

THE PPC GOVERNMENTAL UPDATE

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OMB Publishes Technical Update for 2021 Compliance Supplement



On April 8, 2022, the Office of Management and Budget (OMB) published a technical update for two federal award programs that were included in the 2021 Compliance Supplement (issued in August 2021) and Addendum 1 (issued in December 2021). The two programs affected are the Department of Health and Human Services (HHS) Assistance Listing 93.498 Provider Relief Fund and Treasury Assistance Listing 21.027 Coronavirus State and Local Fiscal Recovery Funds (SLFRF).

What's Changed?

The technical update makes changes as follows:

- **HHS Assistance Listing 93.498 Provider Relief Fund:** Updated to remove *Part 4—Section III(N)(1) Special Test and Provisions: Out-of-Network Patient Out-of-Pocket Expenses*. HHS has determined that the review requirements are no longer meaningful and applicable to the oversight of this program.

- **Treasury Assistance Listing 21.027 Coronavirus State and Local Fiscal Recovery Funds:** Updated to provide in *Part 4, Section IV—Other Information* an alternative audit approach for eligible SLFRF recipients that would otherwise not be required to undergo an audit under 2 CFR part 200, subpart F, if it were not for the expenditures of SLFRF funds directly awarded by Treasury. This alternative is intended to reduce the burden of a full single audit or program-specific audit on eligible recipients (estimated at more than 10,000 entities) and practitioners, as well as uphold Treasury's responsibility to be good stewards of federal funds.
- **Supplement Part 8 Appendix VII:** Adds the alternative compliance examination engagement in accordance with the Government Accountability Office's *Government Auditing Standards* for eligible recipients of the SLFRF.

Effective Dates

This technical update to the Compliance Supplement was effective April 8, 2022, and applies to fiscal year audits beginning after June 30, 2020.

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Comments Due

All comments to the 2021 Technical Update must be in writing and received by May 9, 2022. Late comments will be considered to the extent practicable.

Practical Consideration:

The Technical Update for the 2021 Compliance Supplement can be accessed at www.federal-register.gov/public-inspection/2022-07463/uniform-administrative-requirements-cost-principles-and-audit-requirements.



Component Audit Scope and Materiality in Governmental Group Audits

Group audits have specific auditing requirements under generally accepted auditing standards (GAAS). AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, is the standard that applies. (See the February 2022 article, *Is Your Governmental Audit a “Group Audit”?*)

Group financial statements include financial information of more than one component. They may include combined financial statements and other aggregated remaining fund information, including joint ventures, equity method investments, decentralized departments or divisions, and other combinations of entities or activities with outsourced operations or service concession arrangements.

Planning and performing an audit of group financial statements generally involves the same steps, procedures, and decisions as other GAAS audits, but there are special considerations that apply specifically to a group audit.

Determining Group Auditor Involvement

Group auditors are required to obtain sufficient appropriate audit evidence as the basis for the group audit opinion. This evidence includes work performed

on the combining process and procedures performed by the group engagement team and the component auditors on the financial information of the components. The group auditor will determine the type of work to be performed by the group engagement team or by component auditors on the financial information of the components and the nature, timing, and extent of involvement in the work of component auditors.

The group engagement team establishes the overall audit strategy and audit plan for the group and assesses the extent to which component auditors are used. Individually for each component, the group engagement team may either—

- assume responsibility for the work of a component auditor or
- not assume responsibility for the work of a component auditor by making reference to the component auditor in the group audit report.

Identifying Components

When identifying potential components, auditors consider how the group is structured, along with the nature of the financial information and how it’s accumulated and reported. If the operations, management, and financial reporting of a business activity are separate from the group’s, it’s likely to be a component. This is a matter of professional judgment.

Significant Components

Once components are identified, the components that are of individual financial significance to the group should be identified. The determination of whether a component is significant to the group financial statements is important because greater audit effort needs to be directed to significant components. The professional standards provide limited guidance on how to determine a component’s financial significance, so this is another area where auditors will need to apply judgment. Consideration should be given to the most appropriate method or benchmark for the type of entity and specific facts and circumstances.

Components may also be significant based on risks of material misstatement to the group financial statements rather than being financially significant. Components with complex transactions from an operational or accounting perspective often may be identified as significant based on risks. Another consideration may be whether the component has significantly higher or lower revenue than expected. For a component that is significant because of its individual financial significance to the group, an audit of the component’s financial information using component materiality should be performed.

For a component that is significant not because of its individual financial significance but because it is likely to include significant risks of material misstatement of the group financial statements, one or more of the following should be performed:

- An audit of the component's financial information using component materiality.
- An audit of one or more account balances, classes of transactions, or disclosures relating to the likely significant risks of material misstatement of the group financial statements.
- Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements.

