. Although it is management's responsibility to identify and comply with relevant laws and regulations, the auditor should obtain an understanding of various compliance requirements and adequately train audit personnel. Paragraph 11 of SAS No. 68 discusses how the auditor may obtain an understanding of the effects of laws and regulations. Depending on the environment, auditors should consider including a description of the type of engagement in any proposal, contract, or engagement letter. Such a description would include statements about whether the engagement is intended to meet a cognizant agency's requirements.

6.3. A wide spectrum of compliance requirements may apply to NPOs. The requirements vary from state to state and among the several forms of NPOs. Appendix C of this SOP describes various approaches followed by state governments in establishing compliance requirements. The auditor should consider compliance requirements by consulting audit guides or other guidance relevant to the particular engagement.

The Auditor's Responsibility for Compliance Auditing in Accordance With GAAS

6.4. When performing an audit of an NPO in accordance with GAAS, auditors should consider the federal, state, and local laws and regulations that are generally recognized to have a direct and material effect on the determination of financial statement amounts.

6.5. SAS No. 68 describes the auditor's responsibility for considering laws and regulations and their effect on a GAAS audit. Paragraphs 6 and 7 of SAS No. 68 reiterate the auditor's responsibility for detecting misstatements caused by illegal acts, errors, and irregularities. Paragraph 8 states:

> Thus, the auditor should design the audit to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts.

Paragraphs 11 through 15 of SAS No. 68 describe the auditor's responsibility to understand the effect of laws and regulations and to consider the related audit risk.

6.6. According to SAS No. 68, the independent auditor of an NPO should—

- Assess whether management has identified laws and regulations, noncompliance with which could have a direct and material effect on the determination of amounts in the financial statements.
- Become familiar with those laws and regulations that could have a direct and material effect on financial statement amounts.

- Understand the characteristics of those laws and regulations that could, if they were not followed, potentially lead to a misstatement on the financial statements.
- Assess the risk that a material misstatement has occurred because of such noncompliance.
- Design and conduct an audit to provide reasonable assurance of detecting such material noncompliance.

6.7. It is management's responsibility to identify the compliance requirements of the NPO. The auditor should discuss these requirements with the organization's operating personnel, chief financial officer, and, if necessary, legal staff. Those discussions should focus on compliance matters included in laws and regulations, including the bylaws, that could, if not complied with, have a direct and material effect on the financial statements. If necessary, the auditor should contact a state auditor or an appropriate oversight body to obtain information about key areas of compliance applicable to the NPO, including state statutes, regulations, and uniform reporting requirements. In addition, the following approaches may be helpful in identifying compliance requirements:

- Obtain publications pertaining to federal tax and other reporting requirements, such as those of the Department of the Treasury and the Internal Revenue Service pertaining to information returns and regulations concerning the calculation of arbitrage rebates and refunds.
- Review materials available from other professional organizations, such as state societies of CPAs.
- Identify sources of revenue received by an NPO and inquire about restrictions, limitations, terms, and conditions under which such revenue is received. Review any related agreements (for example, loans and grants) and inquire about the applicability of any overall regulations of governments that apply to the accounting for the revenue.
- Obtain copies of and review pertinent sections of the state constitution and state laws concerning the organization. The sections of these documents pertaining to debt, taxation, budget, and appropriation and procurement matters may be especially relevant.
- Consider contacting the audit, finance, or program divisions of senior levels of government from which grants are received. They usually can be helpful in identifying compliance requirements, which they may identify separately or publish in an audit guide.

6.8. In order to assess the risk of the possible nature of noncompliance with identified laws and regulations and the potential consequences, the auditor should obtain an understanding of the possible effects on financial statements of laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of amounts in an entity's financial statements. Considerations may include: the materiality of the effect on financial statement amounts, the level of management or employee involvement in the compliance assurance process, the opportunity for concealment of noncompliance, and any deficiencies in the internal control structure.

6.9. Based on this risk assessment, the auditor should design the audit to provide reasonable assurance of detecting instances of noncompliance with identified laws and regulations that could have a direct and material effect on the financial statements. In all cases, the auditor should exercise due care and the proper degree of professional skepticism in planning, performing, and evaluating the results of audit procedures to provide reasonable assurance that the financial statements are free of material misstatements resulting from violations of laws and regulations that have a direct and material effect on the determination of financial statement amounts.

6.10. Since the auditor's opinion on the financial statements is based on the concept of reasonable assurance, the auditor is not an insurer and his or her audit report does not constitute a guarantee. Therefore, the subsequent discovery that a material misstatement exists in the financial statements is not, in and of itself, evidence of inadequate planning, performance, or judgment on the part of the auditor.

6.11. Paragraph 19 of SAS No. 68 notes that the auditor should consider obtaining, as part of the written representations from management required by SAS No. 19, *Client Representations,* representations from management acknowledging that—

a. It is responsible for the entity's compliance with laws and regulations applicable to it.

b. It has identified and disclosed to the auditor all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

Illegal Acts—Indirect and Material

6.12. With respect to detecting and reporting illegal acts that do not directly relate to specific financial statement amounts, the auditor should be aware of the possibility that certain types of illegal acts may have occurred. If specific information comes to the auditor's attention that provides evidence concerning the existence of possible illegal acts that could have a material, indirect effect on the financial statements, the auditor should apply audit procedures specifically directed at ascertaining whether an illegal act has occurred.

6.13. Examples of such illegal acts may include violations of occupational safety and health, environmental, food and drug, and price-fixing laws and regulations. Generally, these laws and regulations relate more directly to the nonfinancial operations of an NPO and, accordingly, have only an indirect effect on the financial statements. An auditor ordinarily does not have a sufficient basis for recognizing possible violations of such laws and regulations. Due to the indirect nature of such violations, an audit made in accordance with GAAS provides no assurance that these violations will be detected or that any contingent liabilities that may result will be disclosed. Examples of laws and regulations that fall into this category may include informational tax-reporting requirements and investment policies that, for social reasons, prohibit investments in organizations doing business in certain countries.

Compliance Auditing Requirements of *Government Auditing Standards*

6.14. While incorporating GAAS as described in paragraph 1.5 of this SOP, paragraph 5 on page 5-2 of *Government Auditing Standards* also requires that the auditor issue a *written* report on compliance with applicable laws and regulations that may have a direct and material effect on financial statement amounts. Paragraphs 20 through 30 of SAS No. 68 provide guidance on reporting on compliance with applicable laws and regulations.

Compliance Auditing Requirements of OMB Circular A-133

6.15. In addition to the requirements of GAAS and *Government Auditing Standards,* Circular A-133 requires that the auditor determine whether "the institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major federal program" (paragraph 12[b][3]).

Major Program Compliance

6.16. With regard to major programs, however, Circular A-133 requires that "the auditor obtain sufficient evidence to support an opinion on compliance" (paragraph 13[c][3]). As set forth in Circular A-133 and in SAS No. 68, the opinion should cover types of services allowed or not allowed (including, as set forth in the general requirements, compliance with the cost principles), eligibility of program beneficiaries, matching, federal financial reports, and special tests and provisions. The auditor should gain an understanding of the laws and regulations related to these aspects of major programs that is sufficient to assess the risk of material misstatement of program financial results.

6.17. In order to determine which federal awards are to be tested for compliance, recipients should identify in their accounts all federal funds received and expended and the programs from which they were received. This includes funds received directly from federal agencies and those passed through from state and local governments or other recipients. The auditor should test the recipient's identification of major programs.

6.18. In determining the nature, timing, and extent of testing of an organization's compliance with such requirements, the auditor should consider audit risk and materiality related to each major program. That is, in addition to testing compliance with laws and regulations that have a direct and material effect on the financial statements, the auditor should test compliance with laws and regulations that have a direct and material effect on each major program. This typically results in a lower level of materiality, since materiality is evaluated at the program level rather than at the financial statement level. The testing for compliance provides the basis for the auditor's opinion on compliance illustrated in exhibits D-4 through D-7 of appendix D to this SOP.

6.19. Once the NPO identifies major programs, the auditor designs an approach to testing the specific requirements that could have a direct and material effect on the results of each major program. The auditor generally tests the compliance requirements through the following:

a. Inquiry, observation, and testing at the organizational level

b. Procedures, including tests of transactions, directed at the major program level

6.20. The Compliance Supplements set forth compliance requirements regarded by federal agencies as having a potentially direct and material effect on major programs. The Compliance Supplements suggest audit procedures for testing federal programs for compliance with both the general and the specific requirements.

6.21. Audits under Circular A-133 include the selection and testing of an adequate number of representative transactions from each major federal program to provide sufficient evidence to support the auditor's opinion on whether the organization has complied, in all material respects, with the specific requirements applicable to each major program. In determining the number of items to select, the auditor should assess materiality in relation to the individual major program being tested rather than in relation to the major programs taken as a whole or in relation to the financial statements.

6.22. The extent of testing is based on the auditor's professional judgment regarding factors such as—

- The amount of expenditures for the program.
- The diversity or homogeneity of expenditures for the program.
- The length of time that the program has operated, or changes in its conditions.
- Prior experience with the program, particularly as revealed in audits and other evaluations (for example, inspections, program reviews, or system reviews required by the federal acquisition regulations).
- The extent to which the program is carried out through subrecipients.
- The extent to which the program contracts for goods or services.
- The level to which the program is already subject to program reviews or other forms of independent oversight.
- The results of the tests of adequacy of the controls for ensuring compliance.
- The expectation of adherence or lack of adherence to the applicable laws and regulations.
- The potential impact of adverse findings.

Nonmajor Program Transactions

6.23. The auditor should also consider samples selected during tests of the internal control structure and during the audit of the financial statements to identify nonmajor program transactions that will require further compliance testing.

6.24. For the issuance of a report on compliance with the specific requirements applicable to nonmajor program transactions, Circular A-133 requires that transactions selected from nonmajor federal programs be tested for compliance with the federal laws and regulations that apply to such transactions. For example, selection of nonmajor program transactions may occur during an auditor's organization-wide test of payroll or disbursement transactions. If the auditor has selected nonmajor transactions, they should be tested for compliance with the specific requirements that apply to the individual transactions and be reported on in accordance with exhibit D-18 of appendix D to this SOP. If no tests are made of transactions from nonmajor programs, no report is required.

6.25. The specific requirements for which nonmajor program compliance should be tested customarily relate to the allowability of the program expenditure and the eligibility of the individuals or groups to whom the NPO provides federal awards. If the auditor selects a transaction from a nonmajor program in the financial statement or internal control work, it is not expected that the general requirements will be tested. For example—

- If, in the audit of the financial statements, the auditor examined a payroll transaction that was directly charged to a nonmajor program, he or she should determine that the position could reasonably be charged to that program and that the individual's salary was correctly charged to that program. (The auditor would not be required to test the transactions for compliance with general requirements, for example, civil rights or cash management requirements.)

- If, during the audit of the organization's disbursements, the auditor examined a travel claim that was directly charged to a nonmajor program, he or she should examine evidence indicating whether the person who performed the travel worked on the program, whether the purpose of the travel was related to the program, whether administrative travel was an allowable charge to the program (for example, whether it complied with the Fly America Act), and whether the travel allowance was within administratively prescribed limits. (The auditor would not be required to test the transactions for compliance with general requirements, for example, civil rights or cash management requirements.)
- If the auditor examined a program-related payment made directly to an individual or organization, he or she should determine whether the payment was for the purpose intended by the program and for services allowed by the program and whether the individual or organization was eligible. (The auditor would not be required to test the transaction for compliance with general requirements, for example, civil rights or cash management requirements.)

Audit Sampling for Major Federal Programs

6.26. As noted above, Circular A-133 requires the auditor to select and test a sufficient number of transactions to support an opinion on compliance with specific requirements related to each major program. Although the term sampling is not mentioned, independent accountants often perform audit sampling to achieve this objective. SAS No. 39, *Audit Sampling,* discusses the factors to be considered in planning, designing, and evaluating audit samples. In addition, the AICPA Audit and Accounting Guide, *Audit Sampling,* provides detailed guidance to assist auditors in implementing SAS No. 39. Both documents discuss the use of audit sampling for tests of controls and for substantive tests of details of account balances or classes of transactions.[23]

6.27. Although Circular A-133 does not require statistical sampling, it does require that a "representative number of transactions be selected from each major federal financial assistance program." Auditors should use professional judgment in determining sample selection methods and sample sizes for major programs sufficient to support an opinion on compliance with applicable laws and regulations relative to each major program.

6.28. The objectives of auditing procedures for federal awards are to provide sufficient, competent evidential matter to provide reasonable assurance of detecting material noncompliance with specific requirements applicable to major federal award programs and issue a report containing either an opinion on compliance with these requirements or a statement that such an opinion cannot be expressed. The testing to obtain those objectives is substantive. Based on the auditor's assessment of control risk, the auditor should select

[23] The U.S. Department of Education's *Audits of Student Financial Assistance Programs* (the Education Audit Guide) specifies testing procedures and sample sizes.
For a Circular A-133 audit, the Education Audit Guide procedures and sample sizes are not required, but the auditor may use them as guidance. However, if the entity elects to have a program audit because it has only one program or it received less than $100,000 in federal awards, the auditor must follow the guidance on testing in the Education Audit Guide.

sample sizes that will provide sufficient evidence for a conclusion on the NPO's compliance with the specific requirements applicable to each major program. The auditor's professional judgment should be used when selecting sample sizes. However, when exercising that judgment, the auditor should be aware that samples of a few items with a low dollar value from a large population will probably not be sufficient to enable the auditor to express an opinion concerning compliance.

6.29. OMB Circular A-133 requires that an adequate number of transactions be selected from each major program, but it does not require that separate samples be used for each major program. Experience has shown, however, that it is generally preferable to select separate samples from each major program, since the separate sample clearly provides evidence of the tests performed, the results of those tests, and the conclusions reached. If the auditor chooses to select audit samples from the entire universe of major program transactions, the working papers should be presented in such a fashion that they clearly indicate (*a*) that a sample was selected from each major program and (*b*) that the results of tests of such samples, together with other audit evidence, are sufficient to support the opinion on *each* major program's compliance with the specific requirements.

Materiality Considerations

6.30. In auditing compliance with specific requirements governing major programs in accordance with OMB Circular A-133, the auditor's consideration of materiality differs from that in an audit of financial statements in accordance with GAAS. In an audit of an NPO's financial statements, materiality is considered in relation to the financial statements being audited. In an audit of an organization's compliance with specific requirements governing major programs in accordance with Circular A-133, however, materiality is considered in relation to *each* major program to which the transaction or finding relates. Although Circular A-133 and the Compliance Supplement require the auditor to test particular specific and general requirements, the auditor should apply the concept of materiality to each major program, taken as a whole, rather than to each individual requirement. If the tests of compliance reveal a material misstatement at the program level, the auditor should consider its effect on the financial statements.

6.31. For purposes of assessing compliance with laws and regulations governing federal awards in the performance of an organization-wide audit under Circular A-133, a material instance of noncompliance is defined as a failure to follow requirements, or a violation of prohibitions, established by statutes, regulations, contracts, or grants, that results in an aggregation of misstatements (that is, the auditor's best estimate of the total misstatement) that is material to the affected federal award program.

6.32. *Government Auditing Standards* (page 3-13) states that, in determining whether a compliance finding is material, the auditor should consider *both* quantitative (monetary value) and qualitative factors. Qualitative factors include, but are not limited to, the cumulative effect and impact of immaterial items, the objectives of the work undertaken, and the use of the reported information by the user or groups of users of the information. Decisions on these criteria are based on the auditor's professional judgment. In government audits, the materiality level and/or threshold of acceptable risk may be lower than in similar type audits in the private sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions.

6.33. Qualitative factors indicating an immaterial compliance finding are a low risk of public or political sensitivity, a single exception with a low risk of being pervasive, and the auditor's judgment and experience are that federal agencies or prime recipients would normally not need to resolve the finding or take follow-up action, or that the cost of recovery would exceed the amount of the finding.

6.34. Because the auditor expresses an opinion on *each* major program and not on all the major programs combined, reaching a conclusion about whether the instances of noncompliance (either individually or in the aggregate) are material to a major program requires consideration of the type and nature of the noncompliance as well as the actual and projected effect on each major program in which the noncompliance was noted. Instances of noncompliance that are material to one major program may not be material to a major program of a different size or nature. In addition, the level of materiality relative to a particular major program can change from one period to another. Finally, an error in one period may not be material to a two-year period being audited under the biennial option in Circular A-133.

6.35. The auditor should follow a process such as the following in deciding how to report instances of noncompliance for major programs and whether to include them in his or her report on compliance or in a separate communication to management:

a. If the noncompliance is not significant (i.e., it does not meet the criteria for materiality discussed in paragraph 6.32 of this SOP in relation to the specific requirements), the auditor may report the finding in a separate communication to management.

b. If the noncompliance is significant, the auditor should assess whether it is material to the major program being tested taken as a whole.

c. If the noncompliance is material to the major program, the auditor should modify his or her report on compliance.

d. If the auditor's assessment is that the noncompliance is material to the specific requirement, but not material to the major program being tested as a whole, the auditor should disclose the matter in his or her report as a finding or questioned cost and not in a separate communication to management.

Compliance Testing—Specific Requirements

6.36. The auditor is required to perform sufficient work to render an opinion on whether—

a. The amounts reported as expenditures were for allowable services.

b. The records show that those who received services or benefits were eligible to receive them.

c. Matching requirements, levels-of-effort, and earmarking limitations were met.

d. Federal financial reports *and* claims for (1) advances and (2) reimbursements contain information that is supported by the books and records from which the general-purpose or basic financial statements were prepared.

e. Amounts (1) claimed for reimbursement or (2) used for matching were determined in accordance with the cost principles and matching or cost-sharing requirements set forth in (*a*) Circular A-21; (*b*)

Circular A-110; (*c*) Circular A-122; (*d*) Federal Acquisition Regulation (FAR), subpart 31, cost principles; and (*e*) other applicable cost principles or regulations. It also may be necessary to refer to HHS OASC-3, *Cost Principles for Hospitals.*

f. Special tests and provisions where federal agencies have determined noncompliance could materially affect the program. (For example, some agencies set a deadline for the expenditure of federal financial assistance or require that all international travel be performed in accordance with the Fly America Act.) In addition, when auditing a major student financial aid program at an educational institution, an auditor would typically perform compliance testing of the laws and regulations of the Department of Education as specified in the Compliance Supplement relating to the eligibility of participants, the calculation of awards, and exercise of due diligence in the collection of loans.

Allowable Costs and Cost Principles

6.37. Transactions selected by the auditor from each major program should be tested to determine whether the costs meet the criteria of the cost principles that apply to each program. The auditor's working papers should document the applicable criteria reviewed, the results of the audit work performed, and the conclusion reached by the auditor.

