Federal Accounting Standards Advisory Board

Accrual Estimates for Grant Programs

Federal Financial Accounting Technical Release

Exposure Draft

Written comments are requested by April 22, 2010

March 22, 2010

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

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The Accounting and Auditing Policy Committee

The Accounting and Auditing Policy Committee (AAPC) was organized in May 1997 by the Department of the Treasury, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), the Chief Financial Officers' Council (CFOC), and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) [formally the President's Council on Integrity and Efficiency (PCIE)], as a body to research accounting and auditing issues requiring guidance.

The AAPC serves as a permanent committee established by the Federal Accounting Standards Advisory Board (FASAB). The mission of the FASAB is to develop accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information. The mission of the AAPC is to assist the federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues as they relate to the specific application of existing authoritative literature.

The AAPC is intended to address issues that arise in implementation, which are not specifically or fully discussed in Federal accounting and auditing standards. The AAPC's guidance is cleared by FASAB before being published.

Additional background information on the AAPC is available from the FASAB or its website:

- "Charter of the Accounting and Auditing Policy Committee"
- "Accounting and Auditing Policy Committee Operating Procedures"

Federal Accounting Standards Advisory Board

March 22, 2010

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Accounting and Auditing Policy Committee (AAPC or Committee) of the Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Federal Financial Accounting Technical Release entitled, *Accrual Estimates for Grant Programs*. Specific questions for your consideration appear on page 6 and are available for your use in Word format on the FASAB website at http://www.fasab.gov/ exposure.html. However, you are welcome to comment on any aspect of this proposal. Your response would be more helpful to the Committee and the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by April 22, 2010.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to PayneW@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the specific date, time and location of the hearing will be published in the Federal Register and in the FASAB newsletter.

Wendy M. Payne

AAPC Chair

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Introduction

Purpose

1. A series of roundtables in April 2009 indicated that guidance for estimating accruals for grant programs would be helpful for agencies. Specifically, agencies indicated a need for guidance that describes a cost-effective framework for developing reasonable estimates of accrued grant liabilities.

Scope

2. This Technical Release (TR) applies to **grants**[1] that are paid by a federal entity to a non-federal entity. This TR does not apply to contracts or other purchases of goods or services. This TR does not establish new reporting requirements. This TR does not affect reporting in the Budget of the United States or special-purpose reports such as those required by law or regulation to be prepared in accordance with guidance other than generally accepted accounting principles.

Effective Date

3. This technical release is effective immediately.

Request for Comments

4. Q1. Do you agree or disagree with the guidance for preparing accrual estimates for existing (mature) grant programs in paragraphs 16 -20? Please provide the rationale for your answer.

5. Q2. Do you agree or disagree with the guidance for preparing accrual estimates for new grant programs or changes to existing programs in paragraphs 16 - 18 and 21 - 24? Please provide the rationale for your answer.

6. Q3. Do you agree or disagree with the guidance on display in paragraph 26? Please provide the rationale for your answer.

7. Q4. Do you agree or disagree with the guidance on internal controls in paragraphs 27 -38? Please provide the rationale for your answer.

8. Q5. Do you agree or disagree with the guidance on training of grantees and monitoring of grantee reporting in paragraphs 40 - 43? Please provide the rationale for your answer.

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[1] Terms first appearing in **bold** are defined in the glossary.

9. Q6. Do you agree or disagree with the guidance on materiality considerations and risk assessment in paragraphs 34- 49? Please provide the rationale for your answer.

10. Q7. Do you believe that the example decision tree diagrams in Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals are helpful? Please provide the rationale for your answer.

11. Q8. Do you believe that the illustrative example of a note on netting grant advances and accrued liabilities in Appendix C: Illustrative Example of Note on Netting Grant Advances and Accrued Liabilities is helpful? Please provide the rationale for your answer.

12. Q9. The scope of this ED does not include cooperative agreements (as defined in 31 USC 6305) because cooperative agreements involve more communication between the agency and the grantee. Accordingly, the participants of the roundtables and the task force did not indicate a need for guidance on developing accrual estimates for cooperative agreements. Do you agree? Please provide the rationale for your answer.