For components that aren't significant, analytical procedures at the group level should be performed.

Additional Component Testing

If sufficient appropriate audit evidence on which to base the group audit opinion won't be obtained from (1) the work performed on significant components, (2) the work performed on group-wide controls and the consolidation process, and (3) the analytical procedures performed at the group level, additional components that aren't significant should be selected and the group auditor or a component auditor should perform one or more of the following:

- An audit of the component's financial information using component materiality.
- An audit of one or more account balances, classes of transactions, or disclosures.
- A review of the component's financial information using component materiality.
- Specified audit procedures.

The selection of such individual components should be varied over time.

Combining Process

The group engagement team should also design and perform audit procedures on the combining process, including:

- Performing additional audit procedures to respond to assessed risks of material misstatement of the group financial statements arising from the combining process.
- Evaluating whether all components have been included in the group financial statements.
- Evaluating the appropriateness, completeness, and accuracy of combining adjustments and reclassifications.
- Evaluating whether any fraud risk factors or indicators of possible management bias exist.

- Determining whether the financial information identified in the component auditor's communication is the information incorporated in the group financial statements.
- Determining whether appropriate adjustments have been made when the financial information of a component isn't prepared on the same accounting basis as the group financial statements or when the component has a year end that differs from the group's year end.

Component Materiality

The determination of component materiality is part of the planning process. Component materiality is determined by the group engagement team for the purposes of the group audit and only needs to be determined for component financial information subject to audit or review.

In a group audit, the engagement team must determine the following:

- Materiality (planning and performance) for the group financial statements as a whole.
- Materiality for particular classes of transactions, account balances, or disclosures in the group financial statements for which there is substantial likelihood that misstatements of lesser amounts than materiality for the group financial statements as a whole would influence a reasonable user's judgment.
- Materiality (planning and performance) for components that will be audited or reviewed by the group engagement team or a component auditor.
- The threshold for clearly trivial misstatements.

The group auditor should determine component materiality for planning purposes for those components on which the group engagement team will perform (or assume responsibility for the work of a component auditor who performs) an audit or review of component financial information. When a separate auditor's report will be issued on the financial statements of a component (regardless of whether reference will be made), it can ordinarily be expected that the materiality amount determined by the component auditor for purposes of the separate report will be acceptable for purposes of the group audit. When reference is to be made to the component auditor, the group auditor isn't required to establish materiality for the component auditor.

AU-C 600 explains that component materiality should be determined taking into account all components, regardless of whether reference is made to a component auditor. AU-C 600 also specifies that—

- Component materiality should be lower than the materiality for the group financial statements as a whole.

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- Component performance materiality should be lower than performance materiality for the group financial statements as a whole.
- Different component materiality amounts may be established for different components.
- The aggregate of component materiality may exceed group materiality.

AU-C 600 doesn't provide specific guidance about how to determine component materiality. However, it does say that component materiality, although it may, doesn't need to be determined based on the ratio of each component's benchmark (such as total assets or total revenue) to the group benchmark. In determining component materiality, consideration might be given to the following amounts:

- Group materiality.
- Adjusted group materiality.
- Separate component materiality.

Based on those amounts, and considering the auditor's reporting responsibilities; the number, size, and nature of components; and client expectations, the auditor applies judgment to determine an appropriate amount for component materiality. Group materiality would typically be considered the ceiling for component materiality, and separate component materiality would typically be considered the floor.

Practical Consideration:

ALG-CX-3.5 assists auditors in documenting and analyzing group audits.

OMB Issues the 2022 Compliance Supplement

"Yes, Virginia, there is a Santa Claus."

The federal award compliance community was stunned to find that the Office of Management and Budget (OMB) issued the 2022 OMB Compliance Supplement on May 11, 2022. It has been many, many years since we have seen a Compliance Supplement released in May. It seems that the extraordinarily late 2021 Compliance Supplement drew enough attention to bring about focus and change at the federal level—at least, for 2022. We will see if such focus and change is strong enough to bleed over to years 2023 and after!

The 2022 Compliance Supplement is effective for audits of fiscal years beginning after June 30, 2021, and supersedes the 2021 Compliance Supplement, including its December 2021 and January 2022 addenda and April 2022 technical correction. It can be found at www.whitehouse.gov/wp-content/uploads/2022/05/2022-Compliance-Supplement_PDF_Rev_05.11.22.pdf.

The next edition of *PPC's Governmental Update* will explore the 2022 Compliance Supplement in more detail.