6.38. The cost principles set forth in Circulars A-21 and A-122, FAR subpart 31, and HHS OASC-3 establish standards for determining costs applicable to grants, contracts, and other agreements. Costs are allowable for federal reimbursement only to the extent of benefits received by the federal programs. To be eligible for federal reimbursement, both direct and indirect costs should meet the criteria generally contained in the Basic Considerations section of the applicable cost principles. These criteria require that the cost be—

- Necessary and reasonable for the performance and administration of the federal program and allocable thereto under the provisions of the cost principles.
- Authorized or not prohibited under state or local laws or regulations and approved by the awarding agency, if appropriate. Certain costs require specific approval by the grantor agency, while some are not allowed as set forth in the section of the applicable cost principles dealing with Selected Items of Costs.
- In conformance with any limitations or exclusions set forth in the applicable cost principles, or with any limitations in the program agreement or specific requirements in the program regulations.
- Given consistent treatment with policies, regulations, and procedures applied uniformly to federal and nonfederal activities of the recipient organization.
- Given consistent accounting treatment within and between accounting periods and not allocable to, or included as a direct cost of, a federal program if the same or similar costs are allocated to the federal program as an indirect cost.
- Determined in accordance with generally accepted accounting principles or another comprehensive basis of accounting.

- Not included as a cost or used to meet cost-sharing requirements of another federally supported activity of the current or a prior period.
- Allocable to the federal awards. The charges should be allocable to a particular cost objective, such as a grant, project, or other activity, in accordance with the relative benefits received. A cost is allocable to a federal award if it (*a*) is incurred specifically to advance the work under the award; (*b*) benefits both an award and other work and can be distributed in an equitable manner in relation to benefits received; (*c*) is necessary to the overall operation of the organization; and (*d*) is otherwise allowable under the cost principles provided in HHS OASC-3, if applicable, and OMB Circulars A-21 and A-122. An allocable cost of an award or other cost objective may not be shifted to other federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of an award.
- Net of all applicable credits, for example, volume or cash discounts, refunds, rental income, trade-ins, scrap sales, direct billings (in the case of indirect cost), etc.
- Supported by underlying documentation, for example, time and attendance payroll records, personnel activity reports or other time and effort records for employees charged to federal awards or to more than one activity, approved purchase orders, receiving reports, vendor invoices, canceled checks, etc., as appropriate, and correctly charged as to account, amount, and period.

6.39. There should be an advance understanding for special or unusual costs. The reasonableness and allocability of certain items of costs may be difficult to determine. Should such costs be disclosed during the audit, the auditor should determine whether the organization had an advance understanding about whether the costs would be considered allowable. The understanding should preferably be in writing and approved by the awarding or cognizant agency in advance of the expenditure; otherwise the costs may be disallowed.

6.40. If subject to prior approval in accordance with HHS OASC-3, OMB Circulars A-21 or A-122, or the terms of the award, the charges should be approved in advance. OMB Circulars A-21 and A-122 and HHS OASC-3 indicate that prior approval is required for specific types of expenditures, such as for the purchase of equipment and for foreign travel. In addition, an award agreement may require advance approval for other specific costs.

Indirect Costs

6.41. In addition to federal reimbursement for direct program costs, NPOs often receive reimbursement for indirect costs or for the costs of centralized services. To obtain reimbursement, NPOs generally should establish a basis for allocating such costs to federal programs by preparing a cost allocation plan or an indirect-cost rate proposal. Cost allocation plans and/or indirect-cost rate proposals can differ significantly between large and smaller not-for-profit organizations. For example, one of the most basic differences is that most large organizations have multiple missions, while the missions of smaller NPOs are more narrowly focused. These multiple missions of large organizations may benefit from indirect costs in a variety of ways. These costs are usually allocated on a multiple allocation-base method—a method in which the use of cost pools may obscure the details of what costs are actually included in the cost pools.

6.42. *Smaller Entities.* Small NPOs usually have missions that benefit equally from indirect costs. For these NPOs, the allocation of indirect costs may be accomplished by separating the entity's total costs as either direct or indirect costs and dividing the total allowable indirect cost by an equitable distribution base to arrive at an indirect-cost rate. By reviewing a schedule of the costs included in the direct and indirect areas it is usually possible to identify the major unallowable or inappropriate costs. To assess the allowability of such indirect costs, the auditor should refer to procedures set forth for indirect costs in the general requirements section of the Compliance Supplements. Auditors should note that, although an opinion specifically related to the allocation of indirect costs is not required, allowability of total costs is one of the specific requirements on which the auditor opines.

6.43. *Compliance Requirement (Indirect Costs Only).* The NPOs indirect-cost rate proposal provides the basis for allocating indirect costs to federal programs and for negotiating an indirect-cost rate. Circulars A-88 and A-122 provide for cognizance systems whereby one federal agency is designated as the cognizant agency to deal with a college, university, or nonprofit organization on behalf of the entire federal government and to negotiate indirect-cost and other rates, which are used by all other federal agencies in dealing with that recipient organization. In most cases, therefore, proposals are submitted to an appropriate cognizant agency.

6.44. Proposals are usually prepared on a prospective basis using actual financial data from a prior period or budgeted data for the current year. When the actual costs for the year are determined, the differences between the originally proposed costs and the actual costs for the year are either carried forward to a subsequent period's rate or adjusted with the granting federal agency on a retroactive basis. In cases where predetermined rates are determined and approved by the cognizant federal agency, subsequent adjustments are not made, with the exception of eliminating any unallowable costs. Audit procedures must be tailored according to the type of rate and size and type of organization being audited. If unallowable costs are found, cost recoveries and adjustments should be made in accordance with the provisions of the applicable cost principles.

6.45. *Universities.* Indirect costs are apportioned between research and the other major functions of a university, such as instruction, other sponsored activities, and other institutional activities, based on various allocation procedures prescribed in Circular A-21. That portion of indirect costs identified with research is then further distributed to individual research projects by an indirect-cost rate(s). Where necessary, an indirect-cost rate is also established for the instruction function and for Other Sponsored Programs.

6.46. Indirect costs at large educational institutions are normally classified in the following categories: (*a*) building and equipment depreciation/use allowances, (*b*) operation and maintenance expenses (including utility expenses), (*c*) general administration expenses, (*d*) departmental administration expenses, (*e*) sponsored projects administration expenses, (*f*) library expenses, and (*g*) student administrative services expenses.

6.47. Currently, most large universities use a predetermined indirect-cost rate. This rate is negotiated in advance for future years (normally a three-year period) based upon a proposal that uses costs from a prior year. An example would be a university that has a negotiated predetermined indirect-cost rate with no provision for carryover for the three fiscal years 1989, 1990, and 1991. Usually, the indirect-cost proposal would be prepared in fiscal year 1991 using fiscal year 1990 costs and would be the basis for the indirect-cost rates in fiscal years 1992, 1993, and 1994. The audit of the 1990 fiscal year would include testing the indirect-cost proposal that was prepared using 1990 data. The next indirect-cost proposal required to be submitted by the institution would use fiscal year 1993 costs and be submitted within six months of the end of fiscal year 1993. In this example, there is no requirement that an indirect-cost proposal be submitted for fiscal years 1991, 1992, and 1994.

6.48. An auditor engaged to audit fiscal year 1991, 1992, or 1994 would not be required to audit the indirect-cost proposal, as none was required to be submitted. However, the auditor for the years when a proposal was not required to be submitted would be required to test the financial systems that will be used in preparing future indirect-cost proposals. Examples of such systems are those for equipment and fixed assets, and those used in classifying expenditures. An auditor would also be concerned that costs treated as indirect in the negotiating process were not being charged as direct costs. This would require an understanding of the previous proposal. If the auditor finds any unallowable costs that were included in a proposal (whether in the current proposal or in a previous proposal on which the 1991, 1992, or 1994 rate was based), these costs should be questioned.

6.49. If a predetermined indirect-cost rate with no provisions for carry-over has been negotiated for the year under audit, the opinion on whether costs claimed are allowable would be related to the application of the negotiated rate. The indirect-cost proposal that is the basis for claiming costs in future years would be tested as a general requirement. In cases where the negotiated rate is provisional or has a carry-forward provision, the indirect-cost proposal would affect the specific requirement related to the allowability of costs.

6.50. *Procedures for Indirect Costs.* The Circular A-133 Compliance Supplement sets forth the following procedures for audits of indirect costs. These procedures may be modified for smaller entities.

a. Determine whether indirect costs are charged to federal awards. If not, the rest of this section does not apply. If such costs are charged, the following guidelines should be followed.

b. Obtain and read the current negotiation agreement, as well as any agreements, conditions, or understandings related thereto, and determine the types of rates and procedures required.

c. Select a sample of claims for reimbursement submitted to the federal agency and determine whether the amounts charged and rates used are in accordance with agreements, and whether rates are being properly applied to the appropriate base.

d. Determine whether the rates used or amounts charged are final or predetermined, or whether they are still open to adjustment or revision, either immediately or as a carry-forward adjustment in a future period. If final, the results of the audit work should be reflected, if appropriate, in recommendations for future procedural improvements. However, if the final or predetermined rates include unallowable costs, they should be identified and reported along with the estimated federal share of the costs.

e. Determine whether costs or types of costs, chargeable directly to federal awards or any other direct activity (including any costs required for matching or cost changing), have been eliminated from the pool of indirect-costs and included in the allocation or rate base.

f. Determine whether the established procedures to identify and eliminate unallowable costs are comprehensive and applied in a consistent manner. Verify that the results of these procedures are incorporated into the indirect cost proposal submitted to the cognizant agency.

g. Test supporting documentation to determine whether—

— The indirect-cost pools contain only items that are consistent with the applicable cost principles and negotiated agreements. This testing should be aimed at determining whether the indirect-cost pools contain any unallowable costs, as defined by the cost principles (e.g., entertainment, lobbying, etc.).

— The methods of allocating the costs are in accordance with the provisions of the appropriate cost principles, other applicable regulations, and negotiated agreements and produce an equitable distribution of costs.

— Statistical data (e.g., square footage, population or full-time equivalents, salaries and wages) in the proposed allocation bases are current, reasonable, updated as necessary, and do not contain any material omissions.

— Personnel activity reports, time and effort reports, or other methods used to allocate salary and wage costs are mathematically and statistically accurate, are implemented as approved, and are based on the actual effort devoted to the various functional and programmatic activities to which the salary and wage costs are charged.

— Special costs analysis studies (such as library studies or energy studies) are mathematically and statistically accurate, are factually based to the extent possible, use reasonable and supportable assumptions, produce reasonable results, and, if appropriate, agree with any prior agreements with, or conditions placed by, the cognizant agency concerning such studies.

— The data can be reconciled with the most recently issued financial statements. Investigate significant reconciling items.

Other Testing Considerations

6.51. As noted above, the Compliance Supplement contains suggested audit procedures that, if completed by the auditor, constitute a safe harbor, that is, such procedures are deemed to meet OMB and grantor agency audit expectations. PCIE Position Statement No. 6, Question 63, states that, "for programs contained in a Compliance Supplement which have not had subsequent changes, an audit of the requirements contained in the Compliance Supplement will meet the A-133 single audit requirements." Although each requirement appearing in the Compliance Supplements is accompanied by suggested audit procedures that can be used to test for compliance with laws and regulations, the auditor is not restricted to the use of only these audit procedures. The auditor should use professional judgment in determining the appropriate audit procedures.

6.52. An auditor may also be engaged to test and report on compliance with state and local laws and regulations. Paragraphs 98 and 99 of SAS No. 68 provide guidance on the auditor's responsibilities in these circumstances. Although Circular A-133 does not specifically address auditing compliance requirements for state or local government grants, state or local assistance may be covered by a state's audit requirement. Such a requirement may specify compliance tests, similar to those set forth in Circular A-133, to be performed at the option of the local government or in accordance with state law. When this is the case, auditors should consult state or local government officials or other sources concerning the nature and scope of required testing. However, state or local government funds provided to NPOs should be distinguished from state or local pass-throughs of federal funds. The latter pass-through funds are considered part of the federal awards received by the local recipient when conducting an audit in accordance with Circular A-133.

Compliance Testing—General Requirements

6.53. The Compliance Supplements identify general requirements for which the auditor should test compliance in all Circular A-133 audits. According to SAS No. 68, the auditor should test for compliance with general requirements whether or not the NPO has major programs. The auditor is not expected to express an opinion on an NPO's compliance with the general requirements. However, two general requirements (i.e., allowable costs and federal financial reports) are also included in the opinion on specific requirements as noted in Circular A-133. Rather, as illustrated in exhibit D-15 of appendix D to this SOP, the report provides positive and negative assurance and sets forth procedures and material findings. The general requirements are described in the following paragraphs.

6.54. *Political Activity.* The Hatch Act and the Intergovernmental Personnel Act of 1970, as amended, specify that federal funds cannot be used for political activity of any kind.

6.55. *Davis-Bacon Act.* When required by applicable legislation, construction programs are required to follow the provisions of the Davis-Bacon Act, which in general requires wages of laborers and mechanics employed by contractors of federally funded projects to be no lower than the prevailing regional wage rate as established by the Secretary of Labor.

6.56. *Civil Rights.* Federal programs provide that no person shall be excluded from participation or be subjected to discrimination in any program funded, in whole or in part, by federal funds because of race, color, national origin, sex, age, or physical impairment.

6.57. *Cash Management.* Many recipients receive funds through a letter-of-credit arrangement with the grantor agency. Cash should be withdrawn only in amounts necessary to meet immediate needs or to cover program disbursements already made.

6.58. *Federal Financial Reports.* Attachment H of Circular A-110 specifies that recipients of federal awards should file the financial reports for each federal award program. Paragraphs 6.62 through 6.65 below discuss the review of federal financial reports.

6.59. *Allowable Costs and Cost Principles.* These principles prescribe the direct and indirect costs allowable for federal reimbursement.

6.60. *Drug-Free Workplace.* This law prescribes that organizations certify that they provide a drug-free workplace (see paragraph 6.66).

6.61. *Administrative Requirements.* These prescribe administrative requirements that should be followed (see paragraph 6.67).

Review of Federal Financial Reports

6.62. In connection with tests of compliance with applicable laws and regulations, Circular A-133 states that the auditor should determine whether the "federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared. . . ." The Compliance Supplements require the auditor to determine if the federal financial reports are presented in accordance with Attachment H, "Financial Reporting Requirements," of Circular A-110.

6.63. The auditor should compare the statement of expenditures incurred under federally sponsored programs, as shown on the Schedule of Federal Awards, with the books and records of the organization and, as a part of his or her testing of control policies and procedures used in administering federal awards, compare the books and records with periodic financial reports to the federal government for tested items. This requirement has generally been interpreted to mean that federal financial reports are traceable to the recipient's financial records, that is, they are not based on estimates.

6.64. Attachment H describes the following reports that recipients should prepare, if applicable, and submit to the federal government:

- A financial status report
- A federal cash-transactions report
- A request for advance or reimbursement
- An outlay report and a request for reimbursement for construction programs

6.65. Individual federal award agreements may include the specific reporting requirements to be followed by the recipient. However, Attachment H establishes the standard financial-reporting requirements for all federal awards programs. When auditing a subaward or a state award or program, the auditor would also test financial reports submitted to the prime recipient or state.

Drug-Free Workplace

6.66. Direct recipients of grants and cooperative agreements from any federal agency are required to certify that they will provide a drug-free workplace as a precondition for receiving the grants. All grantees, except states, are required to make this certification for all grants. States, including state agencies, may elect to make an annual certification to each federal agency from which they obtain financial assistance. This requirement also applies to contractors that have contracts of $25,000 or more with the federal government. PCIE Position Statement No. 6, Question 68, states that the requirement does not, however, extend to subrecipients, unless the subgrantor (primary recipient) requires compliance with Drug-Free Workplace Act requirements. The federal government does not make this requirement.

Administrative Requirements (OMB Circular A-110)

6.67. Circular A-110 includes various administrative requirements with which NPOs should comply.[24] The requirements of Circular A-110 apply to federal awards in the form of grants and cooperative agreements. Federal awards in the form of entitlements generally are granted to states and passed through to NPOs. Such awards would be subject to the terms of the subaward

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[24] The OMB Compliance Supplement for Institutions of Higher Education and Other Non-Profit Institutions contains specific procedures for—

- Financial reporting.
- Cost principles.
- Cash management.
- Program income.
- Procurement.
- Property management.

as well as Circular A-110. Contracts are covered by their own terms and conditions.[25]

Other General Requirement Testing Considerations

6.68. The Compliance Supplements suggest procedures that can be performed to test an organization's compliance with the general requirements; however, the application of the Compliance Supplements' procedures is only recommended, not required. It has become generally accepted that the nature of these procedures is sufficient to satisfy the requirements of Circular A-133 with respect to the general requirements.

6.69. The auditor should issue a report on compliance with general requirements regardless of whether the NPO being audited has major programs. Determining the extent of any tests of compliance with general requirements is a matter of professional judgment. Among the matters the auditor considers are the extent of any tests of compliance with general requirements performed for major programs. If the NPO being audited has no major programs, the auditor should consider whether his or her tests of controls over compliance with general requirements provide evidence that would also support a report on compliance. If the tests of controls do not provide sufficient evidence to support a report on compliance, additional procedures to test compliance with the general requirements would need to be performed.

6.70. Many organizations receive federal awards from several federal agencies and, consequently, develop uniform controls and procedures over all federal programs. In relation to general requirements, however, many organizations may not formally document their administrative controls and procedures, since they are considered to be requirements that are unrelated to the determination of financial statement amounts. To identify the established controls and procedures for these general requirements, the auditor normally makes inquiries of key personnel of the organization, including grant managers. The auditor may also identify these controls and procedures by reviewing policy and procedure manuals, if any exist, and by observing the general workplace of the organization. The auditor's report on the general requirements is described in paragraph 7.25 and illustrated in exhibit D-15 of appendix D to this SOP.

Evaluation of Noncompliance

6.71. The auditor's tests of compliance with laws and regulations may disclose instances of noncompliance or questioned costs. Under Circular A-133, material instances of noncompliance and questioned costs should be reported in a schedule of findings and questioned costs and reported as discussed in paragraphs 7.30 through 7.32 of this SOP. The auditor may describe immaterial findings in a separate letter to the organization or include them with the report covering material instances of noncompliance. Paragraph 15 of the Attachment to Circular A-133 requires management to submit a copy of the letter covering immaterial instances of noncompliance to the federal grantor agencies or subgrantor sources. Although the auditor may issue as many as four different compliance reports in an organization-wide audit, findings and questioned costs may be presented in one schedule.

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[25] PCIE Position Statement No. 6, Question 67, states that, "since program income will normally be included in Federal financial reports, the auditor should consider program income in determining whether Federal financial reports contain information that is supported by books and records from which the basic financial statements are prepared. The auditor's responsibility for program income, as it relates to internal controls and compliance testing, is the same as that for program expenditures."

6.72. When instances of noncompliance with general requirements are identified and can be quantified, materiality is generally assessed at the program (or programs) level to which the noncompliance relates, and a determination to modify the auditor's report should be made at that level. However, when the noncompliance is not quantifiable (for example, failure to adopt a drug-free workplace policy), materiality is generally assessed at the financial statement level, that is, the auditor should consider the effect of any contingent liability in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies.*

6.73. The level at which materiality is assessed is critical in assessing whether a modification to the unqualified auditor's report is needed. In determining whether such a modification is needed, the auditor should—

a. Assess the actual error noted against the materiality level established for the individual program.

b. Assess the projected error against the materiality level established for the individual program.

6.74. If the auditor determines that the actual error is material to the individual program, depending on the circumstances, the auditor's report should be modified as illustrated in appendix D of this SOP. If the projected error is material to the individual program, the auditor should consider whether additional audit procedures should be applied.

