THOMSON REUTERS
CHECKPOINT™

S. Davis & Associates, P.A.
Certified Public Accountants & Consultants

THE PPC
GOVERNMENTAL UPDATE

JULY 2022, VOLUME 29, NO. 7

# Environmental, Social, and Governance Matters for Governments

Sustainability reporting is increasingly on the minds of regulators, credit rating agencies, citizens, and other interested parties across all industries. Demand for environmental, social, and governance (ESG) information is high and constantly changing.

While ESG reporting is evolving for many entities, governmental financial statement preparers and their auditors need to consider ESG matters that can affect operations and create potential risks, including the risk of material misstatement of the financial statements.

The following discussion explores some of the current considerations and developments regarding reporting ESG matters for finance departments and their external accountants and auditors.

## What Are the Current ESG Challenges?

Currently, entities across all industries are in many different stages of ESG reporting. Auditor involvement in reviewing or providing assurance over ESG information is also an emerging area.

Governments report ESG matters in different ways, including the annual comprehensive financial report (such as sustainability metrics, financial statement disclosures, and management's discussion and analysis). More often, they report ESG information on websites and separate sustainability reports. There are multiple reporting frameworks for entities to assess, which have different target audiences, metrics, and definitions of materiality.

A significant issue is that ESG data is often maintained throughout the organization, isn't subject to internal controls over financial reporting, may not be captured in computer systems, and may even be located within third-party systems. Historically, directors of finance may not have been directly involved with ESG reporting.

Because this is an emerging area, finance departments need to get up to speed on new ESG developments, reporting frameworks, and terminology. Finance

**In this Issue:**


- Environmental, Social, and Governance Matters for Governments
- Relief for Recipients of COVID Funds

departments can help ensure that ESG reporting is integrated into financial reporting, as well as help establish effective governance over the ESG reporting process.

External accountants and auditors might be able to assist their clients with their evaluation of which ESG standards to apply, the development of policies and procedures, and implementation of internal controls over ESG reporting that ensure high quality data. Many entities are using their external accountants or other external sources as a resource for ESG training, along with implementing cross-functional teams and on-the-job training.

## Governance and ESG Matters

Governing bodies and audit committees are spending increasing amounts of time on ESG matters. ESG reporting has become part of the overall existing governance responsibility for financial reporting and disclosures.

Like other emerging risk areas, governments need a plan for greater governing body engagement and effective governance. External auditors can provide resources to governing bodies on best practices and emerging trends in their involvement in ESG matters.

## Existing Financial Reporting Requirements for ESG Matters

The GASB hasn't yet issued specific standards for what are now known as ESG matters. However, some ESG-type issues have always been inherent in the existing standards in the form of accountability.

The GASB issued an educational paper in May 2022 that provides an overview of how ESG matters intersect with the accountability concept. For example, it explains that financial reporting should provide information on the government's stewardship responsibilities (as reflected in fund and budgetary reporting) and interperiod equity (a measure of whether current-year revenues were sufficient to pay for the services provided that year).

The educational paper provides examples of how the objectives of GASB's authoritative guidance intersect with ESG matters. For example, regarding fund accounting, GASB Codification Section 1300 intersects with social and governance matters because many funds are established based on various legal provisions to achieve sound financial administration and accountability to resource providers, including taxpayers and grantors. As another example, in GASB Codification Section 1600, *Basis of Accounting*, and the economic resources measurement focus and accrual basis of accounting, ESG intersects with governance matters because transactions are recognized as they occur, providing transparency about the assets and liabilities of a government and information to assess interperiod equity.

Many other topics are covered in GASB's paper, such as going concern, the statistical section, capital assets, asset retirement obligations, landfill closure, pollution remediation obligations, special assessments, tax abatements, etc.

### Practical Consideration:

The GASB's educational paper is available at **https://gasb.org/Page/ShowPdf?path=ESG%20Memo%20FINAL%2005312022.pdf&title=May%2031,%202022%E2%80%94Intersection%20of%20Environmental,%20Social,%20and%20Governance%20Matters%20with%20Governmental%20Accounting%20Standards**.

## AICPA ESG Audit Guidance

The AICPA has issued an evolving nonauthoritative practice aid, *Consideration of ESG-Related Matters in an Audit of Financial Statements*, to help auditors apply existing auditing guidance in this emerging area. While it is written from a corporate perspective with the examples being of businesses, the underlying regulations are framework neutral and should be equally considered for governmental entities.

Chapter 1 covers the consideration of climate-related topics and risks. The categories of climate-related risks include physical risks attributable to climate change such as floods and wildfires, and transition risks due to the move to alternative sources of energy and away from fossil fuels that emit greenhouse gases. Additional chapters will be added to the practice aid as new topics are developed.

## Management Responsibilities

According to Chapter 1 of the practice aid, when management considers whether climate-related changes have a material effect on the financial statements, it should evaluate risks from the perspective of the overall environment in which the entity operates, including industry, regulatory, and entity-specific factors.

## Those Charged with Governance

The practice aid outlines the responsibilities of those charged with governance in overseeing the financial reporting process and the external audit. This includes understanding management's risk assessment and mitigation plans and discussing how current and future climate-related risks affect accounting estimates, policies, and disclosures. Those charged with governance may want to discuss this knowledge with the external auditor and determine how the auditor considers climate-related risks in the audit.

## Auditor Responsibilities

As required by existing auditing standards, auditors need to obtain an understanding of the entity and its environment, including relevant internal controls. This understanding would encompass management's assessment and response to climate-related risks. The practice aid reminds auditors that they are required to design and implement responses to address assessed risk of material misstatements at the financial statement level and design and perform audit procedures to respond to assessed risk of material misstatements at the relevant assertion level.

