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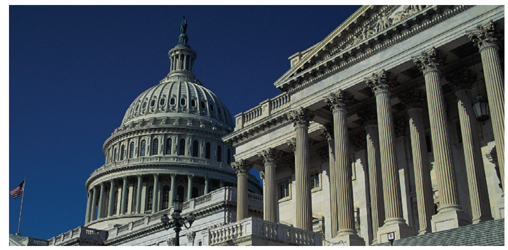

ASB Issues Risk Assessment SAS

Deficiencies in the auditor's risk assessment procedures are a common issue noted in peer review ever since the initial risk assessment standard was issued. As a result, the AICPA identified risk assessment as an area for enhancing audit quality a few years ago, ultimately resulting in the issuance of a new SAS on risk assessment.

What Happened?

In October of 2021, the Auditing Standards Board (ASB) issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. The Standard addresses the auditor's responsibility for identifying and assessing the risks of material misstatement in the financial statements, whether due to fraud or error, at the financial statement and assertion levels. The assessment provides the basis for designing and implementing audit responses to the risks of material misstatements.

What Does It Do?

SAS No. 145 supersedes SAS No. 122, AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and amends other sections in SAS No. 122, along with a number of other auditing standards. While it doesn't materially change the concept of audit risk, it clarifies and enhances the identification and assessment of the risks of material misstatements. It is designed to help auditors determine the financial statement areas that pose the greatest risks of material misstatement, so they can focus more of their procedures on those areas. The new standard includes:

- **A revised definition of *significant risk*.** The definition is revised so that auditors will be focused on where the risks lie on a *spectrum* of inherent risk. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be to overcome that risk.

In this Issue:

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- **Extensive guidance regarding information technology (IT).** Both the use of IT and the consideration of IT general controls are addressed.
- **A new requirement to separately assess inherent risk and control risk.** The risks at the financial statement level potentially affect many assertions, because they relate pervasively to the financial statements as a whole. At the assertion level, the risks of material misstatement consist of inherent risk and control risk. For risks of *material misstatement* at the assertion level, this standard requires a separate assessment of inherent risk and control risk.
- **A new requirement to assess control risk at the maximum level.** If the auditor doesn't plan to test the operating effectiveness of controls, the assessment of the risk of material misstatement is the same as the assessment of inherent risk.
- **A new *stand back* requirement.** This requirement is intended to drive an evaluation of the completeness of the auditor's identification of significant classes of transactions, account balances, and disclosures.
- **New guidance on scalability.** Auditors must apply their professional judgment to determine the nature and extent of risk assessment procedures required to be performed, based on whether entities have established structured systems, processes, and internal controls and how they are documented. The complexity of an entity's activities and its environment, including its system of internal control, drives the scalability when applying SAS No. 145.
- **New guidance on maintaining professional skepticism.** An understanding of the entity and its environment, and the applicable financial reporting framework, provides the basis for being able to maintain professional skepticism throughout the audit.
- **Revised requirements on audit documentation.** Audit documentation should include the risks identified, how the auditor obtained an understanding, an evaluation of the design and operation of internal controls, and the auditor's rationale for significant judgments made about the risk assessment.
- **A conforming amendment to perform substantive procedures for each *relevant* assertion of each *significant* class of transactions, account balance, and disclosure, regardless of the assessed level of control risk.** Prior to the amendment, auditors were required to perform substantive procedures for *all* relevant assertions related to each *material* class of transactions, account balance, or disclosure, regardless of the assessed risks of material misstatement.

This is just an overview of a very complex statement. We'll have more to say on the topic as the effective date nears.

When Is It Effective?

SAS No. 145 will be effective for audits of financial statements for periods ending on or after December 15, 2023.

Practical Consideration:

SAS No. 145 is available on the AICPA's website at **https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/sas-145.pdf**.

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In-relation-to Opinion on the SEFA with Out-of-period Amounts

Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), section 200.515(a) requires the auditor to give an opinion "as to whether the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole." This requirement is commonly referred to as an *in-relation-to opinion* on the schedule of expenditures of federal awards (SEFA), which is based on the requirements under AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.

While this hasn't been a problem since the beginning of time, we all know the pandemic changes everything so why not this. In a nutshell, the federal government is dictating when certain transactions should appear in the SEFA to a period other than when they occurred in the financials statements. Read on to see how the profession is dealing with this situation.

Existing In-relation-to Reporting Guidance

AU-C 725.05 indicates that in order to express an in-relation-to opinion on the SEFA, the auditor should determine that all of the following conditions are met:

- The SEFA was derived from and directly relates to the underlying accounting and other records used to prepare the financial statements.
- The SEFA relates to the same period as the financial statements.
- The financial statements were audited and the auditor issued a report on those financial statements.
- The auditor did not issue an adverse or disclaimer of opinion on the financial statements.
- The SEFA will either accompany the audited financial statements or the audited financial statements will be made readily available by the entity.