6.75. Auditors also have the responsibility of assessing the impact of the actual and projected error noted in the testing on the financial awards programs against the materiality level established for the basic financial statements. SAS No. 47, *Audit Risk and Materiality in Conducting an Audit,* paragraph 31, states:

> If the auditor concludes, based on his or her accumulation of sufficient evidential matter, that the aggregation of likely misstatements causes the financial statements to be materially misstated, he should request management to eliminate the material misstatement. If the material misstatement is not eliminated, he should issue a qualified or adverse opinion on the financial statements.

6.76. Guidance on qualified audit reports is provided in chapter 7 of this SOP. Circular A-133 does not require that the auditor's report on compliance include a projection of questioned costs to the universe of federal programs, nor does it require that the auditor expand the scope of an audit to determine with greater precision the effect of any questioned costs. However, there may be instances in which the circumstances of specific questioned costs could establish a basis for the auditor, the grantor, or both to question all costs charged to a federal program or programs. For example, if eligibility requirements or matching or cost-sharing conditions have not been met by the recipient, the entire amount expended in connection with affected programs may be questioned. If such questioned costs are subsequently disallowed by the federal agency, the entire amount may be required to be refunded by the recipient. The auditor should consider the effect of the liability or contingent liability on the basic financial statements. FASB Statement No. 5 provides guidance on accruing and disclosing contingent liabilities.

6.77. The auditor is required by Circular A-133 to identify the total amounts of questioned costs, if any, for each federal award as a result of noncompliance, and to recommend any necessary corrective action. The auditor's designation of a cost as questioned does not necessarily mean that a federal grantor agency will disallow the cost. In most instances, the auditor is unable to determine whether a federal grantor agency will ultimately disallow a questioned cost, because the grantor has considerable discretion in these matters. The nature of the questioned costs, as well as the amounts involved, are considered by the grantor in deciding whether to disallow them. Most federal grantor agencies have established appeal and adjudication procedures for questioned costs.

6.78. The auditor should evaluate the effect of reportable conditions and noncompliance on all of the reports required by Circular A-133.

Reporting Illegal Acts

6.79. Circular A-133 requires the auditor to report any illegal acts as set forth in *Government Auditing Standards.*

6.80. *Government Auditing Standards* requires that any illegal acts or indications of illegal acts be reported in the compliance report or in a separate report (see paragraphs 31 and 32 of SAS No. 68). Pages 5-4 through 5-6 of *Government Auditing Standards,* particularly paragraphs 5-13 and 5-16, discuss the appropriate parties who should be informed of illegal acts. (Paragraphs 7.17 and 7.18 of this SOP discuss illegal acts.)

Findings and Questioned Costs

6.81. *Government Auditing Standards* defines a finding as the "result of information development—a logical pulling together of information about an organization, program, activity, function, condition, or other matter which was analyzed or evaluated." It also states that factual data supporting all findings should be presented accurately and fairly in the auditor's report and that these findings should be adequately supported by sufficient evidence in the working papers.

6.82. When performing an audit in accordance with GAAS, the auditor should consider the effect of any instance of noncompliance on the financial statement opinion. When auditing in accordance with *Government Auditing Standards,* the auditor is required to issue a report on the results of the auditor's testing of compliance with laws and regulations at the general-purpose financial statement level. Also, the auditor is required by Circular A-133 to issue reports on compliance with requirements applicable to federal awards. Chapter 7 of this SOP describes these reporting requirements. Appendix D of this SOP includes illustrative compliance reports.

Criteria for Questioning Costs

6.83. The criteria established for questioning costs that are to be reported in the compliance report vary from one agency to another. Many of the criteria are imposed by Congress at the time the programs are authorized and funds are provided; other criteria are established through agency regulations. Generally, the criteria for reporting questioned costs relate to the following:

- *Unallowable costs.* Certain costs specifically unallowable under the general and special award conditions or agency instructions, including, but not limited to, pre-grant and postgrant costs and costs in excess of the approved grant budget, either by category or in total.
- *Undocumented costs.* Costs charged to the grant for which adequate detailed documentation does not exist (for example, documentation demonstrating their relationship to the grant or the amounts involved).

- *Unapproved costs.* Costs that are not provided for in the approved grant budget, or for which the grant or contract provisions or applicable cost principles, require the awarding agency's approval, but for which the auditor finds no evidence of approval.
- *Unreasonable costs.* Costs incurred that may not reflect actions that a prudent person would take in the circumstances, or costs resulting from in-kind contributions to which unreasonably high valuations have been assigned.

The auditor should review prior audit reports and other related correspondence to determine the nature of previous findings and questioned costs, as well as the status of unresolved issues. (See paragraphs 7.30 through 7.32 for further discussion of findings and questioned costs.)

Client Representations—Audits Performed Under OMB Circular A-133

6.84. Paragraph 91 of SAS No. 68 states that the auditor should obtain certain written representations from management as part of an audit conducted to express an opinion on compliance with requirements that have a material effect on a federal award program. Representations that should ordinarily be obtained in an organization-wide audit include the following:[26]

a. Management has identified in the schedule of federal awards all awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.

b. Management has identified the requirements governing political activity, the Davis-Bacon Act, civil rights, cash management, relocation assistance and real property management, federal financial reports, allowable costs/cost principles, drug-free workplace, and administrative requirements over federal awards.

c. Management has identified the requirements governing the types of services allowed or not allowed: eligibility; matching, level of effort, or earmarking; special provisions; reporting; claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to its major programs, which are identified in the schedule of federal awards.

d. Management has complied, in all material respects, with the requirements in connection with federal awards except as disclosed to the auditor.

e. Information presented in federal financial reports and claims for advances and reimbursements are supported by the books and records from which the basic financial statements have been prepared.

f. Amounts claimed for reimbursement or used for matching were determined in accordance with OMB and agency requirements.

g. Management has monitored subrecipients to determine that they have expended financial assistance in accordance with applicable

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[26] These representations may be added to a representation letter obtained in connection with an audit of financial statements instead of obtaining a separate letter.

laws and regulations and have met the requirements of Circular A-133 or other applicable federal audit requirements.

h. Management has taken appropriate corrective action on a timely basis after receipt of a subrecipient's auditor's report that identifies noncompliance with federal laws and regulations.

i. Management has considered the results of the subrecipient's audits and made any necessary adjustments to the entity's own books and records.

j. Management has identified and disclosed to the auditor all amounts questioned, any known noncompliance with requirements that could have a material effect on a major program, and any other known noncompliance with the specific and general requirements of federal awards.

k. Management is responsible for complying with requirements in Circular A-133.

l. Management has disclosed all contracts or other agreements with the NPO's service organization.

m. Management has disclosed to the auditor all communications from the NPO's service organization relating to noncompliance at the NPO's service organization.

n. Management has disclosed whether, subsequent to the date as of which compliance is audited, any changes in the internal control structure or other factors that might significantly affect the internal control structure, including any corrective action taken by management with regard to reportable conditions (including material weaknesses), have occurred.

6.85. Management's refusal to furnish written representation constitutes a limitation on the scope of the audit sufficient to require a qualified opinion or disclaimer of opinion on the institution's compliance with Circular A-133 requirements. Further, the auditor should consider the effects that management's refusal will have on his or her ability to rely on other management representations.

Chapter 7
REPORTING

Chapter Overview

7.1. *Government Auditing Standards* and OMB Circular A-133 broaden the auditor's responsibility to include reporting not only on an organization's financial statements but also on its internal control structure and its compliance with laws and regulations. This chapter presents the required compliance reports and the auditor's consideration of the internal control structure in audits performed in accordance with *Government Auditing Standards* and in those performed in accordance with Circular A-133. A pyramid depicting the reports required by GAAS, GAS, and Circular A-133 appears in exhibit 3 of chapter 1 of this SOP. Auditors need to understand the intended purpose of each report and should tailor the reports to their specific situations. The standard reports are illustrated in appendix D of this SOP. Modifications to the standard reports for circumstances such as uncertainty are also presented in appendix D. Other situations may arise that will require other modifications to these reports. It is not practicable to anticipate all situations that may be encountered by the auditor. Professional judgment should be exercised in any situation not specifically addressed in this SOP.

Reports Required by *Government Auditing Standards*

7.2. The following reports should be issued in an audit performed in accordance with *Government Auditing Standards:*

- A report on the organization's basic financial statements
- A report on internal control structure policies and procedures based solely on an understanding of the internal control structure and an assessment of control risk obtained as a part of the audit of the basic financial statements
- A report on compliance with laws and regulations that may have a direct and material effect on the basic financial statements

The Auditor's Report on the Basic Financial Statements

7.3. Financial reporting under *Government Auditing Standards* includes an organization's basic financial statements and the auditor's report on the basic financial statements as required by generally accepted auditing standards.

7.4. Circular A-133 requires the auditor to express an opinion about whether the basic financial statements of an NPO as a whole are presented fairly in conformity with GAAP.[27] The financial statements provide the appropriate funding agency with an understanding of an entity's accounting policies and procedures. When assessing whether the basic financial statements are presented fairly in conformity with GAAP, the auditor should consider whether noncompliance with any federal, state, or local laws would materially affect the statements. Although chapter 5, paragraph 3, of *Government Auditing Standards* states that, for NPO financial audits, a statement should be included in the auditor's report that the audit was made in

[27] If an organization prepares its basic financial statements in conformity with a comprehensive basis of accounting other than GAAP, the cognizant audit agency may be contacted to ascertain whether these financial statements will meet the Circular A-133 audit requirement. Reporting guidance for financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP is presented in SAS No. 62.

accordance with generally accepted government auditing standards, and although the PCIE checklists include a question on whether the report includes such a statement, federal reviewers have accepted reports on the financial statements, but not other reports, that do not refer to *Government Auditing Standards.* The auditor is permitted to refer to both GAAS and *Government Auditing Standards* in the auditor's report in the situations illustrated in exhibit D-1 herein, as follows: ". . . we conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. . . ."

The Auditor's Report on the Internal Control Structure

7.5. Both *Government Auditing Standards* and SAS No. 60 require the communication of reportable conditions noted in an audit. However, *Government Auditing Standards* differs from GAAS in that GAS requires a *written* report on the internal control structure in all audits, regardless of whether reportable conditions are noted. To issue this report on the internal control structure, the auditor should complete the level of audit work required by SAS No. 55. It should be noted that, beyond the issuance of an auditor's report on the internal control structure, GAS requires no more work on the internal control structure than does GAAS. An illustrative report on the internal control structure is presented in exhibit D-3 of appendix D to this SOP.

7.6. The following chart summarizes the differences between SAS No. 60 and GAS.

GAS Report on the Internal Control Structure—
How It Differs From SAS No. 60

	GAS	*SAS No. 60*
When is a report issued?	In every audit	When reportable conditions are noted
What is the form of the report?	Written	Oral or written
Should the auditor identify the internal control structure categories considered?	Yes	No
Should the auditor separately identify those reportable conditions that are significant enough to be material weaknesses?	Yes	Permitted but not required

Identification of Controls

7.7. Depending on the circumstances, classifications or categories of controls identified as part of an organization's internal control structure may include operating cycles, financial statement captions, accounting system applications, or other classifications. *Government Auditing Standards* includes the following categories according to which the internal control structure might be classified in the auditor's report:

- Cycles of the entity's activity
  - Treasury or financing
  - Revenue/receipts
  - Purchases/disbursements
  - External financial reporting

- Financial statement captions
  - Cash and cash equivalents
  - Receivables
  - Inventory
  - Property and equipment
  - Payables and accrued liabilities
  - Debt
  - Fund balance
- Accounting applications
  - Billings
  - Receivables
  - Cash receipts
  - Purchasing and receiving
  - Accounts payable
  - Cash disbursements
  - Payroll
  - Inventory control
  - Property and equipment
  - General ledger

7.8. Types of controls vary from entity to entity. Auditors may modify these examples or use other classifications, as appropriate, for the particular circumstances on which they are reporting. Only those controls that are relevant in the circumstances should be listed in the report.

7.9. The auditor's report on internal control structure required by *Government Auditing Standards* is based on the auditor's consideration of the internal control structure as required by SAS No. 55. The report does not express an opinion on the NPO's internal control structure, but rather describes the extent of work performed as required by SAS No. 55. The report includes the requirements of SAS No. 60 as well as the additional requirements of *Government Auditing Standards.* These additional requirements include the identification of significant internal control structure categories and a description of the scope of the auditor's work in obtaining an understanding of the internal control structure and in assessing control risk. Page 5-6 of *Government Auditing Standards* notes that these controls include the internal control structure policies and procedures established to ensure compliance with laws and regulations that could have a direct and material effect on the financial statements. When federal awards are material to the NPO's financial statements, the control categories identified include the controls over the general and specific compliance requirements relative to federal awards programs. *Government Auditing Standards* also states that the report should include a description of reportable conditions as well as separately identify those reportable conditions that are considered material weaknesses. An example of standard reporting language is presented in exhibit D-3 of appendix D of this SOP, and a modification when there are no material weaknesses and no reportable conditions is shown in note 3 to exhibit D-3 in appendix D of this SOP.

Identification of Reportable Conditions

7.10. Reportable conditions are defined in SAS No. 60 as "significant deficiencies in the design or operation of the internal control structure that could adversely affect the entity's ability to record, process, summarize, and report financial data in the financial statements." Although *Government*

Auditing Standards, like SAS No. 60, does not require the auditor to search for reportable conditions, the auditor should be aware, during the course of the audit, that such deficiencies may exist.

7.11. Paragraph 17 of SAS No. 60 prohibits the auditor from issuing a written report representing that no reportable conditions were noted during an audit. Note 3 to exhibit D-3 of appendix D to this SOP illustrates a report that an auditor may issue to satisfy the requirements of *Government Auditing Standards* if no reportable conditions are noted during an audit.

Nonreportable Conditions

7.12. If an auditor issues a separate written communication describing "nonreportable conditions," as discussed in paragraphs 38 and 39 of SAS No. 68, the auditor's report on the internal control structure should refer to that separate communication in order to comply with *Government Auditing Standards.* An example of such a reference is included in Note 3 to exhibit D-3 of appendix D to this SOP.

The Auditor's Report on Compliance With Laws and Regulations

7.13. *Government Auditing Standards* requires auditors to report on compliance with laws and regulations that, if violated, could have a direct and material effect on an entity's financial statements. The report encompasses federal, state, and local laws and regulations that, if violated, could materially affect the basic financial statements, and expresses positive assurance on items tested and found to be in compliance with applicable laws and regulations and negative assurance on items not tested. The auditor will have complied with the requirements of *Government Auditing Standards* by designing the audit to provide reasonable assurance of detecting errors, irregularities, and illegal acts resulting from violations of laws and regulations that have a direct effect on the determination of financial statement amounts that are material to the financial statements, as required by SAS No. 53 and SAS No. 54. An illustrative report on compliance with laws and regulations is presented in exhibit D-4 of appendix D to this SOP.

7.14. Positive assurance is expressed as a statement by the auditor that the tested items were in compliance with applicable laws and regulations. Negative assurance is expressed as a statement that nothing came to the auditor's attention in the course of performing specified procedures that caused him or her to believe that the untested items were not in compliance with applicable laws and regulations.

7.15. The auditor may need to modify the statement of negative assurance based on the results of his or her tests of compliance. In the event that instances of noncompliance are reported as a result of tests performed, the auditor should consider the extent to which the pervasiveness of reported instances of noncompliance may affect the auditor's ability to express negative assurance with respect to items not tested. For example, an auditor may find a systemic miscalculation of amounts due to suppliers who were selected for testing that the auditor believes is material to the financial statements. Because the exception is systemic and has probably affected other untested items, the auditor may not be able to provide negative assurance. If, based on the results of compliance tests performed, the auditor concludes that negative assurance cannot be provided, he or she should so state in the report and include the reason(s) that such assurance cannot be provided.

7.16. Paragraph 7 of page 5-3 of *Government Auditing Standards* requires that the auditor's report on compliance include all material instances of noncompliance related to the organization's financial statements or to the program, award, claim, fund, or group of accounts being audited. Immaterial instances of noncompliance are not required to be included in the compliance report but should be reported to the organization in a separate letter. Paragraph 30 of SAS No. 68 states that if the auditor has issued a separate letter describing immaterial instances of noncompliance, the compliance report should include a reference to that letter.

Illegal Acts

7.17. Illegal acts are violations of laws or government regulations. They may include such matters as falsification of records or reports and misappropriation of funds or other assets. SAS No. 54 discusses the auditor's responsibilities with respect to illegal acts, and paragraphs 31 and 32 of SAS No. 68 and chapter 5 of *Government Auditing Standards* provide additional guidance on the reporting of illegal acts.

7.18. If the auditor is aware of the occurrence of illegal acts and he or she remains uncertain about whether they will materially affect the financial statements, his or her report on the financial statements should be qualified or a disclaimer of opinion should be issued. Both SAS Nos. 53 and 54 discuss situations in which the independent auditor may wish to consult with legal counsel about withdrawing from an engagement.

Reports Required by OMB Circular A-133

7.19. SAS No. 68 and Circular A-133 require the auditor to issue the following reports on an organization's federal awards:

a. Reports required to be issued in an audit performed in accordance with *Government Auditing Standards,* as described in paragraphs 7.2 through 7.16 of this SOP

b. A report on a supplementary schedule of the entity's federal awards

c. A report on the internal control structure policies and procedures used in administering federal awards

d. A report on compliance with specific laws and regulations that may have a direct and material effect on each major program

e. A report on compliance with certain laws and regulations applicable to nonmajor programs

f. A report on compliance with general requirements

The Auditor's Report on the Schedule of Federal Awards

7.20. The recipient or subrecipient of an award is responsible for preparing a schedule of federal awards. Chapter 4 of this SOP describes the presentation requirements governing the schedule. Illustrative reports on the schedule of federal awards are presented in exhibits D-1 and D-2 of appendix D to this SOP.

Additional Schedules

7.21. Circular A-133 does not require recipients to provide additional schedules such as a schedule of indirect costs. Although not required, the recipient may include any additional information that will make the reports more useful to the federal agencies. For example, a federal agency may need a schedule of indirect costs in lieu of performing a separate audit. In this case, it may be mutually beneficial for the NPO to include the schedule as part of the report.

The Auditor's Report on the Internal Control Structure Used in Administering Federal Awards

7.22. Circular A-133 expands on *Government Auditing Standards* and requires that the auditor determine and report whether an NPO has an internal control structure to provide reasonable assurance that it is managing its federal awards in compliance with applicable laws and regulations. The auditor's report should include—

- If applicable, a statement that the auditor has audited the financial statements and a reference to the auditor's report on the financial statements.
- A description of the scope of work performed to obtain an understanding of the internal control structure, to assess control risk, and to test the internal control structure policies and procedures.
- A description of the NPO's significant control policies and procedures established to provide reasonable assurance that it is managing its federal awards in compliance with applicable laws and regulations.
- Any reportable conditions noted, including the identification of material weaknesses.

It should be noted that these requirements exceed the minimum requirement of SAS No. 55 to understand the internal control structure and assess control risk in that they require the auditor to test the internal control structure policies and procedures related to federal awards. An illustrative report on the internal control structure used in administering federal awards is presented in exhibit D-8 of appendix D to this SOP.