Background

Overview

13. This TR addresses procedures for estimating accruals[2] for grant programs, including acceptable procedures until sufficient relevant and reliable historical data is available for new grant programs or changes to existing programs. This TR also provides guidance on acceptable sources of documentation for grant accrual estimates; display of grant accrual estimates; internal controls, including monitoring of internal controls and validation of grant accrual estimates; training of grantees; monitoring of grantee reporting; and materiality considerations and risk assessment.

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[2] Agencies must recognize and report balances due to or advanced to grantees at the end of the reporting period. Adjustments are needed to provide for eligible expenses that grantees have incurred as of the reporting date but have not yet reported to the agencies. Since these adjustments are based upon estimates they are referred to as "accrual estimates" in this guidance. In particular:

- Advances: Amounts issued as advances must be adjusted, even if grantees have not yet reported expenses incurred. (See SFFAS 1, *Accounting for Selected Assets and Liabilities*, par. 57-59.)
- Accounts Payable: Where there is no advance or no remaining advance, agencies must estimate amounts payable to grantees. (See SFFAS 5, *Accounting for Liabilities of the Federal Government*, par. 24-25.)

Related Accounting Literature

14. The related accounting standards are listed below. Relevant excerpts are provided in Appendix D: Relevant Citations of Existing Guidance

    a. Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*,

    b. SFFAS 3, *Accounting for Inventory and Related Property*,

    c. SFFAS 5, *Accounting for Liabilities of the Federal Government*,

    d. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definition of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*

Technical Guidance

Definitions

15. **Grants**: 31 USC Section 6304 defines grants as follows: An executive agency shall use a grant agreement as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when (1) the principal purpose of the relationship is to transfer a thing of value to the State or local government or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and (2) substantial involvement is not expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.[3]

Preparing Accrual Estimates for Grant Programs

16. Preparing reliable and timely accrual estimates for grant programs must be a joint effort between the budget, Chief Financial Officer and program offices at

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[3] 31 USC Section 6302 excludes the following from the definition of a grant agreement: agreements under which is provided only -
(A) direct United States Government cash assistance to an individual;
(B) a subsidy;
(C) a loan;
(D) a loan guarantee; or
(E) insurance.

each agency. These offices should work together to ensure that the procedures and internal control recommendations[4] outlined in this TR are implemented and operating as designed. However, some agencies may not be able to effectively implement all of these procedures, because they have not yet developed the necessary data stores and/or methods for preparing year-end accrual estimates. Therefore, until sufficient relevant historical information on all grant programs is available, the acceptable alternatives outlined in this TR should be utilized for developing year-end grant accrual estimates.

17. Each agency should document and maintain support for the data and assumptions used to develop the year-end grant accrual estimate. The documentation will facilitate the agency's review of the assumptions, a key internal control, and will also facilitate auditor validation of the estimates. Documentation should be complete and stand on its own, i.e., a knowledgeable independent person could perform the same steps and replicate the same results. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purpose of reconstructing the estimate.

18. For both existing grant programs and new or modified grant programs, management's documentation of relevant program design factors may include:

    a. Program definition including legislation

    b. Legislation or regulations changing the terms, maximum grant amount, total program size, or characteristics of the grantee population

    c. Program eligibility requirements

    d. Grant agreements detailing the terms and conditions of the grants

Preparing Accrual Estimates for Existing (Mature) Grant Programs

19. Agencies must accumulate sufficient relevant and reliable data on which to base accrual estimates. Each agency should prepare grant accrual estimates

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[4] Internal control is an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, risk assessment, control activities, information and communications and monitoring.(Source: Summarized from *Internal Control Integrated Framework*, issued by the Committee of Sponsoring Organizations (COSO), consisting of the American Institute of CPAs (AICPA), the Institute of Management Accountants (IMA), the Institute of Internal Auditors (IIA), Financial Executives International (FEI), and the American Accounting Association (AAA). See http://www.aicpa.org/audcommctr/toolkitsnpo/Internal_Control.htm (accessed 3-12-2010)

based upon the best available data at the time the estimates are made. Guidance on the types of supporting documentation that are acceptable for existing (mature) grant programs is found in paragraphs 18 and 20 of this document.

