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Auditor of State Advisory Memo

To: All Auditor of State Clients
Independent Public Accountants

From: Keith L. Faber, Auditor of State

Date: July 2, 2021

Subject: **Prior Fiscal Year Expenditures Reimbursed with Federal Funds in the Subsequent Fiscal Year**

In response to the pandemic, the Congress has passed several pieces of legislation providing significant COVID-19 Federal funding among various new and pre-existing programs to states and local governments. In many cases, the funding was distributed to local governments after the local government incurred allowable expenditures and prior to Federal agencies issuing specific programmatic guidance. Both new and pre-existing Federal programs with COVID-19 funding have identified a covered period in which allowable expenditures may be charged to the program. In many cases, these covered periods are retroactive back to the beginning of the COVID-19 public health emergency, for example, various dates in March 2020. The retroactivity of the COVID-19 Federal program covered periods has raised several questions about the timing of when a government should recognize allowable expenditures incurred in its financial statements and Schedule of Expenditures of Federal Awards (SEFA). This Advisory is intended to assist governments and their auditors with this reporting, particularly when a government retroactively charges an allowable expenditure within a covered period that has already been audited.

Uniform Guidance, specifically 2 Code of Federal Regulations (CFR) § 200.510(b), describes the criteria and requirements for preparing the Schedule of Expenditures of Federal Awards (SEFA). The SEFA must be prepared for the same period and reporting entity, and using the same underlying accounting records as the related financial statements. To date, the federal Office of Management and Budget (OMB) has not provided specific guidance on how to report COVID-19 federal expenditures to retroactive covered periods. Therefore, until or unless further guidance is provided by OMB, the Auditor of State (AOS) will defer to the CFR and guidance as further described in this Advisory.

This guidance does not apply to errors in reporting, which are governed under other standards and requirements.

Cash Basis SEFA Guidance:

2 CFR 200.502(a) of the Uniform Guidance (UG) states that the determination of when a federal award is expended must be based on when the activity related to the federal award *occurs*. The AOS interpretation of this UG section is that expenditures are considered *made* when they are charged to the program. That is, an expenditure does not become an expenditure of federal awards until which time management:

Identifies an allowable cost, based upon the terms and conditions of a federal program, has been or will be incurred; *and* makes the decision to allocate the identified allowable cost to the federal program.

The expenditure is reported on the current year SEFA in situations where:

- If the award is determined to exist as of fiscal year-end,
- The federal government allowed the local or state government to charge expenditures during a covered period, including expenditures paid in a prior fiscal year,
- The initial expenditure was made, for example, cash basis check issued in a previous fiscal year without management having an expectation of charging an expenditure to a federal program, and
- During the current fiscal year, management identified an allowable expenditure from a previous period and made the decision to reallocate the allowable expenditure to a Federal program within its established covered period.

This allows the activity related to the federal award to be reported when it occurred, that is if the award is determined to exist as of the fiscal year end, management had sufficient knowledge of the terms and conditions of the federal program and made the decision to reallocate the expenditure to the eligible federal program.

See also financial statement reporting guidance in the examples below.

The American Institute of Certified Public Accountants (AICPA), Government Audit Quality Center (GAQC) *Nonauthoritative Guidance on the Reporting of Certain COVID-19 Awards on an Accrual Basis SEFA* (issued February 4, 2021, updated April 14, 2021) provides that procedures auditors may consider for determining the appropriateness of the “award date” used by the auditee include: (1) inquiries of management regarding the facts and circumstances surrounding award arrangements; and (2) reviewing client supporting records such as Board minutes, e-mail correspondence, or instructions provided to a subrecipient from a pass-through entity for claiming expenditures.

Elementary and Secondary School Emergency Relief (ESSER) Example:

Congress authorized a second Elementary and Secondary School Emergency Relief (ESSER) program, known as “ESSER II,” in December 2020 as part of the Consolidated Appropriations Act of 2021, however the covered period of performance in which funds may be applied to qualifying expenditures runs from March 13, 2020 through September 30, 2023. As a result, schools may use the ESSER II funds to reimburse expenditures from roughly the last quarter of the 2019-2020 school year. The Ohio Department of Education (ODE) has advised school districts to use all their remaining ESSER I funds received under the Coronavirus Aid, Relief, and Economic Security (CARES) Act before making use of ESSER II funds, given ESSER I funds have a shorter remaining period for SEAs, LEAs, and other subgrantees to obligate the funds.

Financial Statement Accounting for ESSER II expenditure reimbursements:

Management should record the original receipt of the ESSER II funds in the 2020-2021 school year as revenue in the ESSER II fund, for example, a separate special cost center (SCC) within Fund 507.

Management should prepare a detailed invoice documenting the fund that reported the original expenditure of allowable costs (Original Fund), charge the invoice to the appropriate ESSER II SCC within Fund 507, and record a refund of prior year expenditure in the Original Fund. Management should charge the appropriate functions or objects within the SCC of Fund 507 based on the billing received from the Original Fund. The refund of prior year expenditure is allowable on the budgetary reporting basis, but must be reclassified on the financial statements. The reclassification would move the refund of prior expenditures to a revenue line item, usually Miscellaneous Revenue. A reduction of expenditure could be used if the amount is immaterial. Some judgment may be needed to determine the best presentation of these reclassifications in each particular circumstance.

Schedule of Expenditures of Federal Awards Reporting for these expenditures:

In accordance with the SEFA Guidance section noted above, management should report this federal award activity on the fiscal year 2021 SEFA.

AOS will not take exception of those entities that have already included these expenditures on their fiscal year (FY) 20 financial statements or SEFA and were subject to audit at that time. Due to the lack of clarity in the existing Federal guidance, we believe a reasonable interpretation can be made to charge these “retroactive” allowable expenditures to federal programs in either fiscal year.