7.23. Circular A-133 states that "tests of controls will not be required for those areas where internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance. . . ." Such a situation is a reportable condition. In addition, Circular A-133 states that if the auditor limits his or her consideration of the internal control structure for any reason, the circumstances should be disclosed in the auditor's report on the internal control structure.

The Auditor's Report on Compliance With Laws and Regulations Related to Major Programs

7.24. Uncertainties and Scope Limitations. Testing an entity's compliance with general and specific compliance requirements demands that auditors make a comply/noncomply decision about an entity's adherence to those laws and regulations. Circular A-133 requires the auditor to express an opinion about whether the NPO has complied with laws and regulations that may have a direct and material effect on each of its major programs. To comply with this requirement, the auditor should provide an opinion about whether each major program is in compliance, in all material respects, with the specific requirements identified in the report. The report makes reference to any immaterial instances of noncompliance with specific requirements that are included in the schedule of findings and questioned costs or in a separate communication to the management of the NPO. If there are no such immaterial instances of noncompliance, the auditor may so note in the report. If a comply/noncomply decision cannot be made because the auditor is prevented from performing sufficient procedures by the client or by other circumstances, a scope limitation, not an uncertainty, would exist. When an instance of noncompliance has occurred but the resolution of the noncompliance is not known, an uncertainty would exist. The following situations could occur when the auditor is reporting on the results of compliance testing:

- If appropriate evidence cannot be examined to support the comply/noncomply decision, a scope limitation would exist and the audit report would need to be modified. (For illustrations of such reports, see exhibit D-10 in appendix D to this SOP.) However, if the auditor concludes that compliance with a requirement cannot be reasonably estimated or measured, the auditor would be precluded from issuing an opinion on compliance with a specific requirement (see exhibit D-14 in appendix D to this SOP). Further guidance on reporting on compliance with specific requirements for major programs is contained in paragraphs 80 through 86 of SAS No. 68.
- If the auditor examined sufficient evidence to support a noncompliance finding, a modification to the auditor's report on compliance should be considered in light of several factors, including the number and type of instances of noncompliance, determinability of questioned costs, and materiality of questioned costs. If, after considering these factors, the auditor—
  - Believes the instance of noncompliance has a material effect on a federal program, the auditor's report should be modified-qualified or adverse (see exhibits D-11 and D-12 in appendix D to this SOP).
  - Cannot determine whether the instance of noncompliance could have a material effect on the program, an uncertainty exists. Accordingly, the report on compliance should state that noncompliance occurred but that the effect on the federal award program cannot presently be determined. The auditor also should consider the effect of uncertainties associated with federal programs on the basic financial statements and modify that report if necessary. (See exhibit D-14 in appendix D to this SOP.)

Illustrative reports on compliance with laws and regulations related to major programs are presented in appendix D to this SOP as follows:

Exhibit	*Nature of Report*
D-9	Unqualified opinion
D-10	Qualified opinion—scope limitation
D-11	Qualified opinion—noncompliance
D-12	Adverse opinion
D-13	Disclaimer of opinion
D-14	Uncertainties

Reporting on Compliance With General Requirements

7.25. Circular A-133 requires the auditor to issue a report on compliance with general requirements regardless of whether the organization being audited has major programs. SAS No. 68 states that determining the extent of any tests of compliance with the general requirements is a matter of professional judgment. SAS No. 68 does not require the auditor to issue an opinion on compliance with the general requirements; rather, the auditor should issue a report on the results of procedures used to test compliance with the general requirements. SAS No. 68 specifies the basic elements of a report expressing positive and negative assurance on compliance with the general requirements.

As noted in paragraph 7.15, the auditor may need to modify the statement of negative assurance based on the results of his or her tests of compliance. An illustrative report on compliance with the general requirements is presented in exhibit D-15 of appendix D to this SOP.

Reporting Compliance With Specific Requirements Applicable to Nonmajor Program Transactions

7.26. Circular A-133 requires the auditor to issue a report on nonmajor programs that provides "a statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested." The auditor may have selected transactions from nonmajor programs for testing in connection with the audit of the financial statements or the consideration of the internal control structure. As noted in chapter 6, if the auditor has selected such transactions, they should be tested for compliance with the specific requirements that apply to the individual transactions. The auditor need not test for compliance with the general requirements or the specific requirements that apply to the program as a whole, such as matching and reporting requirements. If the auditor has not selected any nonmajor program transactions, or if the entity has no nonmajor programs, no report is required. An illustrative report on compliance with nonmajor program requirements is presented in exhibit D-18 of appendix D to this SOP.

Dating of Reports

7.27. Since the report on the Schedule of Federal Awards indicates that the auditor is reporting "in relation to" the basic financial statements, it should carry the same date as the report on these statements. Furthermore, since the reports on compliance and internal control structure, as required by *Government Auditing Standards,* relate to the basic financial statements and are based on GAAS audit procedures performed, they should also be dated the same date as the report on the basic financial statements.

7.28. Ideally, the reports required by OMB Circular A-133 should also be dated the same as the other reports, but they often carry a later date because some of the audit work to satisfy the Circular A-133 audit requirements may be done subsequent to the work on the basic financial statements. In any case, when issuing the report on the basic financial statements, the auditor should consider the effect of any material contingent liabilities resulting from possible noncompliance in accordance with FASB Statement No. 5. If, after issuing the report on the basic financial statements, the auditor discovers instances of noncompliance that materially affect the statements, he or she should follow the guidance in SAS No. 1, sections 560 and 561.

Combined Reporting

7.29. The reports issued to comply with the reporting requirements of Circular A-133 involve varying levels of materiality and different forms of reporting. Although it may be feasible in some circumstances to combine certain of the reports, it is very difficult to combine them without making them very long and confusing. In addition, the PCIE Desk Review Checklist is designed to review each of the seven individual reports. Accordingly, auditors are strongly discouraged from issuing combined reports.

Schedule of Findings and Questioned Costs

7.30. Circular A-133 requires that the auditor's report on compliance include a summary of material findings of noncompliance and an identification of total amounts questioned as a result of noncompliance, if any, for each federal award and the corrective action recommended by the auditor. Immaterial findings may be included in a schedule of findings and questioned costs or in a separate communication to the management of the NPO.

7.31. According to Circular A-133 and *Government Auditing Standards*, in reporting material instances of noncompliance, auditors should "place their findings in proper perspective." This perspective is both quantitative and qualitative. The extent of material noncompliance should be considered in relation to the number and dollar amount of transactions tested, the size of the population in terms of number of items and dollars, its likely impact on questioned costs, and the dollar amount questioned in order to give the reader a context within which to judge the extent of noncompliance. The auditor's report on compliance should include a summary of all material instances (findings) of noncompliance and identify total amounts questioned, if any, for each federal award. A table may be an appropriate method of summarizing extensive findings.

7.32. In presenting the findings, the auditor should refer to the guidance on report contents and report presentation in paragraphs 9 through 69 of chapter 7 of *Government Auditing Standards,* although these relate specifically to performance rather than financial audits. That guidance suggests that well-developed findings are those that provide sufficient information to federal, state and local officials to permit timely and corrective action. Findings generally consist of statements of the conditions (what is), criteria (what should be), effect (the difference between what is and what should be), and cause (why it happened). PCIE Position Statement No. 6, Question 41, states that the following specific information should be included in findings:

- The award name, award number, grantor, CFDA number, and grant year;
- The condition found, including facts relied on that indicate that noncompliance occurred;
- Specific requirement for which noncompliance is found, including regulatory, statutory, or other citation;
- Identification of the questioned costs and how they were computed;
- The cause of the noncompliance;
- Recommendation for corrective action to prevent future occurrences of noncompliance;
- Pertinent views of responsible officials of the audited entity concerning the finding and what corrective action is planned; and
- Other information necessary to determine the cause and effect in order to take proper corrective action.

Views of Responsible Officials (Organization's Comments)

7.33. The subsection entitled "Views of Responsible Officials" on page 7-10 of *Government Auditing Standards* states:

> The report should include the pertinent views of responsible officials of the organization, program, activity, or function audited concerning the auditor's findings, conclusions, and recommendations, and what corrective action is planned.

Normally, these views would be presented in the recipient's comments on the auditor's findings and recommendations in accordance with paragraph 15(g) of Circular A-133.

7.34. The comments should include a statement by responsible officials of the audited organization concerning their agreement with the findings, conclusions, and recommendations reported. If the organization disagrees with the findings, conclusions, and recommendations and the auditor concludes that they are valid, a rebuttal to the organization's comments addressing the reasons why the auditor has not changed the findings, conclusions, and recommendations should be included in the schedule of findings and questioned costs. The presentation of views is separate from the organization's corrective action plan, which it submits directly to the sponsor or cognizant agency.

Audit Resolution

7.35. The first step in resolving audit findings is for the organization to respond to the auditor's findings and recommendations. The response will normally be in the form of a written corrective action plan and should include who will take what corrective action by what date. The organization should indicate and provide reasons when it does not agree with the auditor's findings or does not think corrective action is necessary. The corrective action plan should be submitted with the audit report, which is due within thirty days after completion of the audit.

7.36. As noted in PCIE Position Statement No. 6, Question 45, the federal agencies responsible for audit resolution will evaluate the auditor's findings and recommendations along with the NPO's corrective action plan. Each federal agency responsible for audit resolution is required to issue a management decision within six months of receipt of the audit report. The management decision is the federal agency's response to the auditor's findings and the NPO's corrective action plan. A management decision can include additional actions necessary to resolve the findings.

7.37. Resolution normally occurs when the federal agency responds with a management decision. Upon learning of the finding, the NPO should proceed with corrective action as rapidly as possible.

7.38. Resolution of findings that relate to the programs of a single federal agency is the responsibility of that agency. Resolution of findings affecting programs of more than one federal agency is coordinated by the cognizant agency. A prime recipient is required to ensure that appropriate corrective action is taken by a subrecipient.

7.39. Sanctions such as disallowed costs, or withholding or suspending awards, are available to federal agencies when proper corrective action on audit findings is not made in a timely manner.

7.40. Findings may also serve as a basis for a federal agency's conducting or contracting for additional audit work. Appendix F of this SOP includes illustrations of the reporting of noncompliance.

Audit Follow-Up (Status of Prior Audit Findings)

7.41. Section 2.i of Attachment F to Circular A-110 provides that an organization have a systematic method to assure timely and appropriate resolution of audit findings and recommendations. Paragraphs 3.47 and 3.48 of this SOP describe the requirement for audit follow-up in *Government Auditing Standards.*

7.42. Federal agencies are required to track the status of management's actions on significant or material findings and recommendations from prior audits.

7.43. The management of some NPOs advocate routine disclosure of the status of separate grantor audits of grant or entitlement programs. Such disclosure is not necessary in the absence of uncertainties related to claims for refunds asserted in connection with such third-party audits. The auditor should consider the effect of aggregated identified noncompliance on the financial statements when preparing his or her report. FASB Statement No. 5 provides guidance in accounting for and reporting on such matters.

7.44. Some events of noncompliance do not have material financial implications on the financial statements, and disclosure of them, therefore, is not required. Nevertheless, special consideration should be given to those events for purposes of reporting to sponsors or donors and other purposes.

Submission of Reports

7.45. Circular A-133 requires that copies of the audit reports be submitted in accordance with *Government Auditing Standards*. GAS requires that the audit reports be submitted to the organization being audited and to the appropriate officials of the organizations requiring or arranging for the audits (including external funding organizations) thirty days after the completion of the audit, unless legal restrictions, ethical considerations, or other arrangements prevent such distribution. Subrecipients should submit copies of the audit reports to recipients that provided federal awards.

7.46. The reports are due within thirty days after the completion of the audit, but the audit should be completed and the report submitted no later than thirteen months after the end of the recipient's fiscal year, unless the cognizant or oversight agency agrees to a longer period.

7.47. The NPO is responsible for submitting *all* reports to each federal agency that provides direct federal funds. Also, subrecipients must distribute copies of reports to all recipients that provide them with federal funds. The report distribution requirements are met when the report is distributed by either the NPO or its auditor. PCIE Position Statement No. 6 includes a schedule of federal agency contact points for Circular A-133 audits.

7.48. The NPO should include with the report a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings.

7.49. Both recipients and subrecipients receiving federal awards over $100,000 are required to send a copy of the report to the central clearinghouse designated by the Office of Management and Budget. The address is:

Federal Audit Clearinghouse
Bureau of the Census
1201 E. 10th Street
Jeffersonville, IN 47132

7.50. While the various auditor's reports may have different dates and may be received by the NPO at different times, they should be delivered together to the cognizant or other oversight agency.

Program Audit Reporting

7.51. As noted in PCIE Position Statement No. 6, Question 22, in many cases a program-specific audit guide will be available to provide specific guidance on compliance testing, audit procedures, and reporting. The auditor should determine the availability of agency-prepared supplements or audit guides. This can be done by reviewing the *Program Audit Guide Survey* (October 1991) prepared by the PCIE Standards Subcommittee. The survey (order number PCIE-06-064) may be obtained by written request to the

Treasury Office of Inspector General, Room 7210, ICC Building, 1201 Constitution Ave., N.W., Washington, DC 20220 or by FAX to (202) 927-5418.

7.52. The auditor may also contact the appropriate Inspector General's Office to determine whether subsequent audit guides have been issued or to obtain a copy of an audit guide. When a current program-specific audit guide is not available, the auditor may obtain guidance from the program laws and regulations, grant agreements, and the Compliance Supplements.

7.53. Program-specific audits for which no current federal agency audit guide is available must conform to the reporting required by *Government Auditing Standards.* The reporting should normally include an opinion on the financial statements of the program, a report on the program's internal controls, and a report on program compliance with laws and regulations. A schedule of findings and questioned costs, management letter, or report on illegal acts may also be required when applicable.

7.54. A program audit may usually be performed on either the NPO fiscal year or the award year. However, for first-time audits or changes to existing audit periods, the auditor should contact the grantor agency or review the program audit guide, laws, and regulations concerning the proper audit period.

Stub Periods

7.55. Stub periods may occur when converting from one type of audit to another or when changing audit periods. Arrangements should be made to meet audit requirements for federal expenditures during the stub period. This is usually done either as a separate audit of the stub period or by including federal expenditures during the stub period with the Circular A-133 audit. The cognizant, oversight, or grantor agency should be contacted for advice on audit procedures for stub periods.

Freedom of Information Act

7.56. In accordance with the principles of the Freedom of Information Act (Title 5 of U.S. Code Section 552), audit agency and nonfederal reports issued to grantees and contractors are available, if they are requested, to members of the press and the general public, to the extent that information contained in them is not subject to exemptions of the Act that the cognizant agency chooses to exercise. Accordingly, the auditor should not include names, social security numbers, other personal identification, or other potentially sensitive matters in either the body of the report or any attached schedules.

APPENDIX A

OMB Circular A-133

SUBJECT: Audits of Institutions of Higher Education and Other Nonprofit Organizations

1. *Purpose.* Circular A-133 establishes audit requirements and defines Federal responsibilities for implementing and monitoring such requirements for institutions of higher education and other nonprofit institutions receiving Federal awards.

2. *Authority.* Circular A-133 is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541.

3. *Supersession.* Circular A-133 supersedes Attachment F, subparagraph 2h, of Circular A-110, "Uniform Administrative Requirements for Grants and other Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations."

4. *Applicability.* The provisions of Circular A-133 apply to:

a. Federal departments and agencies responsible for administering programs that involve grants, cost-type contracts and other agreements with institutions of higher education and other nonprofit recipients.

b. Nonprofit institutions, whether they are recipients, receiving awards directly from Federal agencies, or are sub-recipients, receiving awards indirectly through other recipients.

These principles, to the extent permitted by law, constitute guidance to be applied by agencies consistent with and within the discretion, conferred by the statutes governing agency action.

5. *Requirements and Responsibilities.* The specific requirements and responsibilities of Federal departments and agencies and institutions of higher education and other nonprofit institutions are set forth in the attachment.

6. *Effective Date.* The provisions of Circular A-133 are effective upon publication and shall apply to audits of nonprofit institutions for fiscal years that begin on or after January 1, 1990. Earlier implementation is encouraged. However, until this Circular is implemented, the audit provisions of Attachment F to Circular A-110 shall continue to be observed.

7. *Policy Review (Sunset) Date.* Circular A-133 will have a policy review three years from the date of issuance.

8. *Inquiries.* Further information concerning Circular A-133 may be obtained by contacting the Financial Management Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-3993.

Richard G. Darman
Director

ATTACHMENT

1. *Definitions.* For the purposes of this Circular, the following definitions apply:

a. "Award" means financial assistance, and Federal cost-type contracts used to buy services or goods for the use of the Federal Government. It includes awards received directly from the Federal agencies or indirectly through recipients. It does not include procurement contracts to vendors under grants or contracts, used to buy goods or services. Audits of such vendors shall be covered by the terms and conditions of the contract.

b. "Cognizant agency" means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 3 of this Attachment.

c. "Coordinated audit approach" means an audit wherein the independent auditor, and other Federal and non-federal auditors consider each other's work, in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with *Government Auditing Standards* and meet the objectives and reporting requirements set forth in paragraph 12(b) and 15, respectively, of this Attachment. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner.

d. "Federal agency" has the same meaning as the term 'agency' in Section 551(1) of Title 5, United States Code.

e. "Federal Financial Assistance."

(1) "Federal financial assistance" means assistance provided by a Federal agency to a recipient or subrecipient to carry out a program. Such assistance may be in the form of:

- grants;
- contracts;
- cooperative agreements;
- loans;
- loan guarantees;
- property;
- interest subsidies;
- insurance;
- direct appropriations;
- other non-cash assistance.

(2) Such assistance does not include direct Federal cash assistance to individuals.

(3) Such assistance includes awards received directly from Federal agencies, or indirectly when sub-recipients receive funds identified as Federal funds by recipients.

(4) The granting agency is responsible for identifying the source of funds awarded to recipients; the recipient is responsible for identifying the source of funds awarded to sub-recipients.

f. "Generally accepted accounting principles" has the meaning specified in the *Government Auditing Standards.*

g. "Independent auditor" means:

(1) A Federal, State, or local government auditor who meets the standards specified in the *Government Auditing Standards;* or

(2) A public accountant who meets such standards.

h. "Internal control structure" means the policies and procedures established to provide reasonable assurance that:

(1) Resource use is consistent with laws, regulations, and award terms;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

i. "Major program" means an individual award or a number of awards in a category of Federal assistance or support for which total expenditures are the larger of three percent of total Federal funds expended or $100,000, on which the auditor will be required to express an opinion as to whether the major program is being administered in compliance with laws and regulations.

Each of the following categories of Federal awards shall constitute a major program where total expenditures are the larger of three percent of total Federal funds expended or $100,000:

— Research and Development.

— Student Financial Assistance.

— Individual awards not in the student aid or research and development category.

j. "Management decision" means the evaluation by the management of an establishment of the findings and recommendations included in an audit report and the issuance of a final decision by management concerning its response to such findings and recommendations, including actions concluded to be necessary.

k. "Nonprofit institution" means any corporation, trust, association, cooperative or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. The term "nonprofit institutions" includes institutions of higher education, except those institutions that are audited as part of single audits in accordance with Circular A-128 "Audits of State and Local Governments." The term does not include hospitals which are not affiliated with an institution of higher education, or State and local governments and Indian tribes covered by Circular A-128 "Audits of State and Local Governments."

l. "Oversight" agency means the Federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency, unless no direct funding is received. Where there is no direct funding, the Federal agency with the predominant indirect funding will assume the general oversight responsibilities.