20. For existing programs, management should ensure that the following documentation is available for accrual estimates relating to existing grant programs:

    a. Procedures used for calculating the estimate

    b. Documentation for the review and approval process for the estimate

    c. Support for the calculation of the estimate, including the underlying assumptions used

    d. Historical data supporting the assumptions

    e. Documentation of relevant supporting actual cash and/or accrual experience (including the date and source of reports, whether grantees reported on a cash or accrual basis, and how recently the data were updated). The documentation may include:

        i. Historical data and trends, citing sources of information and relevant time frame

        ii. An analysis that identifies the most critical factors

        iii. Trend analysis developed from reports from the accounting or program management systems

        iv. Evidence of experience by other agencies with similar programs

        v. Evidence of emergencies or legislated changes, such as changes in program terms, program size, or characteristics of grant recipients

        vi. Evidence of other relevant factors that may be identified by grant program managers

    f. Explanation of any sampling process used, including if applicable treatment of grant programs with different payment patterns, and/or legislation.

    g. Explanation of the calculation concept used, such as simple linear regression, statistical analysis, or other appropriate method

    h. Procedures for error checking

    i. Procedures for monitoring/validation subsequent to fiscal year-end

Preparing Accrual Estimates for New Grant Programs or Changes to Existing Grant Programs

21. In the absence of sufficient relevant and reliable historical data on which to base accrual estimates, agencies should prepare estimates based upon the best available data at the time the estimates are made. Paragraphs 18 and 24 of this document provide guidance on acceptable types of supporting documentation.

22. In certain limited instances, informed opinion may be used to support grant accrual estimates in the absence of sufficient relevant and reliable historical data. Informed opinion refers to the judgment of agency staff or others who make estimates based on their programmatic knowledge and/or experience without using a fully satisfactory information store and, in some cases, without using an econometric or other statistical model. Informed opinion may be used only as a last resort when relevant and reliable historical data and/or modeling capabilities are not available. This could occur when a new program has been established or when the Congress has changed an existing program in ways that cannot be represented by historical data. Informed opinion should therefore be used as an interim method only, and the agency should develop an action plan to establish an information store, appropriate models, and supporting documentation.

23. If an expert is used, the expert's qualifications, such as professional or academic certification or length and kind of experience, must be assessed. The basis of the stated opinion must be articulated and documented in sufficient detail to allow review and validation by independent sources, including independent auditors. For example, a statistician may be best qualified to determine the appropriate model for year-end grant accrual estimates using limited or imperfect data.

24. Management should ensure that the following documentation is available for new programs or changes to existing programs that do not have historical supporting documentation. In the absence of relevant and reliable historical experience as the support for estimates, the agency should document the basis for accrual estimates. Typical support may include:

    a. Relevant experience from other agencies, including documentation of why another agency's experience is relevant, as well as similarities and differences (particularly possible biases) between the other agency's experience and the new programs or changes to existing programs of the agency relying on the experience of the other agency

    b. Extrapolation from subsets of prior program activity, e.g., while prior grants were not specifically targeted to a certain pool of grantees, it may be possible to identify prior activity with grantees with the same or similar characteristics to the targeted pool

c. Information from program managers regarding grantee activity and spending patterns

d. When expert opinion is used as an interim measure, the agency should document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis for the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:

i. Reports and studies on relevant issues

ii. Minutes from internal meetings and other relevant communications describing the basis for any assumptions or changes in assumptions.

25. An illustrative decision tree diagram of the grant accrual process is displayed in Figure 1 of Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals.

Display

26. When grant accrual estimates are prepared on an aggregate level, agencies may display a net amount on the balance sheet and report estimated disaggregated advances and liabilities in a note. (An illustrative example is displayed in Appendix C: Illustrative Example of Note on Netting Grant Advances and Accrued Liabilities.)