The practice aid includes a listing of various AU-C sections that may be relevant to climate-related matters along with specific examples of how climate matters may apply under each section.

### Practical Consideration:

The AICPA practice aid is available at **www.aicpa.org/resources/download/considerations-of-esg-related-matters-in-an-audit-of-financial-statements**.

# Relief for Recipients of COVID Funds

In an effort to reduce the burden of obtaining a full single audit or a program-specific audit by the recipients of Coronavirus State and Local Fiscal Recovery Funds (CSLFRF) (21.027), the U.S. Department of Treasury (Treasury) has provided a less demanding alternative. The alternative was developed through a collaboration of Treasury, the Office of Management and Budget (OMB), the AICPA Governmental Audit Quality Center (GAQC), and the National Association of State Auditors, Comptrollers, and Treasurers.

Instead of requiring a single audit or a program-specific audit under 2 CFR Part 200, Subpart F, OMB has authorized using an alternative compliance examination engagement performed in accordance with *Government Auditing Standards*. The reduction in burden is achieved in several ways, including not having a financial statement audit and not having a formal schedule of expenditures of federal awards.

## Background

CSLFRF was part of the American Rescue Plan Act that delivered $350 billion to state, local, and tribal governments to help respond to and recover from the COVID-19 pandemic. Many recipients, including small governments, who have historically received little to no federal funding, received CSLFRF awards of $750,000 or more and are now subject to a single audit or a program-specific audit.

In response, Treasury has developed an alternative approach available for CSLFRF recipients that would otherwise not be required to undergo an audit if it were not for the CSLFRF funds directly awarded by Treasury. The 2022 Compliance Supplement, which was issued in May 2022, describes this alternative approach (in Part 4, 21.027, and Part 8, Appendix VII) and continues to designate the CSLFRF as a high-risk program.

### Practical Consideration:

Treasury's CSLFRF alternative compliance examination engagement submission instructions can be found at **https://home.treasury.gov/policy-issues/coronavirus/assistance-for-state-local-and-tribal-governments/state-and-local-fiscal-recovery-funds**.

## Who Is Eligible to Use the Alternative?

According to the 2022 Compliance Supplement, Part 4, 21.027, Section IV, CSLFRF recipients that spend $750,000 or more during the recipient's fiscal year in federal awards and who meet *both* criteria listed below have the option to follow the alternative CSLFRF compliance examination engagement:

- The recipient's total CSLFRF award received directly from Treasury or received (through states) as a non-entitlement unit of local government is at or below $10 million.
- The recipient's other federal award funds expended—*not including their CSLFRF award funds*—are less than $750,000 during the recipient's fiscal year.

## What Does It Entail?

If a recipient qualifies based on the criteria mentioned above, the eligible recipient is permitted to engage a practitioner to perform a compliance

The PPC Governmental Update is published monthly by Thomson Reuters/Tax & Accounting, P.O. Box 115008, Carrollton, Texas 75011-5008, (800) 431-9025. 

THOMSON REUTERS®

Tax & Accounting - Checkpoint
P.O. Box 115008
Carrollton, Texas 75011-5008
UNITED STATES OF AMERICA

**ADDRESS SERVICE REQUESTED**

PRSRT STD
U.S. POSTAGE
PAID
Thomson

examination engagement in accordance with the U.S. Government Accountability Office's (GAO) *Government Auditing Standards*. However, the GAO requires practitioners to conduct an examination engagement in accordance with the AICPA Statements on Standards for Attestation Engagements. The AICPA attestation standards are codified in the AT-C section of the AICPA's *Professional Standards* and AT-C section 315, *Compliance Attestation*. An examination engagement is much smaller in scope than a regular single audit engagement, which would also include a financial statement audit and a schedule of expenditures of federal awards.

## Practical Consideration:

*PPC's Guide to Nontraditional Engagements* provides guidance on performing an examination engagement. PPC's SMART Practice Aids™—Single Audit Suite includes a separate federal award selection under Assistance Listing 21.027 (Alternative Compliance Examination) to prepare a compliance audit program for those recipients that qualify for the alternative compliance examination.

Under the examination engagement, the practitioner is engaged to test a narrow scope of compliance requirements relating only to CR A, Activities Allowed or Unallowed, and CR B, Allowable Cost and Cost Principles. The objectives of the examination are to determine whether the recipients used CSLFRF funds for ineligible uses and whether the recipients significantly deviated from their established practices and policies regarding the incurrence of costs. The practitioner does not need to test internal control over compliance as required by 2 CFR 200.514(c). Instead, the practitioner needs to obtain an understanding of relevant portions of internal control over compliance sufficient to plan the engagement and to assess control risk for compliance with specified requirements.

The 2022 Compliance Supplement lists suggested procedures that assist the practitioner in achieving the objectives. Additionally, the practitioner must audit recipients on award funds expended for their fiscal year 2022 based on the requirements outlined in the Act, Treasury's Interim Final Rule, Treasury's Final Rule, and Frequently Asked Questions that were in effect at the time of those expenditures. At the end of the engagement, the practitioner will issue an examination opinion on compliance that will include the examination report prepared in accordance with AT-C 315 and *Government Auditing Standards* and a schedule of findings and responses (if applicable) that includes findings required to be reported under GAGAS and the related finding elements required by GAGAS.

The GAQC has posted three illustrative reports, prepared in accordance with AT-C Section 315, *Compliance Examinations*, and *Government Auditing Standards*, to assist practitioners performing the alternative examination engagements. In addition, the GAQC is developing a related practice aid to assist practitioners further. Treasury's CSLFRF website will provide engagement submission instructions.

## Practical Consideration:

The GAQC illustrative examination reports can be found at **www.aicpa.org/resources/download/cslfrf-compliance-attestation-engagement-illustrative-reports**.