The duties of the oversight agency are described in paragraph 4 of this Attachment.

m. "Recipient" means an organization receiving financial assistance to carry out a program directly from Federal agencies.

n. "Research and development" includes all research activities, both basic and applied, and all development activities that are supported at universities, colleges, and other nonprofit institutions. "Research" is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. "Development" is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

o. "Student Financial Assistance" includes those programs of general student assistance in which institutions participate, such as those authorized by Title IV of the Higher Education Act of 1965 which is administered by the U.S. Department of Education and similar programs provided by other Federal agencies. It does not include programs which provide fellowships of similar awards to students on a competitive basis, or for specified studies or research.

p. "Sub-recipient" means any person or government department, agency, establishment, or nonprofit organization that receives financial assistance to carry out a program through a primary recipient or other sub-recipient, but does not include an individual that is a beneficiary of such a program. A sub-recipient may also be a direct recipient of Federal awards under other agreements.

q. "Vendor" means an organization providing a recipient or sub-recipient with generally required goods or services that are related to the administrative support of the Federal assistance program.

2. ***Audit of Nonprofit Institutions.***

a. *Requirements Based on Awards Received.*

(1) Nonprofit institutions that receive $100,000 or more a year in Federal awards shall have an audit made in accordance with the provisions of this Circular. However, nonprofit institutions receiving $100,000 or more but receiving awards under only one program have the option of having an audit of their institution prepared in accordance with the provisions of the Circular or having an audit made of the one program. For prior or subsequent years, when an institution has only loan guarantees or outstanding loans that were made previously, the institution may be required to conduct audits for those programs, in accordance with regulations of the Federal agencies providing those guarantees or loans.

(2) Nonprofit institutions that receive at least $25,000 but less than $100,000 a year in Federal awards shall have an audit made in accordance with this Circular or have an audit made of each Federal award, in accordance with Federal laws and regulations governing the programs in which they participate.

(3) Nonprofit institutions receiving less than $25,000 a year in Federal awards are exempt from Federal audit requirements, but records must be available for review by appropriate officials of the Federal grantor agency or subgranting entity.

b. *Oversight by Federal Agencies.*

(1) To each of the larger nonprofit institutions the Office of Management and Budget (OMB) will assign a Federal agency as the cognizant agency for monitoring audits and ensuring the resolution of audit findings that affect the programs of more than one agency.

(2) Smaller institutions not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them with the most funds.

(3) Assignments to Federal cognizant agencies for carrying out responsibilities in this section are set forth in a separate supplement to this Circular.

(4) Federal Government-owned, contractor-operated facilities at institutions or laboratories operated primarily for the Government are not included in the cognizance assignments. These will remain the responsibility of the contracting agencies. The listed assignments cover all of the functions in this Circular unless otherwise indicated. The Office of Management and Budget will coordinate changes in agency assignments.

3. ***Cognizant Agency Responsibilities.*** A cognizant agency shall:

a. Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

b. Provide technical advice and liaison to institutions and independent auditors.

c. Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

d. Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. A cognizant agency should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

e. Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

f. Coordinate, to the extent practicable, audits or reviews made for Federal agencies that are in addition to the audits made pursuant to this Circular, so that the additional audits or reviews build upon audits performed in accordance with the Circular.

g. Ensure the resolution of audit findings that affect the programs of more than one agency.

h. Seek the views of other interested agencies before completing a coordinated program.

i. Help coordinate the audit work and reporting responsibilities among independent public accountants, State auditors, and both resident and non-resident Federal auditors to achieve the most cost-effective audit.

4. ***Oversight Agency Responsibilities.*** An oversight agency shall provide technical advice and counsel to institutions and independent auditors when requested by the recipient. The oversight agency may assume all or some of the responsibilities normally performed by a cognizant agency.

5. ***Recipient Responsibilities.*** A recipient that receives a Federal award and provides $25,000 or more of it during its fiscal year to a sub-recipient shall:

a. Ensure that the nonprofit institution sub-recipients that receive $25,000 or more have met the audit requirements of this Circular, and that sub-recipients subject to OMB Circular A-128 have met the audit requirements of that Circular;

b. Ensure that appropriate corrective action is taken within six months after receipt of the sub-recipient audit report in instances of non-compliance with Federal laws and regulations;

c. Consider whether sub-recipient audits necessitate adjustment of the recipient's own records; and

d. Require each sub-recipient to permit independent auditors to have access to the records and financial statements as necessary for the recipient to comply with this Circular.

6. ***Relation to Other Audit Requirements.***

a. An audit made in accordance with this Circular shall be in lieu of any financial audit required under individual Federal awards. To the extent that an audit made in accordance with this Circular provides Federal agencies with the information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits or reviews necessary to carry out responsibilities under Federal law and regulation. Any additional Federal audits or reviews shall be planned and carried out in such a way as to build upon work performed by the independent auditor.

b. Audit planning by Federal audit agencies should consider the extent to which reliance can be placed upon work performed by other auditors. Such auditors include State, local, Federal, and other independent auditors, and a recipient's internal auditors. Reliance placed upon the work of other auditors should be documented and in accordance with *Government Auditing Standards.*

c. The provisions of this Circular do not limit the authority of Federal agencies to make or contract for audits and evaluations of Federal awards, nor do they limit the authority of any Federal agency Inspector General or other Federal official.

d. The provisions of this Circular do not authorize any institution or sub-recipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits, evaluations or reviews.

e. A Federal agency that makes or contracts for audits, in addition to the audits made by recipients pursuant to this Circular, shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits or reviews include financial, performance audits and program evaluations.

7. ***Frequency of Audit.*** Audits shall usually be performed annually but not less frequently than every two years.

8. ***Sanctions.*** No audit costs may be charged to Federal awards when audits required by this Circular have not been made or have been made but not in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit in accordance with the Circular, Federal agencies must consider appropriate sanctions including:

— withholding a percentage of awards until the audit is completed satisfactorily;

— withholding or disallowing overhead costs; or

— suspending Federal awards until the audit is made.

9. ***Audit Costs.*** The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provisions of Circular A-21, "Cost Principles for Universities" or Circular A-122, "Cost Principles for Nonprofit Organizations," FAR Subpart 31, or other applicable cost principles or regulations.

10. ***Auditor Selection.*** In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations."

11. ***Small and Minority Audit Firms.***

a. Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular.

b. Recipients of Federal awards shall take the following steps to further this goal:

(1) Ensure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable;

(2) Make information on forthcoming opportunities available and arrange timeframes for the audit to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(3) Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals;

(4) Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs, and in cases where this is not possible, assure that these firms are given consideration for audit subcontracting opportunities;

(5) Encourage contracting with consortiums of small audit firms as described in section (1), above, when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals; and

(6) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

12. ***Scope of Audit and Audit Objectives.***

a. The audit shall be made by an independent auditor in accordance with *Government Auditing Standards* developed by the Comptroller General of the United States covering financial audits. An audit under this Circular should be an organization-wide audit of the institution. However, there may be instances where Federal auditors are performing audits or are planning to perform audits at nonprofit institutions. In these cases, to minimize duplication of audit work, a coordinated audit approach may be agreed upon between the independent auditor, the recipient and the cognizant agency or the oversight agency. Those auditors who assume responsibility for any or all of the reports called for by paragraph 15 should follow guidance set forth in *Government Auditing Standards* in using work performed by others.

b. The auditor shall determine whether:

(1) The financial statements of the institution present fairly its financial position and the results of its operations in accordance with generally accepted accounting principles;

(2) The institution has an internal control structure to provide reasonable assurance that the institution is managing Federal awards in compliance with applicable laws and regulations, and controls that ensure compliance with the laws and regulations that could have a material impact on the financial statements; and

(3) The institution has complied with laws and regulations that may have a direct and material effect on its financial statement amounts and on each major Federal program.

13. ***Internal Controls Over Federal Awards; Compliance Reviews.***

a. *General.* The independent auditor shall determine and report on whether the recipient has an internal control structure to provide reasonable assurance that it is managing Federal awards in compliance with applicable laws, regulations, and contract terms, and that it safeguards Federal funds. In performing these reviews, independent auditors should rely upon work performed by a recipient's internal auditors to the maximum extent possible. The extent of such reliance should be based upon the *Government Auditing Standards*.

b. *Internal Control Review.*

(1) In order to provide this assurance on internal controls, the auditor must obtain an understanding of the internal control structure and assess levels of internal control risk. After obtaining an understanding of the controls, the assessment must be made whether or not the auditor intends to place reliance on the internal control structure.

(2) As part of this review, the auditor shall:

(a) Perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. Tests of controls will not be required for those areas where the internal control structure policies and procedures are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or a material weakness should be reported in accordance with paragraph 15c(2) of this Circular.

(b) Review the recipient's system for monitoring subrecipients and obtaining and acting on sub-recipient audit reports.

(c) Determine whether controls are in effect to ensure direct and indirect costs were computed and billed in accordance with the guidance provided in the general requirements section of the compliance supplement to this Circular.

c. *Compliance Review.*

(1) The auditor shall determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. In addition, transactions selected for nonmajor programs shall be tested for compliance with Federal laws and regulations that apply to such transactions.

(2) In order to determine which major programs are to be tested for compliance, recipients shall identify, in their accounts, all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies, through other state and local governments or other recipients. To assist recipients in identifying Federal awards, Federal agencies and primary recipients shall provide the CFDA numbers to the recipients when making the awards.

(3) The review must include the selection of an adequate number of transactions from each major Federal financial assistance program so that the auditor obtains sufficient evidence to support the opinion on compliance required by paragraph 15c(3) of this

Attachment. The selection and testing of transactions shall be based on the auditors' professional judgment considering such factors as the amount of expenditures for the program; the newness of the program or changes in its conditions; prior experience with the program particularly as revealed in audits and other evaluations (e.g., inspections, program reviews, or system reviews required by FAR); the extent to which the program is carried out through sub-recipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(4) In making the test of transactions, the auditor shall determine whether:

— the amounts reported as expenditures were for allowable services, and

— the records show that those who received services or benefits were eligible to receive them.

(5) In addition to transaction testing, the auditor shall determine whether:

— matching requirements, levels of effort and earmarking limitations were met,

— Federal financial reports and claims for advances and reimbursement contain information that is supported by books and records from which the basic financial statements have been prepared, and

— amounts claimed or used for matching were determined in accordance with (1) OMB Circular A-21, "Cost Principles for Educational Institutions"; (2) matching or cost sharing requirements in Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations"; (3) Circular A-122, "Cost Principles for Nonprofit Organizations"; (4) FAR subpart 31 cost principles; and (5) other applicable cost principles or regulations.

(6) The principal compliance requirements of the largest Federal programs may be ascertained by referring to the *"Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-profit Institutions,"* and the *"Compliance Supplement for Single Audits of State and Local Governments,"* issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplements, the auditor should ascertain compliance requirements by reviewing the statutes, regulations, and agreements governing individual programs.

(7) Transactions related to other awards that are selected in connection with examinations of financial statements and evalua-

tions of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

14. ***Illegal Acts.*** If, during or in connection with the audit of a nonprofit institution, the auditor becomes aware of illegal acts, such acts shall be reported in accordance with the provisions of the *Government Auditing Standards*.

15. ***Audit Reports.***

a. Audit reports must be prepared at the completion of the audit.

b. The audit report shall state that the audit was made in accordance with the provisions of this Circular.

c. The report shall be made up of at least the following three parts:

(1) The financial statements and a schedule of Federal awards and the auditor's report on the statements and the schedule. The schedule of Federal awards should identify major programs and show the total expenditures for each program. Individual major programs other than Research and Development and Student Aid should be listed by catalog number as identified in the *Catalog of Federal Domestic Assistance.* Expenditures for Federal programs other than major programs shall be shown under the caption "other Federal assistance." Also, the value of non-cash assistance such as loan guarantees, food commodities or donated surplus properties or the outstanding balance of loans should be disclosed in the schedule.

(2) A written report of the independent auditor's understanding of the internal control structure and the assessment of control risk. The auditor's report should include as a minimum: (1) the scope of the work in obtaining understanding of the internal control structure and in assessing the control risk, (2) the nonprofit institution's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and those that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations, and (3) the reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk. If the auditor limits his/her consideration of the internal control structure for any reason, the circumstances should be disclosed in the report.

(3) The auditor's report on compliance containing:

— An opinion as to whether each major Federal program was being administered in compliance with laws and regulations applicable to the matters described in paragraph 13(c)(3) of this Attachment, including compliance with laws and regulations pertaining to financial reports and claims for advances and reimbursements;

— A statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested;

- Material findings of noncompliance presented in their proper perspective:
  - The size of the universe in number of items and dollars,
  - The number and dollar amount of transactions tested by the auditors,
  - The number and corresponding dollar amount of instances of noncompliance;
- Where findings are specific to a particular Federal award, an identification of total amounts questioned, if any, for each Federal award, as a result of noncompliance and the auditor's recommendations for necessary corrective action.

d. The three parts of the audit report may be bound into a single document, or presented at the same time as separate documents.

e. Nonmaterial findings need not be disclosed with the compliance report but should be reported in writing to the recipient in a separate communication. The recipient, in turn, should forward the findings to the Federal grantor agencies or subgrantor sources.

f. All fraud or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, may be covered in a separate written report submitted in accordance with the *Government Auditing Standards.*

g. The auditor's report should disclose the status of known but uncorrected significant material findings and recommendations from prior audits that affect the current audit objective as specified in the *Government Auditing Standards.*

h. In addition to the audit report, the recipient shall provide a report of its comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

i. Copies of the audit report shall be submitted in accordance with the reporting standards for financial audits contained in the *Government Auditing Standards.* Sub-recipient auditors shall submit copies to recipients that provided Federal awards. The report shall be due within 30 days after the completion of the audit, but the audit should be completed and the report submitted not later than 13 months after the end of the recipient's fiscal year unless a longer period is agreed to with the cognizant or oversight agency.

j. Recipients of more than $100,000 in Federal awards shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audit reports on file.

k. Recipients shall keep audit reports, including subrecipient reports, on file for three years from their issuance.

16. ***Audit Resolution.***

a. As provided in paragraph 3, the cognizant agency shall be responsible for ensuring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and the agency. Alternate arrangements may be made on case-by-case basis by agreement among the agencies concerned.

b. A management decision shall be made within six months after receipt of the report by the Federal agencies responsible for audit resolution. Corrective action should proceed as rapidly as possible.

17. ***Audit Workpapers and Reports.*** Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

APPENDIX B

Reference Documents for Compliance Auditing of Not-for-Profit Organizations

In the planning stage of the audit, independent auditors should become familiar with the applicable documents presented below. The documents are among the most important ones to be used for verification and reference purposes in auditing compliance for NPOs. Sources for these materials are identified below. The auditor should use the most current reference material that applies to the period under audit.

The AICPA publications listed below may be obtained from the American Institute of Certified Public Accountants, Harborside Financial Center, 201 Plaza III, Jersey City, NJ 07311-3881, or by calling 800-862-4272. Federal government publications may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402 (order desk telephone: 202-783-3238). Standards of the President's Council on Integrity and Efficiency (except for PCIE Position Statement No. 6) can be obtained by writing or faxing the Treasury Office of Inspector General, Room 7210, ICC Building, 1201 Constitution Avenue, NW, Washington, DC 20220 (fax: 202-927-5418).

Cost Principles

a. OMB Circular A-21, *Cost Principles for Colleges and Universities*

b. OMB Circular A-122, *Cost Principles for Nonprofit Organizations*

c. OASC-3 (45 CFR, Part 74), *Cost Principles for Hospitals*

Auditing Standards

a. AICPA *Professional Standards,* volume 1, including SAS No. 68, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*

b. *Government Auditing Standards,* issued by the Comptroller General of the United States (1988 revision)

c. *Guide for Review of Sensitive Payments,* published by the General Accounting Office (GAO)

AICPA Audit Guides and Statements of Position

a. *Audits of Certain Nonprofit Organizations,* which includes SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*

b. *Audits of Voluntary Health and Welfare Organizations*

c. *Audits of Colleges and Universities*

d. *Audits of Providers of Health Care Services*

e. *Audit Sampling*

f. *Consideration of the Internal Control Structure in a Financial Statement Audit*

g. *Audits of State and Local Governmental Units*

h. SOP 92-7, *Audits of State and Local Governmental Entities Receiving Federal Financial Assistance*

Office of Management and Budget (OMB) and Other Compliance Guidelines

a. OMB Circular A-21, *Cost Principles for Educational Institutions*

b. OMB Circular A-73, *Audits of Federal Operations and Programs*

c. *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions* (October 1991)

d. *Guidelines for Audits of Federal Awards to Nonprofit Organizations,* issued by the Office of Inspector General of the United States Department of Health and Human Services

e. *Compliance Supplement for Single Audits of State and Local Governments* (September 1990)

f. *Catalog of Federal Domestic Assistance*

g. OMB Circular A-88, *Indirect Cost Rates, Audit and Audit Follow-Up at Educational Institutions,* and successive publications (cognizant audit responsibilities)

h. OMB Circular A-110, *Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations*

i. OMB Circular A-122, *Cost Principles for Nonprofit Organizations*

j. OMB Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions*

PCIE Statements and Guidance

a. PCIE Statement No. 1 provides guidance on determining when a series of audits of individual federal departments, agencies, and establishments may be considered an audit for purposes of the Single Audit Act.

b. PCIE Statement No. 2 provides guidance to cognizant agencies on determining whether an audit report that does not meet the 50 percent rule on internal control coverage prescribed in the AICPA *Audit and Accounting Guide Audits of State and Local Governmental Units* should be accepted.

c. PCIE Statement No. 3 provides guidance on using a cyclical approach to internal control reviews of nonmajor programs.

d. PCIE Statement No. 4 establishes uniform procedures for referrals of substandard audits to state boards of accountancy and the AICPA.

e. PCIE Statement No. 5 provides guidance for certain not-for-profit entities other than institutions of higher education or hospitals not covered by OMB Circular A-110.

f. PCIE Statement No. 6 (order number 041-001-00374-6) answers commonly asked questions about audits of federal programs under OMB Circular A-133. This can be obtained by contacting the Government Printing Office.

g. *Program Audit Guide Survey* was issued by the PCIE Standards Subcommittee (October 1991). One copy can be obtained (order number PCIE-06-064) by writing to the PCIE at:

Department of the Treasury
Office of Inspector General
Room 7210, ICC Bldg.
1201 Constitution Ave., N.W.
Washington, DC 20220

Sponsors' Guidelines

- *Financial Aid Handbook,* issued by the Department of Education
- PHS *Grants Administration Manual* and *Grants Policy Statement*
- The National Science Foundation's *Grants for Scientific Research*
- AID Handbooks
- Federal Acquisition Regulations (FAR)
- Defense Department Supplement (DFARS)
- Standards of Accounting and Financial Reporting for Voluntary Health & Welfare Organizations, third edition (1988), issued by the National Health Council (commonly referred to as the "black book")
- 1988 Combined Federal Campaign Rule 5 CFR Part 950, *Solicitation of Federal Civilian and Uniformed Service Personnel for Contributions to Private Voluntary Organizations,* issued by the United States Office of Personnel Management.