Internal Controls: Developing Grant Accrual Estimates

27. Agencies should document the procedures and flow of information used in developing grant accrual estimates at a high level, e.g. flow chart with supporting narrative. These documents should be used to establish consistent procedures for developing grant accrual estimates across grant programs with similar characteristics. These documents should also include a discussion of who is responsible for each step of the estimate as well as the review and approval process followed. Documented procedures are necessary to communicate relevant information on the grant accrual estimation to employees as well as other interested parties, such as auditors. As an agency experiences employee turnover, these documented procedures will provide vital information for new employees on how to complete reliable, well supported grant accrual estimates.

28. Agencies should document the model(s) used, the rationale for selecting the specific methodologies, and, for programs with sufficient historical data, the degree of calibration within the projected spending model(s).[5] Agencies should also document the sources of information, the logic flow, and the mechanics of the model(s), including the formulas and other mathematical functions. In addition, agencies should document the controls over the model(s) used by the agency in preparing worksheets.

29. Agencies should maintain detailed subsidiary accounting records by grant program. Agencies should have an audit trail from individual transactions to the subsidiary ledgers to the general ledger.

30. Management should assess the impact of changes in law or regulations on the reliability of estimates and should ensure that the grant accrual estimate model reflects these changes.

31. Management should assess the impact of subsequent events on their grant accrual estimates. Some subsequent events may require adjustments to the financial statements while others may require disclosure in the notes to the financial statements.[6]

32. Procedures in place should ensure that grant accrual estimates are based on historical transactions in previous years to the extent that relevant and reliable historical data exists.

33. The grant accrual estimation process, including underlying assumptions, should be reviewed and approved at the appropriate level. The agency should perform a trend analysis of grant accrual estimates from year to year. When unusual fluctuations are identified, they should be investigated.

Monitoring Internal Controls

34. Management should monitor controls to determine whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring is a process that assesses the quality of internal

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[5] Calibration is the degree of precision within the model, i.e., the model's ability to accurately predict the trends of expenses incurred for a given grant program. The degree of calibration within the model can be documented by charts or graphs showing projected expenses incurred versus the actual expenses incurred by reporting period. This document would analyze the variance between projected and actual expenses incurred by grantees.

[6] At this time, subsequent events are addressed in other accounting literature and in auditing standards but not in federal accounting standards. However, the Board has proposed requirements for subsequent events. See FASAB Exposure Draft: *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, October 20, 2009.

controls performance over time. The Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, is issued under the authority of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 and provides guidance to federal managers on improving the accountability, efficiency and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on management controls. Circular A-123 provides that:

> Instead of considering internal control as an isolated management tool, agencies should integrate their efforts to meet the requirements of the FMFIA with other efforts to improve effectiveness and accountability. Thus, internal control should be an integral part of the entire cycle of planning, budgeting, management, accounting, and auditing. It should support the effectiveness and the integrity of every step of the process and provide continual feedback to management.
>
> Federal managers must carefully consider the appropriate balance between controls and risk in their programs and operations. Too many controls can result in inefficient and ineffective government; agency managers must ensure an appropriate balance between the strength of controls and the relative risk associated with particular programs and operations. The benefits of controls should outweigh the cost. Agencies should consider both qualitative and quantitative factors when analyzing costs against benefits.[7]

Validation of Grant Accrual Estimates

35. As part of agencies' internal control procedures to ensure that grant accrual estimates are reasonable, agencies should validate grant accrual estimates by comparing the estimates with subsequent grantee reporting.

36. When validating the reasonableness of accrual estimates, an agency does not need to obtain data[8] from 100% of grantees in order to validate the reasonableness of grant accrual estimates. For example, agencies may validate estimates based upon:

[7] OMB Circular A-123, December 21, 2004, Section I, page 5.
[8] Data refers to information about provided by grantees regarding their actual expenses or expenditures. Sources of data may include but are not limited to grantee reports to agencies and audited amounts from Single Audit Act audits.

a. grantee data that represents a majority of the total grant portfolio, or

b. data from a statistically valid sampling of the total grantee portfolio.