Timeline:

June 30, 2020 Fiscal Year End	December 20, 2020	January 2021 through June 2021	June 30, 2021 Fiscal Year End
Expenditures reported on the financial statements in the original purchasing fund.	- Consolidated Appropriation Act of 2021 approved additional funding referred to as ESSER II. - ODE requests ESSER I funds be spent prior to ESSER II. - Therefore, some schools chose to charge additional FY 20 expenditures to ESSER. - AOS anticipates a similar situation will occur for the ESSER II and new ESSER III funding authorized under the American Rescue Plan.	- District identifies allowable expenditures from FY20 that could be reimbursed using ESSER I or ESSER II. - District records the ESSER Revenue in ESSER Fund 507 or ESSER Fund SCC. - Original fund invoices ESSER Fund for expenditures to be reimbursed. - ESSER Fund records the expenditure and the original fund records a Refund of Prior Year's Expenditure.	- ESSER II Fund Expenditures are reported on the FY 21 Schedule of Expenditures of Federal Awards - Entities should reclassify the Refund of Prior Year's Expenditure to a revenue line item for reporting purposes.

Federal Emergency Management Agency (FEMA) Example:

A second round of Disaster Relief Fund Public Assistance Grants' funding to state and local governments was approved in December 2020 as a part of the Consolidated Appropriations Act of 2021, however allocations of these funds were not accessible to local governments until after the 2020 fiscal year end. As a result, entities may use the Disaster Relief Fund Public Assistance Grants funds to reimburse expenditures from fiscal year 2020 that fall within the FEMA approved Period of Performance.

Financial Statement Accounting for these expenditure reimbursements:

Original receipt of the Disaster Relief funds in fiscal year 2021 would be reported as revenue in the FEMA fund and SCC in FY21.

The fund that reported the original expenditure of dollars (Original Fund) would invoice the appropriate FEMA Fund and record a Refund of Prior Year Expenditure (Original Fund). Management would charge the appropriate functions and objects of the FEMA Fund based on

the billing received from the Original Fund. The Refund of Prior Year Expenditure is allowable on the budgetary reporting basis, but must be reclassified on Generally Accepted Accounting Principles (GAAP), Other Comprehensive Basis of Accounting (OCBOA), and AOS Regulatory financial statements. The reclassification would move the refund of prior expenditures to a revenue line item, usually miscellaneous revenue. A reduction of expenditure could be used if the amount is immaterial. There would be some judgment involved on the reclassification based on what would be the best presentation in each particular circumstance.

Schedule of Expenditures of Federal Awards Reporting for these expenditures:

In accordance with the SEFA Guidance section noted above, management should report this federal award activity on the fiscal year 2021 SEFA.

AOS will not take exception of those entities that have already included these expenditures on their FY20 financial statements or SEFA and were subject to audit at that time. Due to the lack of clarity in the existing Federal guidance, we believe a reasonable interpretation can be made to charge these “retroactive” allowable expenditures to federal programs in either fiscal year.

Timeline:

December 20, 2020	December 31, 2020 Fiscal Year End	January through December 2021	December 31, 2021 Fiscal Year End
Consolidated Appropriation Act of 2021 approved additional Disaster Relief Funding.	Expenditures reported to the financial statements in the original purchasing fund because newly approved Disaster Relief funds were not yet available.	- Entity identifies allowable expenditures from FY20 that could be reimbursed using new FEMA Funds. - Entity records the FEMA Revenue in the FEMA Fund. - Original fund invoices FEMA Fund for expenditures to be reimbursed. - FEMA Fund records the expenditure and the original fund records a Reimbursement	- FEMA Fund Expenditures are reported on the SEFA, as based on the guidance. - Entities should reclassify the Refund of Prior Expenditure to a revenue line item for reporting purposes.

		of Prior Year Expenditure.	
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This Advisory includes limited examples. Governments and auditors should evaluate each COVID-19 federal award individually.

Impact of Prior Year Federal Program Reimbursements When Prior Year Already Audited

If following the guidance within this Advisory will result in the activity associated with the additional funding being reported in the current year Financial Statements and SEFA, no reissuance of the prior year audit report will be necessary.

We recognize that some governments have requested or chosen to reopen their fiscal year 2020 audits to record activity associated with additional funding received through the Consolidated Appropriations Act of 2021 on their fiscal year 2020 financial statements and SEFA. Again, AOS will not take exception if the entity already chose this approach; however, we recommend they record the activity in the manner identified above and report the receipt and reimbursement on both the Financial Statements and SEFA the year in which the reimbursement was made. Should an entity have already chosen to reopen their fiscal year 2020 engagement and report the expenditures on the 2020 SEFA, it is critical to assess the impact on the financial statements, SEFA, and major fund determinations. Additional testing and audit reissuance may be necessary.

Entities that initially chose to allocate expenditures to COVID-19 programs authorized by the CARES ACT in fiscal year 2020 and then subsequently reimbursed those expenses with a new funding stream available in the current year in order to free up CARES funding for other allowable expenditures, should report the expenditure in the year the reimbursement was made following the guidance in this Advisory, unless otherwise indicated by federal awarding agencies or the Office of Management and Budget (OMB). We recommend governments identify this situation in a SEFA note disclosure. Review your grant terms and conditions of your federal awards.

It is our understanding that the federal government is currently developing guidance to be included in the Compliance Supplement or issued as separate guidance. Once they issue their guidance we will resend this advisory and auditees should follow the federal guidance.

Applicability of Guidance:

Though this memo specifically addresses fiscal years 2020 and 2021, the concepts and guidance apply to audits regardless of year under audit.

Contact:

Please direct any questions to the Center for Audit Excellence at AOSFederal@ohioauditor.gov