Federal Agency Guidance

Federal Cognizant Agency Audit Organization Guidelines, issued by the President's Council on Integrity and Efficiency (includes desk and quality control review guides, revised May 1991)

Directory of Inspectors General—List of Federal Agency Contact Points for Single Audit Act Questions and Materials

Federal Agency Implementation of Single Audit Requirements

Department of the Interior
Department of Transportation
Department of Agriculture
Department of Commerce
Veterans Administration
Department of Health and Human Services
Department of Labor
Federal Emergency Management Agency
Department of Education
Department of Housing and Urban Development
Department of Energy
Department of Transportation, Federal Highway Administration
Environmental Protection Agency

Quality Standards for Federal Offices of Inspector General, issued by the President's Council on Integrity and Efficiency (Performance Evaluation Committee), January 1986

Common Rule for Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Federal Agency Implementation of Common Rule

Guidelines for Audits of Federal Awards to Non-Profit Organizations, issued by the Office of Inspector General, U.S. Department of Health and Human Services

How to Choose an Auditor, issued by Mid-America Intergovernmental Audit Forum

A Guide for Roles and Responsibilities in Subrecipient Audits, issued by Mid-America Intergovernmental Audit Forum

Review Guide for Long-Form University Indirect Cost Proposals, issued by U.S. Department of Health and Human Services.

APPENDIX C

State and Local Audit and Grant Compliance Requirements

In general, there are three types of models under which state governments prescribe audit requirements:

a. *Single Audit*—The state requires the performance of a single audit covering the grants.

b. *Individual Grant Audits*—The state requires that every state grant be audited; individual agencies implement the audit requirements and specify applicable requirements.

c. *Individual Agency Audits*—The state does not have an audit requirement; individual agencies are left to implement their own requirements. Thus, in some cases, audit requirements may not exist for certain grants.

Some cities and other very large municipal units also use similar types of models. In recent years, an increasing number of states and municipalities have adopted a single-audit model to increase audit efficiency.

In determining the most efficient audit approach, the auditor should—

a. Determine the nature of the audit requirements in the state (e.g., ascertain whether the state uses a single-audit model, an individual grant audit model, or an individual agency audit model).

b. Ascertain the relationship of applicable state requirements to any federal audit requirements.

c. Ascertain the nature of funding for the audit costs of such requirements. Typically, the cost of any state requirements that go beyond federal requirements is not covered by federal sponsors.

If the state follows a multiple-agency model and the auditor is engaged to perform and report separately on an individual grant audit on behalf of a state or local agency, he or she should consider the following steps:

- Obtain any applicable audit guidance from the grantor agency.
- Confirm with the grantor agency that any audit guides expected to be used contain all administrative rulings and amendments pertaining to the grant.
- Discuss with the grantor agency the scope of testing that is expected to be performed. The auditor should consider documenting any agreements resulting from such discussions in a proposal, contract, or engagement letter.

APPENDIX D

Illustrative Audit Reports

The following is a list of the reports illustrated in this appendix:

Exhibit D-1

Report on Schedule of Federal Awards[1]

[Addressee]

We have audited the financial statements of [*name of organization*] for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[2] These financial statements are the responsibility of [*name of organization*]'s management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was made for the purpose of forming an opinion on the basic financial statements of [*name of organization*] taken as a whole. The accompanying Schedule of Federal Awards is stated for purposes of additional analysis and is not a required part of the basic financial statements. The information in that Schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

[Signature]
[Date]

Notes:

1. This report is intended to be issued when the auditor's report on the basic financial statements is issued separately. However, the auditor may consider combining the report on the basic financial statements with this report (see exhibit D-2).
2. Describe any departure from the standard report.

Exhibit D-2

Report on Basic Financial Statements and Schedule of Federal Awards

[*Addressee*]

We have audited the accompanying balance sheet of [*name of organization*] as of June 30, 19XX, and the related statements of changes in fund balances and [*changes in financial position*] [*cash flows*][1] for the year then ended. These financial statements are the responsibility of [*name of organization*]'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [*name of organization*] as of June 30, 19XX, and the changes in its fund balances and its [*financial position*] [*cash flows*] for the year then ended, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic financial statements of [*name of organization*] taken as a whole. The accompanying Schedule of Federal Awards for the year ended June 30, 19XX, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information in that schedule has been subjected to the procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature*]
[*Date*]

Note:

1. Statement titles should be revised to conform with the statements presented by the organization.

Exhibit D-3

Report on the Internal Control Structure Based on an Audit of Financial Statements Performed in Accordance With GAS

[*Addressee*]

We have audited the financial statements of [*name of organization*] as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of [*name of organization*] for the year ended June 30, 19XX, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of [*name of organization*] is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories [*identify internal control structure categories*].[2] For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data in a manner that is consistent with the assertions of management in the financial statements.[3]

[*Include paragraphs to describe the reportable conditions noted.*]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have communicated to the management of [*name of organization*] in a separate letter dated August 15, 19XX.[4]

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[5]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. See paragraph 7.7 for a discussion of categories to be identified. Also, see paragraphs 6.36 and 6.53 through 6.61 for specific and general requirements, respectively.
3. Paragraph 17 of SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in a Financial Statement Audit,* prohibits the auditor from issuing a written report representing that no reportable conditions were noted during an audit. When the auditor notes no reportable conditions during an audit, he or she may issue a report, such as the following, to satisfy the requirements of *Government Auditing Standards.*

    [*The first through the fifth paragraphs of the report are the same as those illustrated above.*]

    Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

[*The last two paragraphs of the report are the same as that illustrated above.*]

4. If a separate letter has not been issued, this paragraph should be omitted.
5. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-4

Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance With GAS When the Auditor's Procedures Disclose No Material Instances of Noncompliance

[*Addressee*]

We have audited the financial statements of [*name of organization*] as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to [*name of organization*] is the responsibility of [*name of organization*]'s management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of [*name of organization*]'s compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, [*name of organization*] complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those provisions.[2]

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[3]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. If the auditor determines noncompliance is pervasive and he or she is not able to provide negative assurance, the auditor's report should consist of the following:

   [*First three paragraphs as illustrated above.*]

   The results of our tests indicate that, with respect to the items tested, the [*name of organization*] complied with those laws and regulations referred to above, except as described in the attached schedule. However, the extent of noncompliance noted in our testing indicates that, with respect to items that were not tested by us, there is more than a relatively low risk that the [*name of organization*] may not have complied with the provisions referred to in the preceding paragraph. These matters were considered by us in evaluating whether the basic financial statements are presented fairly in conformity with generally accepted accounting principles.

[*Last paragraph as illustrated above.*]

3. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-5

Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance With GAS When Material Instances of Noncompliance Exist

[*Addressee*]

We have audited the financial statements of [*name of organization*], as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to [*name of organization*] is the responsibility of [*name of organization*]'s management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of [*name of organization*]'s compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in laws, regulations, contracts, or grants that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements. The results of our tests of compliance disclosed the following material instances of noncompliance, the effects of which have been corrected in [*name of organization*]'s 19XX financial statements.

[*Include paragraphs describing the material instances of noncompliance noted.*]

We considered these material instances of noncompliance in forming our opinion on whether [*name of organization*]'s 19XX financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated August 15, 19XX, on those financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, [*name of organization*] complied, in all material respects, with the provisions referred to in the third paragraph of this report; and, with respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those provisions.[2]

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[3]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. If there is pervasive noncompliance and negative assurance cannot be provided, the report should be modified as shown in exhibit D-4, note 2.
3. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-6

Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance With GAS When Uncertainty About the Effects of Noncompliance Exists

[*Addressee*]

We have audited the financial statements of [*name of organization*], as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to [*name of organization*] is the responsibility of [*name of organization*]'s management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of [*name of organization*]'s compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in laws, regulations, contracts, or grants that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements. The results of our tests of compliance disclosed the following instances of noncompliance, the effects of which may be material to the financial statements but for which the ultimate resolution cannot presently be determined. Accordingly, no provision for any liability that may result has been recognized in [*name of organization*]'s 19XX financial statements.[2]

[*Include paragraphs describing the instances of noncompliance noted.*]

We considered these instances of noncompliance in forming our opinion on whether [*name of organization*]'s 19XX financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated August 15, 19XX, on those financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, [*name of organization*] complied, in all material respects, with the provisions referred to in the third paragraph of this report; and, with respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those provisions.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[3]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. The effect of the instances of noncompliance is considered when reporting on the basic financial statements and, if material to the basic financial statements, an explanatory paragraph similar to the following should be inserted after the opinion paragraph in the auditor's report on the financial statements:

   As discussed in note X, [*name of organization*] failed to comply with certain requirements applicable to the federal awards programs in which it participates. The financial statements do not include an adjustment for any liability that may result from the actions of the organization and federal agencies relative to these instances of noncompliance.

   Auditors should be aware that instances of noncompliance may be material, either individually or in the aggregate, warranting an adverse opinion on the financial statements.
3. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-7

Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance With GAS When the Auditor Decides Not to Perform Any Tests of Compliance[1]

[*Addressee*]

We have audited the financial statements of [*name of organization*], as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[2]

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to [*name of organization*] is the responsibility of [*name of organization*]'s management. As part of our audit, we assessed the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants could cause the financial statements to be materially misstated. We concluded that the risk of such material misstatement was sufficiently low that it was not necessary to perform tests of [*name of organization*]'s compliance with such provisions of laws, regulations, contracts, and grants.

However, in connection with our audit, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with the laws, regulations, contracts, and grants referred to in the preceding paragraph.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[3]

[*Signature*]

[*Date*]

Notes:

1. This report is only appropriate in rare circumstances, based on assessments of materiality and audit risk, where the auditor may decide not to perform any tests of compliance with provisions of laws, regulations, contracts, and grants. (See paragraph *7.27* of this SOP for discussion of dating of reports.)
2. Describe any departure from the standard report.
3. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-8

Report on the Internal Control Structure Used in Administering Federal Awards

[*Addressee*]

We have audited the financial statements of [*name of organization*] as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1] We have also audited [*name of organization*]'s compliance with requirements applicable to major federal programs, and have issued our report thereon dated August 15, 19XX.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether [*name of organization*] complied with laws and regulations, noncompliance with which would be material to a major federal program.

In planning and performing our audits for the year ended June 30, 19XX, we considered [*name of organization*]'s internal control structure in order to determine our auditing procedures for the purpose of expressing our opinions on [*name of organization*]'s financial statements and on its compliance with requirements applicable to major programs and to report on the internal control structure in accordance with OMB Circular A-133. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to federal programs. We have addressed policies and procedures relevant to our audit of the financial statements in a separate report dated August 15, 19XX.

The management of [*name of organization*] is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles, and that federal awards programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in administering federal programs in the following categories: [*identify internal control structure categories*].[2] For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.[3]

During the year ended June 30, 19XX, [*name of organization*] expended X percent of its total federal awards under major programs.[4,5]

We performed tests of controls,[6] as required by OMB Circular A-133, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements; general requirements; and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the organization's major programs, which are identified in the accompanying schedule of federal awards. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters[7] involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to administer federal awards programs in accordance with applicable laws and regulations.

[*Include paragraphs describing the reportable conditions noted.*]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe that none of the reportable conditions described above is a material weakness.[8]

We also noted other matters involving the internal control structure and its operation that we have reported to the management of [*name of organization*] in a separate letter dated August 15, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[9]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. See paragraph 7.7 for a discussion of categories to be identified. Also, see paragraphs 6.36 and 6.53 through 6.61 for specific and general requirements, respectively.

3. If a cyclical approach is used, the last sentence of this paragraph should be modified and the following paragraph added:

   Because of the large number of nonmajor programs and the decentralized administration of these programs, we performed procedures to obtain an understanding of the internal control structure policies and procedures relevant to nonmajor programs on a cyclical basis. Our procedures during the current year covered X percent of the nonmajor program expenditures administered by the organization as a whole. The nonmajor program expenditures not covered during the current year have been or are expected to be subject to such procedures at least once during the X-year cycle.

4. If the total amount expended under major programs is less than 50 percent of total federal awards expended during the year under audit, the auditor should follow the guidance in paragraph 5.23 of this SOP to satisfy the objectives of OMB Circular A-133. When such guidance is followed, the sixth and seventh paragraphs of this report should be modified as follows:

   During the year ended June 30, 19XX, [*name of organization*] expended X percent of its total federal awards under major programs and the following nonmajor programs: [*list appropriate nonmajor programs*].

   We performed tests of controls, as required by OMB Circular A-133, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the organization's major programs, which are identified in the accompanying schedule of federal awards, and the aforementioned nonmajor programs. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

5. If the organization had no major programs during the year under audit, the auditor should follow the guidance in paragraph 5.25 of this SOP to satisfy the objectives of OMB Circular A-133. When such guidance is followed, the second sentence of the first paragraph of the report, which refers to an audit of compliance with requirements applicable to major programs, would be omitted and the phrase "and about whether [*name of organization*] complied with laws and regulations, noncompliance with which would be material to a major federal program" should be omitted. Also, the phrase "and on its compliance with requirements applicable to major programs" should be omitted from the third paragraph. The sixth and seventh paragraphs of this report should be modified as follows:

   During the year ended June 30, 19XX, [*name of organization*] had no major programs and expended X percent of its total federal awards under the following nonmajor programs [*list appropriate nonmajor programs*]:

We performed tests of controls, as required by OMB Circular A-133, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to the aforementioned nonmajor programs. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

6. When no tests of controls are performed for certain compliance requirements, this paragraph and those that follow should be replaced with the following:

Except as discussed in the following paragraph, we performed tests of controls, as required by OMB Circular A-133, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements and amounts claimed or used for matching that are applicable to each of the [*name of organization*]'s major federal programs, which are identified in the accompanying schedule of federal awards. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

For [*identify relevant federal programs*], we performed no tests of controls to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that could be relevant to preventing or detecting material noncompliance with [*identify relevant compliance requirements*]. We did not perform such tests because the results of procedures we performed to obtain an understanding of the design of internal control policies and procedures and whether they have been placed in operation indicated that [*describe the absence of relevant policies and procedures or the circumstances that cause the auditor to conclude that policies and procedures are unlikely to be effective*]. We consider this condition to be a reportable condition under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention concerning significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect [*name of organization*]'s ability to administer federal programs in accordance with applicable laws and regulations. In addition to the reportable conditions identified in the preceding paragraph, we noted other matters involving the internal control structure and its operation that we consider to be reportable conditions.

[*Include paragraphs to describe the reportable conditions noted.*]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level of risk that noncompliance with laws and regulations that would be material to a federal program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of [*name of organization*] in a separate letter dated August 15, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is also a matter of public record and its distribution is not limited.

[*Signature*]

[*Date*]

7. When there are no material weaknesses and no reportable conditions noted, this paragraph and those that follow should be replaced with the following paragraphs:

Our consideration of the internal control structure policies and procedures used in administering federal awards would not necessarily disclose all matters in the internal control structure that might constitute material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal awards program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of [*name of organization*] in a separate letter dated August 15, 19XX.

This report is intended for the information of the audit committee, management, and [*name of organization*]. However, this report is also a matter of public record and its distribution is not limited.

[*Signature*]

[Date]

8. If conditions believed to be material weaknesses are disclosed, the report should describe the weaknesses that have come to the auditor's attention and may state that these weaknesses do not affect the report on the audit of compliance with requirements applicable to major programs. The last sentence of this paragraph of the report should be modified as follows:

    However, we noted the following matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above. These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of [*name of organization*]'s compliance with requirements applicable to its major programs for the year ended June 30, 19XX, and this report does not affect our report thereon dated August 15, 19XX. [*A description of the material weaknesses that have come to the auditor's attention would follow.*]

9. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-9

Unqualified Opinion on Compliance With Specific Requirements Applicable to Major Programs

[*Addressee*]

We have audited the financial statements of [*name of organization*] as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We have also audited [*name of organization*] 's compliance with the requirements governing [*list requirements tested*][2] that are applicable to each of its major federal programs, which are identified in the accompanying schedule of federal awards[3] for the year ended June 30, 19XX. The management of [*name of organization*] is responsible for [*name of organization*]'s compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards; *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about [*name of organization*]'s compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying Schedule of Findings and Questioned Costs. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.[4]

In our opinion, [*name of organization*] complied, in all material respects, with the requirements governing [*list requirements tested*][1] that are applicable to each of its major federal programs for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[5]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. Specific requirements generally pertain to the following matters:
   - Types of services allowed or not allowed
   - Eligibility
   - Matching, level of effort, or earmarking
   - Reporting
   - Special tests and provisions
   - Financial reports and claims for advances and reimbursements

- Amounts claimed or used for matching

3. Major programs should be clearly identified in the schedule of federal awards.
4. If there are no instances of noncompliance, this paragraph should be omitted. Immaterial instances of noncompliance may be communicated to the organization in a separate letter or in the report. If the auditor has issued a separate letter describing immaterial instances of noncompliance, the first sentence of this paragraph should be replaced with a sentence similar to the following: "The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above that we have communicated to the management of [*name of organization*] in a separate letter dated August 15, 19XX."
5. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-10

Qualified Opinion on Compliance With Specific Requirements Applicable to Major Programs—Scope Limitation

[*Addressee*]

[*The first and second paragraphs are the same as those of the standard report on major program compliance illustrated in exhibit D-9.*]

Except as discussed in the following paragraph, we conducted our audit of compliance with those requirements in accordance with generally accepted auditing standards; *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about [*name of organization*]'s compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

We were unable to obtain sufficient documentation supporting [*name of organization*]'s compliance with the requirements of [*identify the major program*] governing types of services allowed or unallowed; nor were we able to satisfy ourselves as to [*name of organization*]'s compliance with those requirements by performing other auditing procedures.

[*The fifth paragraph is the same as the fourth paragraph of the standard report on major program compliance illustrated in exhibit D-9.*]

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding [*name of organization*]'s compliance with the requirements of [*identify the major program*] governing types of services allowed or unallowed, [*name of organization*] complied, in all material respects, with the requirements governing [*list requirements tested*] that are applicable to each of its major federal programs for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[1]

[*Signature*]

[*Date*]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-11

Qualified Opinion on Compliance With Specific Requirements Applicable to Major Programs—Noncompliance

[Addressee]

[The first three paragraphs are the same as those in the standard report on major program compliance illustrated in exhibit D-9.]

The results of our audit procedures for [*identify the major program*] disclosed that [*name of organization*] did not comply with the requirement that [*name of organization*] match the funds received from [*identify the major program*]. In our opinion, [*name of organization*]'s matching of funds received from [*identify the major program*] is necessary for [*name of organization*] to comply with the requirements applicable to [*identify the major program*].

[The fifth paragraph is the same as the fourth paragraph of the standard report on major program compliance illustrated in exhibit D-9.]