37. When developing grant accrual estimates, agencies can only consider data that is available at the time. The nature and reliability of available grant data varies widely and, because of the relationship between the grantor and the grantee, is often only indirectly influenced by management. The validation process includes an understanding that estimates are inherently uncertain, and that management must use judgment in determining:

    a. whether differences between estimated and actual expenses are reasonable, and

    b. if different estimation methods could result in more accurate estimates of net cost in the future.

38. A difference between an accounting estimate and actual result does not necessarily represent a misstatement of the financial statements. Rather, differences could be an outcome of inherent estimation uncertainty. Differences between estimates and actual should be taken into consideration in developing the subsequent period's estimate.

39. An illustrative decision tree diagram of the validation process is displayed in Figure 2 of Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals.

Training and Monitoring of Grantees

40. Since preparation of accrual estimates is dependent upon relevant and reliable data, accurate and timely reporting by grant recipients serves as the basis for historical data used in preparing future estimates and provides reliable actual data to which accrual estimates can be compared. Agencies should consider whether grant recipients need training on completing required financial reports. If needed, training may be delivered via agency sponsored conferences, workshops and/or seminars, customer service centers and help desks, or computer based sources such as webcasts or other training options available through the agency's website. .

41. Reports submitted by grantees should be reviewed to ensure their reasonableness. Agencies should have policies and procedures in place to review and verify the grantee expenditures (or expenses) reported.[9]

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[9] At the time of this writing, grant recipients predominantly report expenditures. However, expenses may be reported in some cases and in the future.

42. When agencies engage in on-site financial monitoring of grantees, protocols should include verifying grant expenditures reported with actual expenditures. Techniques for monitoring of grantee reporting of expenditures may also include stratified sampling.

43. Timely follow up of incorrect reporting should be performed to ensure a higher degree of compliance with reporting requirements. For example, inaccurate grant expenditures reported could be conveyed to grantees by an official letter requesting a corrective action plan. During on-site financial reviews, technical assistance could be provided when grant expenditures reported are inaccurate.

Materiality Considerations and Risk Assessment

44. SFFAS 3, paragraph 14, states that "the accounting and reporting provisions of…standards should be applied to all items that would influence or change the users' judgment of the entity's efficiency and effectiveness and its compliance with laws and regulations in a material manner."[10] In particular, management should consider the materiality of the grant program relative to the agency's statement of net cost.

45. The following list includes some of the factors that management should consider in determining which grant programs may have a higher risk of material misstatement that might cause financial statement users to make incorrect assessments regarding the efficiency and effectiveness of the program:

    a. the degree of variance between past estimates and the program's actual operating cost (if applicable),

    b. significant findings reported in past program audits (if applicable),

    c. the age of the program (other factors being equal, mature programs may have less risk than newer programs),

    d. Congressional and other public policy interest in a given program.

46. For grant programs that are immaterial to the statement of net cost and/or that have a lower risk of misstatement, management might consider validating estimates at less frequent time intervals.

47. Management should use judgment in determining the appropriate investment of time and effort that should be devoted to the process of estimating accruals for grant programs or other activities.

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[10] SFFAS 3, paragraph 14. See Attachment 1 for the full discussion of materiality from SFFAS 3.

48. Statements of Federal Financial Accounting Concepts (SFFACs) represent guidance for the Board in developing accounting standards. SFFAC 1 states that: “the accrual basis of accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated.”[11]

49. SFFAC 1 also discusses balancing costs and benefits in recommending standards. For example, it states that

> …the process of articulating financial reporting objectives and then recommending accounting standards is not a simple progression from canvassing users of federal financial information to recommending standards …because articulating objectives and recommending accounting standards necessarily involve judgments about the costs and benefits of producing more information or of reporting it differently.[12]
> …Finally ...accounting and financial reporting cannot satisfy every need for information and accountability. For many purposes, other information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective. This constraint pervades any discussion of the objectives of federal financial reporting.[13]

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[11] SFFAC 1, par. 197.
[12] SFFAC 1, par. 151.
[13] SFFAC 1, par. 155.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Project History

A1. A series of roundtables in April 2009 indicated that guidance for determining whether estimates of advances and payables for grant programs are reasonable would be helpful for agencies. Specifically, agencies indicated a need for guidance supporting cost-effective development of reasonable estimates.