The Problem

As indicated in the second bullet, in order to issue an in-relation-to opinion on the SEFA, the information has to relate to the same period as the financial statements. However, the U.S. Department of Health and Human Services Provider Relief Fund (PRF) has unique SEFA reporting requirements. Part 4 of the Compliance Supplement provides specific guidance for amounts to report on the SEFA for entities who receive and expend PRF, by their respective fiscal year ends. Those amounts are directly tied to reporting periods that are associated with the PRF Reporting Portal requirements. Therefore, there will be instances where meeting the requirements of AU-C 725.05 is not possible based on the fact that PRF expenditures (and lost revenues, if applicable) relate to different periods than that of the financial statements.

The Solution

In order to address this nuance of PRF SEFA reporting and the in-relation-to opinion requirements under AU-C 725.05, the AICPA has released Q&A 9160.36, *Reporting on the Provider Relief Fund in the Schedule of Expenditures of Federal Awards in Relation to the Financial Statements in a Single Audit*. The Q&A provides an exception to the criteria that the SEFA must relate to the same period as the financial statements. The Q&A clarifies that if all other criteria in AU-C 725.05 are met, and the schedule can be reconciled back either to underlying accounting and other records used in preparing the financial statements or to the financial statements themselves, the auditor may issue an in-relation-to opinion on the SEFA.

Justification

Q&A 9160.36 explains this approach based on the current situation addressed in Q&A 9160.27 where an in-relation-to opinion can be issued when a SEFA is prepared on the cash basis of accounting versus the financial statements prepared in accordance with GAAP. It can be done because the amounts are reconcilable. Similarly, in the current situation, financial activity occurring previously in the financial statements now resides in beginning net assets or net position and is, thus, reconcilable to the current activity in the SEFA.

Practical Consideration:

The AICPA's Q&A 9160.36 should be reviewed in its entirety, and can be accessed at **https://us.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-9160-36.pdf**.

GASB Issues Revised Concept ED on Financial Statement Disclosures

In June of 2021, the GASB issued a revised exposure draft (ED) of a proposed concept statement, *Communication Methods in General Purpose External Financial Statements: Notes to Financial Statements* (the revised ED). The GASB issued the original ED on the topic in early 2020, discussed in our **April 2020 edition**, and has made revisions based on the feedback they received.

This revised proposed concept statement would be one in a series of concept statements that will be issued by the GASB. Concept statements are intended to provide a conceptual framework of interrelated objectives and fundamental principles that can be used to establish consistent accounting and financial reporting standards and assist users and practitioners to better understand the fundamental concepts underlying the accounting and financial reporting standards.

Summary of Key Provisions of the Revised ED

The purpose of the revised ED is to guide the Board when establishing note disclosure requirements for state and local governments, and it proposes concepts such as:

- The purpose of notes to financial statements,
- The intended users of note disclosures,
- The types of information that should be disclosed in the notes, and
- The types of information that are not appropriate for note disclosures.

The revised ED describes certain characteristics that make information included in notes to the financial statements essential to users in making economic, social, or political decisions or assessing accountability, and states that each item disclosed should possess one of the characteristics of essentiality. Essentiality characteristics include the following:

- Users utilize the information in their analyses for making decisions or assessing accountability, or would modify those analyses to incorporate the information if it were made available.

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- The information has or would have a meaningful effect on users' analyses for making decisions or assessing accountability.
- A breadth or depth of users utilize or would utilize the information in their analyses for making decisions or assessing accountability.

Effective Date

The proposed concept statement would be effective once finalized.

Practical Consideration:

The full text of the Exposure Draft is available on Checkpoint at **checkpoint.riag.com** for users that subscribe to GASB content, and at **www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176176950914&acceptedDisclaimer=true**.

Letters and Reports for Yellow Book and Single Audits

The 2021 edition of the AICPA's Audit Guide, *Government Auditing Standards and Single Audits* (GAS/SA Audit Guide), which the AICPA released in September, has been updated to include guidance and illustrative auditor's reports for use after the implementation of SAS Nos. 134–140.

Because this guidance was not available when certain PPC governmental products, such as *PPC's Guide to Audits of Local Governments*, *PPC's Practice Aids for Audits of School Districts*, and *PPC's Practice Aids for Audits of Health Care Entities*, were updated in 2021, appendixes and practice aids were reserved for engagement letters and auditor's reports that were compliant with the new reporting SASs. The reporting SASs, Nos. 134–140, were effective for audits of financial statements for periods ending on or after December 15, 2021, as deferred by SAS No. 141. As a result, it is time to issue engagement letters for those audits and to start pulling together auditor's reports that have been updated for the new reporting SASs.

Consequently, we have posted illustrative Yellow Book and single audit engagement letters and reports to the Thomson Reuters customer support website at **https://thomsonreuterstaxsupport.secure.force.com/pkb**, which have been updated for the new reporting SASs. Please note that the 2022 editions of these products, such as *PPC's Guide to Audits of Local Governments*, which is expected to be available in April 2022, will include these engagement letters and auditor's reports for use after the implementation of these reporting SASs.