In our opinion, except for those instances of noncompliance with the requirements applicable to [*identify the major program*] referred to in the fourth paragraph of this report and identified in the accompanying schedule of findings and questioned costs, [*name of organization*] complied, in all material respects, with the requirements governing [*list requirements tested*] that are applicable to each of its major programs for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[1]

[Signature]
[Date]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-12

Adverse Opinion on Compliance With Specific Requirements Applicable to Major Programs

[*Addressee*]

[*The first three paragraphs of the report are the same as those in the standard report on major program compliance illustrated in exhibit D-9.*]

[*Add a paragraph describing the reasons for the adverse opinion.*]

[*The fifth paragraph is the same as the fourth paragraph of the standard report on major program compliance illustrated in exhibit D-9.*]

In our opinion, because of the noncompliance referred to in the fourth paragraph, [*name of organization*] did not comply, in all material respects, with the requirements governing [*list requirements tested*] that are applicable to each of its major federal programs for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[1]

[*Signature*]
[*Date*]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-13

Disclaimer of Opinion on Compliance With Specific Requirements Applicable to Major Programs

[*Addressee*]

[*The first paragraph of the report is the same as the first paragraph in the report illustrated in exhibit D-9.*]

We were also engaged to audit [*name of organization*]'s compliance with the requirements governing [*list requirements tested*] that are applicable to each of its major federal programs, which are identified in the accompanying schedule of federal awards for the year ended June 30, 19XX. The management of [*name of organization*] is responsible for [*name of organization*]'s compliance with those requirements.

The management of [*name of organization*] has refused to provide us with written representations that generally accepted auditing standards require us to obtain.

Because of the matter described in the preceding paragraph, the scope of our audit work was not sufficient to enable us to express, and we do not express, an opinion on [*name of organization*]'s compliance with the requirements governing [*list requirements tested*] that are applicable to each of its major federal programs for the year ended June 30, 19XX.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[1]

[*Signature*]
[*Date*]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-14

Qualified Opinion on Compliance With Specific Requirements Applicable to Major Programs—Uncertainties

[*Addressee*]

[*The first three paragraphs are the same as those of the standard report on major program compliance illustrated in exhibit D-9.*]

The results of our audit procedures for the [*name*] program disclosed that [*name of organization*] did not comply with the requirements that [*identify the requirements*]. In our opinion, [*name of organization*]'s compliance with this requirement is necessary for [*name of organization*] to comply with the requirements applicable to the [*name*] program.

In addition, the results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to in the second paragraph of this report, which are described in the accompanying Schedule of Findings and Questioned Costs. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, except for those instances of noncompliance with requirements applicable to the [*name*] program referred to in the fourth paragraph of this report and identified in the accompanying Schedule of Findings and Questioned Costs, [*name of organization*] complied, in all material respects, with the requirements governing [*list requirements tested*] that are applicable to each of its major federal programs for the year ended June 30, 19XX.

Resolving instances of noncompliance identified in the fourth paragraph of this report is the responsibility of [*name of organization*] and federal officials. The determination of whether the identified instances of noncompliance will ultimately result in a disallowance of costs cannot be presently determined. Accordingly, no adjustment for any disallowances that may result has been made to the federal program amounts listed in the accompanying schedule of federal awards and no provision for any liability that may result has been recognized in [*name of organization*]'s 19XX financial statements.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[1]

[*Signature*]

[*Date*]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-15

Report on Compliance With General Requirements— No Material Noncompliance Identified

[*Addressee*]

We have audited the financial statements of [*name of organization]* as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

We have applied procedures to test [*name of organization*]'s compliance with the following requirements applicable to its federal programs, which are identified in the accompanying schedule of federal awards for the year ended June 30, 19XX: [*List the general requirements tested.*[2]].

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions* [*or describe alternative procedures performed*]. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [*name of organization*]'s compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of our procedures disclosed no material instances of noncompliance with the requirements listed in the second paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] has not complied, in all material respects, with those requirements. However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying schedule of findings and questioned costs.[3]

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[4]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. General requirements involve the following matters:
   - Political activity
   - Davis-Bacon Act
   - Civil rights
   - Cash management
   - Federal financial reports
   - Allowable costs/cost principles
   - Drug-free workplace
   - Administrative requirements

   The auditor should refer to the Compliance Supplement for additional information on the general requirements.

3. If there are no immaterial instances of noncompliance, this sentence should be omitted. Immaterial instances of noncompliance may be communicated to the organization in a separate letter or in the report. If the auditor has issued a separate letter describing immaterial instances of noncompliance, the last sentence of this paragraph should be replaced with a sentence similar to the following: "The results of our procedures disclosed immaterial instances of noncompliance with the requirements referred to above that we have communicated to the management of [*name of organization*] in a separate letter dated August 15, 19XX."
4. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-16

Report on Compliance With General Requirements When Material Noncompliance Is Identified

[*Addressee*]

[*The first three paragraphs are the same as those of the report on compliance with general requirements illustrated in exhibit D-15.*]

Material instances of noncompliance consist of failure to follow the general requirements that caused us to conclude that the misstatements resulting from those failures are material to [*indicate program(s) or financial statements*]. The results of our tests of compliance disclosed the material instances of noncompliance that are described in the accompanying Schedule of Findings and Questioned Costs.[1]

We considered these material instances of noncompliance in forming our opinion on whether [*name of organization*]'s 19XX financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated August 15, 19XX, on those financial statements.[2]

Except as described above, the results of our procedures to determine compliance indicate that, with respect to the items tested, [*name of organization*] complied, in all material respects, with the requirements listed in the second paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those requirements. However, the results of our procedures also disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Findings and Questioned Costs.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is also a matter of public record and its distribution is not limited.[3]

[*Signature*]
[*Date*]

Notes:

1. If, individually or collectively, the instances of noncompliance are also material to the basic financial statements, the report on compliance required by *Government Auditing Standards* (exhibit D-4) is modified as follows:

    [*First three paragraphs are the same as in the report illustrated in exhibit D-4.*]

    Material instances of noncompliance are failure to follow requirements, or violations of prohibitions, contained in laws, regulations, contracts, or grants, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements. The results of our tests of compliance disclosed the following material instances of noncompliance, the effects of which have been corrected in the 19X2 financial statements of [*name of organization*].

[*Include paragraphs describing the material instances of noncompliance noted.*]

We considered these material instances of noncompliance in forming our opinion on whether the 19X1 financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated August 15, 19XX, on those financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, [*name of organization*] complied, in all material respects, with the provisions referred to in the third paragraph of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those provisions.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[3]

[*Signature*]

[*Date*]

2. The following is an illustration of the auditor's report when the auditor determines noncompliance is pervasive and the auditor is not able to provide negative assurance on general requirements.

[*First three paragraphs and last paragraph are the same as in the report illustrated above.*]

With respect to the items tested, [*name of organization*] complied with the requirements listed in the second paragraph, except as described in the attached schedule. However, the extent of noncompliance noted in our testing indicates that, with respect to items that were not tested by us, there is more than a relatively low risk that [*name of organization*] may not have complied with the requirements referred to in the second paragraph. These matters were considered by us in evaluating whether the financial statements are presented fairly in conformity with generally accepted accounting principles.

3. If the report is not part of public record, this sentence should not be included in the report.

Exhibit D-17

Report on Compliance With General Requirements When a Scope Limitation Exists

[*Addressee*]

[*The first two paragraphs are the same as those of the standard report on compliance with general requirements illustrated in exhibit D-15.*]

Except as described in the following paragraph, our procedures were limited to the applicable procedures described in the Office of Management and Budget's *Compliance Supplement for Audits of Institutions of Higher Learning and Other Non-Profit Institutions* [*or describe alternative procedures performed*]. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [*name of organization*]'s compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

We were unable to obtain sufficient documentation of [*name of organization*]'s compliance with [*identify the requirement*] of [*name*] program, nor were we able to satisfy ourselves by alternative procedures as to [*name of organization*]'s compliance with those requirements of [*name*] program.

With respect to the items tested, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding [*name of organization*]'s compliance with the [*identify the requirement*] of [*name*] program, [*name of organization*] complied, in all material respects, with the requirements listed in the first paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those requirements. The results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Findings and Questioned Costs.

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is also a matter of public record and its distribution is not limited.[1]

[*Signature*]
[*Date*]

Note:

1. If the report is not part of the public record, this sentence should not be included in the report.

Exhibit D-18

Report on Compliance With Specific Requirements Applicable to Nonmajor Program Transactions

[*Addressee*]

We have audited the financial statements of [*name of organization*] as of and for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX.[1]

In connection with our audit of the financial statements of [*name of organization*] and with our consideration of [*name of organization*]'s internal control structure used to administer federal programs, as required by Office of Management and Budget (OMB) Circular A-133, *Audits of Institutions of Higher Education and Other Nonprofit Institutions,* we selected certain transactions applicable to certain nonmajor federal programs for the year ended June 30, 19XX. As required by OMB Circular A-133, we performed auditing procedures to test compliance with the requirements governing [*list requirements tested*][2] that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [*name of organization*]'s compliance with these requirements. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of our procedures disclosed no material instances of noncompliance with the requirements listed in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that [*name of organization*] had not complied, in all material respects, with those requirements.[3] However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying schedule of findings and questioned costs.[4]

This report is intended for the information of the audit committee, management, and [*specify legislative or regulatory body*]. However, this report is a matter of public record and its distribution is not limited.[5]

[*Signature*]
[*Date*]

Notes:

1. Describe any departure from the standard report.
2. See note 2 to exhibit D-9.
3. The following is an illustration of the auditor's report when the auditor determines noncompliance for nonmajor program transactions is pervasive and the auditor is not able to provide assurance.

   [*First two paragraphs and last paragraph are the same as in the report illustrated above.*]

   The results of our tests indicate that, with respect to the items tested, [*name of organization*] complied with those requirements, except as described in the attached schedule. However, the extent of noncompliance noted in our testing indicates that, with respect to nonmajor program transactions not tested by us, there is more than a relatively low risk that [*name of organiza-*

tion] may not have complied with the requirements referred to in the preceding paragraph. These matters were considered by us in evaluating whether the financial statements are presented fairly in conformity with generally accepted accounting principles.

4. If there are no instances of noncompliance, this sentence should be omitted. Immaterial instances of noncompliance may be reported to the organization in a separate letter or in the report. If the auditor has issued a separate letter describing immaterial instances of noncompliance, the last sentence of this paragraph should be replaced with a sentence similar to the following: "However, we noted certain immaterial instances of noncompliance that we have communicated to the management of [*name of organization*] in a separate letter dated August 15, 19XX."
5. If the report is not part of the public record, this sentence should not be included in the report.

APPENDIX E

Sample Not-for-Profit Organization Schedule of Federal Awards

Community Action Agency
Schedule of Federal Awards
For the Year Ended June 30, 19XX

Federal Grantor/Pass-through Grantor/Program Title	*Federal CFDA Number*	*Agency or Pass-through Number*	*Federal Expenditures*
U.S. Dept. of Health and Human Services			
Headstart (Note B)	93.600	05CH5560/07	$ 237,861
	93.600	05CH5560/08	200,000
Subtotal			437,861*
Pass-through From State Dept. of Human Services			
Community Services Block Grant	93.792	K1578	536,987*
Weatherization (Note A)	93.818	K4599	
Subtotal—U.S. Dept. of Health and Human Services			974,848
Other Federal Awards			
ACTION:			
Pass-through State Department on Aging			
Foster Grandparents	72.001	33924	80,987
Total			$1,055,835

* Denotes a major program

Note A: This item is intended to show that a program can be open without monies being received or expended during the audit period. Such programs should be included in the schedule.

Note B: Although not required, this breakout by grant will facilitate review and make the report more meaningful to users.

Sample University Schedule of Federal Awards* †

Browning Version University
Schedule of Federal Awards
For the Year Ended June 30, 19XX

Federal Grantor/Pass-through Grantor/Program Title	*Federal CFDA Number‡*	*Agency or Pass-through Number*	*Federal Expenditures*
MAJOR PROGRAMS			
Research and Development:			
U.S. Dept. of Health and Human Services:			
Human Genome Research	93.172		$ 400,528
General Clinical Research	93.333		863,561
Biomedical Research Support	93.337		450,218
Other National Institutes of Health	—		780,745
Health Resources and Services Administration	—		477,203
Subtotal			2,972,255
U.S. National Foundation on the Arts and Humanities, National Endowment for the Humanities	—		56,186
U.S. Agency for International Development	—		80,037
Total Research and Development			3,108,478
Student Financial Assistance			
U.S. Dept. of Health and Human Services			
Nursing Student Loan (Note A)	93.364		1,000

* Cost sharing, matching, and grant-related revenue could also be added as a separate column to this schedule.

† The Bureau of Census, Single Audit Clearinghouse, plans to use the Schedule to compile federal assistance by the CFDA number.

‡ CFDA numbers may not be available for all programs (for example, National Endowment for the Humanities and U.S. Agency for National Development).

(Continued)

Federal Grantor/Pass-through Grantor/Program Title	*Federal CFDA Number*	*Agency or Pass-through Number*	*Federal Expenditures*
U.S. Dept. of Education			
Guaranteed Student Loans (Note B)	84.032		0
Pell Grants	84.063		3,006,655
Total Student Financial Assistance			3,007,655
OTHER MAJOR PROGRAMS			
U.S. Dept. of Agriculture:			
Cooperative Extension Service	10.500		3,835,136
Total Major Programs			9,951,269
NONMAJOR PROGRAMS			
Other Federal Assistance			
U.S. National Foundation on the Arts and Humanities			
Institute of Museum Services	—		10,500
National Endowment for the Arts			
Irish Harp Festival	—		5,100
Art Festival	—		11,900
Subtotal			27,500
Pass-through State Dept. of Health			
U.S. Dept. of Agriculture Commodities (Note C)	10.550	587G3	968
Total Other Federal Assistance			28,468
Total Federal Assistance			$9,979,737

Note A: The university administers the following federal loan program:

	CFDA Number	*Outstanding Balance at June 30, 1992*
Nursing Student Loan Program	93.364	$218,629

Total loan expenditures and disbursements of the Department of Health and Human Services student financial assistance program for the fiscal year are identified below:

	CFDA Number	*Disbursements*
Nursing Student Loan Program	93.364	$118,629

The above expenditures for the Nursing Student Loan Program include disbursements and expenditures such as loans to students and administrative expenditures. The Schedule only includes administrative costs of the loan program.

Note B: During the fiscal year ending June 30, 1992, the University processed the following amount of new loans under the Guaranteed Student Loan Program (which includes Stafford Loans, Parents' Loans for Undergraduate Students, and Supplemental Loans for Students):

	CFDA Number	*Amount Authorized*
Guaranteed Student Loans	84.032	$40,036,285

Note C: Nonmonetary assistance is reported in the Schedule based on the amount disbursed or received. As of June 30, 1992, the University had the following nonmonetary inventory:

Food Commodities	$20,000

APPENDIX F

Sample Schedules of Findings and Questioned Costs

Example I:

Guaranteed Student Loan (GSL) Program

—CFDA #84.032

(Questioned Cost—$10,000)

Loans	*Population*[A]		*Sample*[A]		*Non-Compliance*[A]	
Authorized	*Size*	*Value*	*Size*	*Value*	*Size*	*Value*
Stafford	821	$2,328,565	25	$69,600	2	$5,500
SLS	388	$ 970,653	25	$65,000	1	$2,500
PLUS	399	$ 985,306	25	$77,500	1	$2,000

Condition

Four students' files failed to contain a copy of the financial aid transcript from the institution that the student previously attended.

Criteria

Until an institution receives a financial aid transcript from each eligible institution the student previously attended, the institution shall not release GSL or SLS proceeds to a student. [34 CFR 668.19(3)]

Effect

The institution disbursed GSL funds to the students in the amount of $10,000, in violation of the provisions of the GSL program.

Cause

Shortly after the students transferred into the institution, there was a change in personnel in the Student Financial Aid Office, which resulted in this required action to obtain the financial aid transcript to be overlooked.

Recommendation

The University should contact the institution from which the students transferred to obtain the required financial aid transcripts. If the University fails to obtain the required transcripts, or if the transcripts show that any of the students exceeded annual or aggregate aid limits, the University should return all unallowable loan proceeds to the appropriate lender.

University's Comments

We have made contact with the other institutions from which the four students transferred, and have made arrangements for receiving the required financial aid transcripts.

Note A: Presentation of population, sample size, and noncompliance is optional for immaterial findings.

Example II:

Agency for International Development (AID)

(Note: AID has not been assigned a CFDA number)

Interest on Federal Advances and Timely Disbursement of Cash

During 19XX, AID revised its directive on cash management to require that all federal advances be deposited in interest-bearing accounts and that the interest be remitted to the sponsor. The organization maintains interest-bearing domestic accounts and non-interest-bearing foreign accounts. We noted the remittance to the sponsors of interest earned by the organization on domestic cash accounts. As shown in the table below, the organization manages the advances so that additional interest will not be significant, even if all funds are invested in interest-bearing accounts. Overseas, the organization does not always use interest-bearing accounts, because it is not practical in all countries.

In our testing for the timely disbursement of cash drawn on the Federal Reserve Letter of Credit, we noted compliance with reasonable guidelines (within three days for domestic accounts and within thirty days for foreign accounts), as follows:

	Domestic Accounts		*Foreign Accounts*	
	19X1	*19X0*	*19X1*	*19X0*
Drawdowns selected for testing	$675,667	$1,858,588	$2,922,966	$645,758
Drawdowns not fully expended within time guidelines	18%	21%	5%	3%

To be in full compliance with AID directives, the organization should place all funds held overseas in interest-bearing accounts.

Management Response

We believe that the corrective action taken regarding the timely disbursement of cash is sufficient to achieve substantial compliance with AID directives. The monitoring of this control function will be given greater emphasis to increase compliance.

At this time, three of the thirteen field offices maintain interest-bearing accounts. All other field locations have indicated that interest-bearing accounts carry restrictions that would impede their ability to meet operational requirements (that is, restrictions on the receipt of infusions of external funds, the number of withdrawals per month, and the availability of commercial interest-bearing accounts). We will continue our investigation concerning interest-bearing accounts with these offices to determine the appropriate action.

Example III:

Headstart—CFDA 93.600

(Questioned Cost—$16,400)

Finding

The grant financial award stated that the award was for the specific purposes contained in the approved budget. The approved budget specified $15,000 for a van and $1,400 for an audiometer. Neither piece of equipment was purchased as evidenced by the inventory. The funds budgeted for equipment acquisition were used to pay for increased field trips approved by the Department without modification to the budget. This occurred because management did not have adequate procedures in place to monitor proposed expenditures against the budget. The grantee should return the $16,400 expended.

Grantee Comment

The institution concurs with this comment. The $16,400 will be returned to the granting agency and procedures will be established to prevent a recurrence of this situation.

Note: *Follow Up On Prior-Year Findings.* We have reviewed the findings reported in the audit of Browning Version University for the year ended June 30, 19XX. Prior-year findings that have not been corrected are restated in the report and identified as both a current and a prior-year finding. All other findings from prior years have been corrected.

APPENDIX G

Illustrative Audit Engagement Letter

[*Addressee*]

This letter sets forth our understanding of the terms and objectives of our engagement, the nature and scope of the services we will provide, and the related fee arrangements.

We will audit the organization's financial statements as of and for the year ended [*date*], in accordance with generally accepted auditing standards, the standards for financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and with the provisions of Office of Management and Budget Circular A-133, dated March 16, 1990. The objective of an audit carried out in accordance with such standards and regulations is (1) the expression of our opinion concerning whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the organization in conformity with generally accepted accounting principles; (2) a report on our determination that the internal control structure provides reasonable assurance of compliance with federal and other laws and regulations; and (3) the expression of an opinion on whether the organization complied with specific terms and conditions of its major federal award programs.

As part of our audit, we will consider the organization's internal control structure and assess control risk, as required by generally accepted auditing standards, for the purpose of establishing a basis for determining the nature, timing, and extent of auditing procedures necessary for expressing our opinion concerning the financial statements, and not to provide assurance on the internal control structure. The management of [*name of organization*] is responsible for establishing and maintaining an internal control structure. To fulfill this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs for internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We will prepare a separate written report on our understanding of the organization's internal control structure and the assessment of control risk made as part of the financial statement audit. Our report will include (1) the scope of our work in obtaining an understanding of the internal control structure and in assessing the control risk; (2) the organization's significant internal controls or control structure, including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements; and (3) the reportable conditions, including the identification of material weaknesses identified as a result of our work in understanding and assessing the control risk. As required by OMB Circular A-133, we will also prepare a written report on our understanding, assessment, and testing of the internal control structure as it relates to major federal award programs.

Our audit will include procedures designed to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements. As you are aware, however, there are inherent limitations in the auditing process. For example, audits are based on the concept of selective testing of the data being examined and are, therefore, subject to the limitation that such matters, if they exist, may not be detected. Also, because of the characteristics of irregularities, including attempts at concealment through collusion and forgery, a properly designed and executed audit may not detect a material irregularity.

Similarly, in performing our audit, we will be aware of the possibility that illegal acts may have occurred. However, it should be recognized that our audit provides no assurance that illegal acts generally will be detected, and only reasonable assurance that illegal acts having a direct and material effect on the determination of financial statements amounts will be detected.

Compliance with laws, regulations, contracts, and grants applicable to [*name of organization*] is the responsibility of [*name of organization*]'s management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of [*name of organization*]'s compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective is not to provide an opinion on overall compliance with such provisions.

As required by *Government Auditing Standards,* we will prepare a separate written report on our tests of compliance with applicable laws and regulations. This report will contain a statement of positive assurance on those items that were tested for compliance, negative assurance on those items not tested, and a description of all material instances of noncompliance.

Likewise, compliance with provisions of laws, regulations, contracts, and grants that govern federal programs is the responsibility of management. As required by OMB Circular A-133, we will determine and report on whether the organization complied in all material respects with the laws and regulations that apply to its major federal award programs. With regard to transactions selected from nonmajor programs, our report on compliance will obtain a statement of positive and negative assurance, as discussed above.

At the conclusion of the engagement, [*name of organization*]'s management will provide to us a representation letter that, among other things,[1] will confirm management's responsibility for the preparation of the financial statements in conformity with generally accepted accounting principles, the availability of financial records and related data, compliance with provisions of laws, regulations, contracts, and grants that govern federal programs, the completeness and availability of all minutes of board of directors (and committee) meetings, and the absence of irregularities involving management or those employees who have significant roles in the control structure.

We understand that our reports on the internal control structure as part of the financial audit and on compliance with laws and regulations are intended for the information of the audit committee, management, and other within [*name of organization*] and [*specify legislative or regulatory body*].

Our fees for the audit will be [*describe fee arrangement*]. We anticipate completing the engagement by [*describe timetable*], unless unexpected factors are encountered. This timetable has been discussed with and agreed to by your [*internal audit and*] accounting department[s], which will provide assistance to us in the audit. Should circumstances prevent [*name of organization*] from providing this assistance, our timetable and fee are likely to be affected. [*On fixed-fee engagements, the auditor may include wording indicating that he or she may have to revise the fee estimate and timetable for unexpected factors of which he or she becomes aware after the engagement has begun.*]

We shall be pleased to discuss this letter with you.

[*Signature*]
[*Date*]

Note:

1. Other matters may be included. This sample letter should be modified as necessary.

Glossary

AICPA. American Institute of Certified Public Accountants.

AID. Agency for International Development.

Award. Defined in OMB Circular A-133 as federal financial assistance (see below) and federal cost-type contracts used to buy services or goods for the use of the federal government. It includes both awards received directly or indirectly through recipients (pass-through funds). It does not include procurement contracts to vendors under grants or subcontracts used to buy goods or services.

CFDA. Catalog of Federal Domestic Assistance.

CFR. Codified Federal Regulation.

Cognizant agency. A federal agency designated by the OMB to provide general oversight of an organization that receives federal funds. Cognizant agencies have certain specified responsibilities, including the coordination of audits of the organization; see the section entitled "Responsibilities of the Cognizant Agency" in chapter 3 of this SOP.

Compliance Supplements. Published by the OMB as a supplement to OMB Circular A-128, *Compliance Supplement for Single Audits of State and Local Governments* (revised in April 1990). It specifies the general and specific program compliance requirements and suggested audit procedures for sixty-two federal financial assistance programs. The OMB published a supplement to OMB Circular A-133, *Compliance Supplement for Audits of Institutions of Higher Learning and Other Nonprofit Institutions.*

Coordinated audit approach. An audit wherein the independent auditor, and other federal and nonfederal auditors, consider each other's work in determining the nature, timing, and extent of his or her own auditing procedures. A coordinated audit must be conducted in accordance with *Government Auditing Standards* and meet the objectives and reporting requirements set forth in paragraphs 12(b) and 15, respectively, of the Attachment to Circular A-133. The objective of the coordinated audit approach is to minimize duplication of audit effort, but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives set forth in paragraph 12(b) or issuing the reports required in paragraph 15 in a timely manner. (Also referred to as a joint audit, although this term more commonly refers to audits carried out by two or more independent CPA firms.)

CPE. Continuing Professional Education.

Cyclical approach. Method by which the auditor obtains an understanding of internal control structure policies and procedures applicable to nonmajor programs over a number of years when multiple operating components of an NPO administer a large number of nonmajor programs. Each nonmajor program for which the cyclical approach is used should be covered at least once every three years. In the first year of the review cycle, the auditor should obtain an understanding of the internal control structure policies and procedures for any program of which he or she has not obtained an understanding. Also, the auditor should obtain an understanding of policies and procedures for new nonmajor programs the first year that the program is active. If a cyclical approach is used, the auditor's report on the internal control structure should be modified to clearly describe the coverage provided for nonmajor programs.

FAR. Federal Acquisition Regulations.

Federal financial assistance. Assistance provided to an organization by a federal agency in such forms as grants of cash and other assets, loans, loan guarantees, and interest-rate subsidies. The term includes pass-through assistance but does not include direct federal cash assistance to individuals.

Findings. *Government Auditing Standards* defines findings as the result of information development—a logical pulling together of information about an organization, program, activity, function, condition, or other matter that was analyzed or evaluated. It also states that factual data supporting all findings should be presented accurately and fairly in the auditor's report and that these findings should be adequately supported by sufficient evidence in the working papers.

FSR. Financial status report.

GAAP. Generally accepted accounting principles.

GAAS. Generally accepted auditing standards.

GAO. The United States General Accounting Office. Its main purposes are to (1) assist Congress in carrying out legislative and oversight responsibilities; (2) carry out legal, accounting, auditing, and claims-settlement functions with respect to federal government programs; and (3) make recommendations to provide for more efficient and effective government operations.

GAS. *Government Auditing Standards.*

General requirements. Described in the Compliance Supplements as "those requirements that involve significant national policy and of which failure to comply could have a material impact on an organization's financial statements." Accordingly, tests for compliance with these requirements "should be included as a part of every audit of state, local, and tribal governments that involves federal financial assistance."

HHS. U.S. Department of Health and Human Services.

Joint audit. An audit for which the recipient of federal funds, the cognizant (or largest funding) agency, and the auditors have agreed on their respective audit scope. (Also referred to as a coordinated audit.)

Major program. A program in which total expenditures are the larger of 3 percent of total federal funds expended or $100,000. Each of the following categories of federal award constitutes a major program if over the threshold:

1. Research and development
2. Student financial assistance
3. Individual awards not in the student aid or research-and-development category

Nonmajor program. Defined by the Single Audit Act as any federal award program that does not meet the specified criteria of a major program.

NPO. Non-profit (or Not-for-profit) organization.

OASC. Office of Assistant Secretary, Comptroller.

OMB. The United States Office of Management and Budget.

OMB Circular A-21, *Cost Principles for Educational Institutions.* Issued to provide that federal assistance programs provided to educational institutions bear their fair share of costs by defining costs that are allowable and unallowable for that assistance.

OMB Circular A-110, ***Uniform Requirements for Grants to Universities, Hospitals and Other Nonprofit Organizations.*** Issued to establish standards (such as insurance requirements, record retention requirements, banking requirements, and so on) for maintaining consistency and uniformity among federal agencies in the administration of grants to and agreements with public and private institutions of higher education, public and private hospitals, and other quasi-public and private nonprofit organizations. It does not apply to grants, contracts, and other agreements between the federal government and units of state and local governments.

OMB Circular A-122, ***Cost Principles for Nonprofit Organizations.*** Issued to provide that federal assistance programs provided to nonprofit organizations bear their fair share of costs by defining costs that are allowable and unallowable for that assistance. This circular does not apply to—

1. Colleges and universities.
2. State, local, and Indian tribal governments.
3. Hospitals.

OMB Circular A-128, ***Audits of State and Local Governments.*** Issued to facilitate the implementation of the Single Audit Act of 1984. It establishes audit requirements and defines federal responsibilities for implementing and monitoring these requirements.

OMB Circular A-133, ***Audits of Institutions of Higher Education and Other Nonprofit Institutions.*** Establishes audit requirements and defined federal responsibilities for implementing and monitoring federal requirements.

Organization-wide audit. Under Circular A-133, it has two main components—an audit of the financial statements and an audit of federal awards. Each component results in a variety of audit reports. The single-audit concept is described in Circular A-133 as an organization-wide audit.

Oversight agency. The federal agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency. For those entities that do not receive any direct funding, the federal agency with predominant indirect funding will assume the responsibilities of the oversight agency. The oversight agency may assume some or all of the responsibilities normally performed by a cognizant agency.

Pass-through funds. Funds received by subrecipients indirectly from the federal government through a primary recipient.

PCIE. President's Council on Integrity and Efficiency.

Provider. A person or entity that undertakes to provide health care services.

Questioned costs. Defined in the Inspector General Act Amendments of 1988 as (1) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds; (2) a finding that, at the time of the audit, such cost is not supported by adequate documentation; or (3) a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable.

R&D. Research and development.

SAS. Statement on auditing standards.

SFA. Student financial aid.

Single Audit Act of 1984. The United States statute (Public Law 98-502) that establishes uniform requirements for audits of federal financial assistance provided to state and local governments. These requirements focus on a single coordinated audit of the aggregate federal financial assistance programs. The requirements include—

1. An audit of the general-purpose financial statements.
2. Additional tests for compliance with applicable laws and regulations related to federal assistance programs received.
3. Reviews of the internal control system for federal financial assistance received.

SOP. Statement of position.

Specific requirements. Defined in the Compliance Supplement as those requirements that pertain to the following categories:

1. Types of services allowed or not allowed
2. Eligibility
3. Matching, level of effort, or earmarking
4. Reporting
5. Special tests and provisions

Subrecipient. An entity receiving government financial assistance when the assistance is initially received by another entity that distributes the assistance for the government program that created and provided the assistance.

Appendix D

Schedule of Changes *to Audits of Certain Nonprofit Organizations*

Reference	Change	Date
General	The term "examination" has been changed to "audit" to conform to the terminology used in SAS No. 58.	October, 1990
Preface	Revised to reflect the issuance of FASB Statement Nos. 116 and 117.	May, 1994
Paragraph 1.04	Reference to SOP 92-9 added.	May, 1994
Paragraph 1.05	Reference to SAS No. 69 added.	April, 1992
Paragraph 1.06	Updated to reflect the issuance of FASB Statement No. 111.	April, 1993
Paragraph 1.07	Added to reflect the issuance of FASB Statement Nos. 116 and 117; Subsequent paragraphs renumbered.	May, 1994
Renumbered paragraph 1.08	Reference to SAS No. 14 changed to SAS No. 62.	October, 1990
Renumbered paragraph 1.09	Reference to SAS No. 47 added.	April, 1992
Renumbered paragraph 1.10	Reference to FASB Statement No. 117 added.	May, 1994
Renumbered paragraph 1.10 (footnote 1)	Note reference to FASB Statement No. 95 added.	October, 1990
Renumbered paragraph 1.12	Conformed to SAS No. 55.	October, 1990
Renumbered paragraph 1.13	The second standard of fieldwork conformed to the current *Codification of Statements on Auditing Standards.*	October, 1990
Renumbered paragraph 1.13	Title conformed to terminology used in SAS No. 55.	February, 1992
Renumbered paragraph 1.14	Reference to SAS No. 1, section 320 changed to SAS No. 55; Reference to SAS No. 3 changed to SAS No. 48; Reference to SAS No. 20 changed to SAS No. 60.	October, 1990
Paragraph 2.01	Reference to FASB Statement No. 117 added.	May, 1994

Reference	Change	Date
Paragraphs 2.03, 2.05, 2.06, 2.08, and 3.05	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 3.06	Terminology conformed to SAS No. 56; Reference to SAS No. 24 changed to SAS No. 56.	October, 1990
Paragraph 3.07	Conformed to the terminology used in SAS No. 55.	April, 1992
Paragraphs 3.09, 3.11, and 3.16	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraphs 4.01, 4.03, and 4.04	References to FASB Statement No. 116 added.	May, 1994
Paragraphs 4.09, 4.10, 4.12, and 4.13	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 4.14	Conformed to the terminology used in SAS No. 56.	April, 1992
Paragraph 4.17	Reference to FASB Statement No. 116 added.	May, 1994
Paragraph 4.19	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 4.21	Reference to FASB Statement No. 116 added.	May, 1994
Paragraph 4.23	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 4.24	Note reference to supersession of SAS No. 11 added.	May, 1994
Paragraph 4.28	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 5.01	Conformed to the terminology used in SAS No. 55.	April, 1992
Paragraph 5.07	Reference to SAS No. 1, section 331 changed to SAS No. 67.	April, 1992

Reference	Change	Date
Paragraph 5.09	Note reference to supersession of SAS No. 11 added.	May, 1994
Paragraph 5.10	Reference to FASB Statement No. 116 added.	May, 1994
Paragraphs 6.01 and 6.07	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 6.08	Reference to SAS No. 17 changed to SAS No. 54.	October, 1990
Paragraph 6.10	Reference to FASB Statement No. 116 added.	May, 1994
Paragraph 6.12	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 6.14	Reference to FASB Statement No. 117 added.	May, 1994
Paragraphs 6.16	The term "internal accounting control" has been changed to "internal control structure policies and procedures" to conform to the terminology used in SAS No. 55.	October, 1990
Paragraph 7.01	Reference to proposed SOP added.	May, 1994
Paragraph 7.02	Reference to SAS No. 6 changed to SAS No. 45.	October, 1990
Paragraph 7.03	Reference to SAS No. 17 changed to SAS No. 54.	October, 1990
Paragraph 7.04	Reference to SAS No. 16 changed to SAS No. 53.	October, 1990
Paragraph 7.06	Conformed to the terminology used in SAS No. 65.	April, 1992
Paragraphs 7.07 and 7.08	Conformed to the terminology used in SAS No. 61.	April, 1992
Paragraph 7.09	Reference to SAS No. 2 changed to SAS No. 58.	October, 1990
Paragraph 8.02	Illustrative auditor's report conformed to SAS No. 58.	October, 1990
Paragraph 8.02 (footnote 4)	Note reference to FASB Statement No. 95 added.	October, 1990
Paragraph 8.02 (footnote 4)	Note reference to FASB Statement No. 117 added.	May, 1994
Paragraphs 8.03 and 8.04	Reference to SAS No. 15 changed to SAS No. 58; Illustrative auditor's report conformed to SAS No. 58.	October, 1990
Paragraph 8.05	Reference to SAS No. 58 added.	October, 1990

Reference	Change	Date
Paragraphs 8.06, 8.07 and 8.09	Illustrative auditor's report conformed to SAS No. 58.	October, 1990
Paragraph 8.10	Reference to SAS No. 1, section 546, changed to SAS No. 58; Text and illustrative auditor's report conformed to SAS No. 58.	October, 1990
Paragraphs 8.11 and 8.12	Added to explain change to paragraph 8.10.	October, 1990
Paragraph 8.13	Conformed to SAS No. 59.	October, 1990
Paragraph 8.14	Conformed to SAS No. 59; Reference to SAS No. 2 changed to SAS No. 58.	October, 1990
Paragraph 8.15	Reference to SAS No. 14 changed to SAS No. 62.	October, 1990
Paragraphs 8.16, 8.18, and 8.19	Illustrative auditor's reports conformed to SAS No. 62.	October, 1990
Paragraph 8.20	Reference to SAS No. 14 changed to SAS No. 62.	October, 1990
Paragraph 8.23	Reference to Auditing Interpretation of SAS No. 14 changed to SAS No. 62; Text from paragraph 24 of SAS No. 62 added.	October, 1990
Paragraphs 8.24 and 8.25	Illustrative auditor's reports conformed to SAS No. 62.	October, 1990
Appendix A	Introductory note revised to reflect the issuance of FASB Statement Nos. 116 and 117.	May, 1994
Appendix A	Notice to Readers revised to reflect SAS No. 69.	April, 1992
Appendix A (Paragraphs 2a and 2b)	Added to reflect the issuance of FASB Statement Nos. 116 and 117.	May, 1994
Appendix A (Paragraphs 15, 16, and 19)	References to FASB Statement No. 117 added.	May, 1994
Appendix A (Paragraphs 21 and 22)	References to FASB Statement No. 116 added.	May, 1994
Appendix A (Paragraphs 25, 30, 32, and 37)	References to FASB Statement No. 117 added.	May, 1994
Appendix A (Heading to paragraph 42)	Reference to proposed SOP added.	May, 1994
Appendix A (Paragraphs 52 and 54)	References to FASB Statement No. 116 added.	May, 1994

Reference	Change	Date
Appendix A (footnote 5)	Reference to hospital audit guide changed to audit and accounting guide for providers of health care services.	February, 1992
Appendix A (Paragraphs 59, 62, 64, 65, 67, 71, and 73)	References to FASB Statement No. 116 added.	May, 1994
Appendix A (Paragraphs 76, 85, and 93)	References to FASB Statement No. 117 added.	May, 1994
Appendix A (Paragraph 97)	Notation of amendment by SOP 87-2, paragraphs 15 through 22 added.	October, 1990
Appendix A (Paragraph 97)	Reference to proposed SOP added.	May, 1994
Appendix A (Paragraph 108)	Amended to conform to FASB Statement No. 93, as amended.	October, 1990
Appendix A (Heading of paragraph 116 and paragraph 121)	References to FASB Statement No. 116 added.	May, 1994
Appendix A (Introduction to Appendix C)	Revised to reflect the issuance of FASB Statement Nos. 116 and 117.	May, 1994
Appendix A (Appendix C)	Revised to conform to FASB Statement Nos. 47, 87, and 106 and SOP 87-2.	January, 1993
Appendix C	SOP 92-9 added.	February, 1993
Appendix C (Paragraph 2.51)	Note reference to supersession of SAS No. 11 added.	May, 1994
Appendix C (footnote 16 of paragraph 2.51)	Note reference to supersession of SAS No. 11 added.	May, 1994

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