A2. A Task Force consisting of representatives from federal agencies and independent accounting and consulting firms assisted FASAB staff in identifying areas where guidance would be helpful. Specifically, members indicated a need for guidance regarding:

a. appropriate reliance on the best available data in light of the often limited access grantee data,

b. situations where no historical data is available such as new or modified grant programs,

c. assessment about materiality and whether it is appropriate to focus on the statement of net cost when making such assessments, and

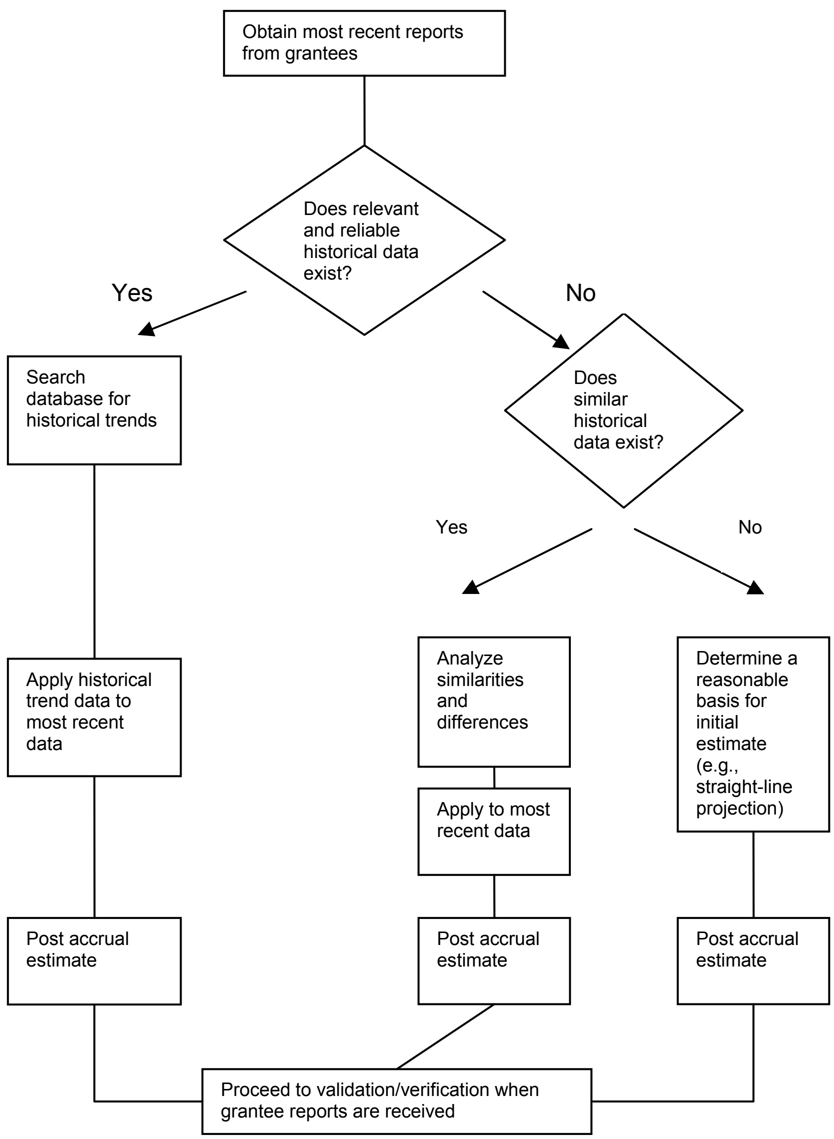
d. cost-effective means of validating previous estimates.

A3. Proposed draft guidance was submitted to the FASAB's Accounting and Auditing Policy Committee (AAPC) for consideration at the January 2010 AAPC meeting. The AAPC agreed to accept the project.

Appendix B: Illustrative Decision Tree Diagrams for Developing and Validating Grant Accruals

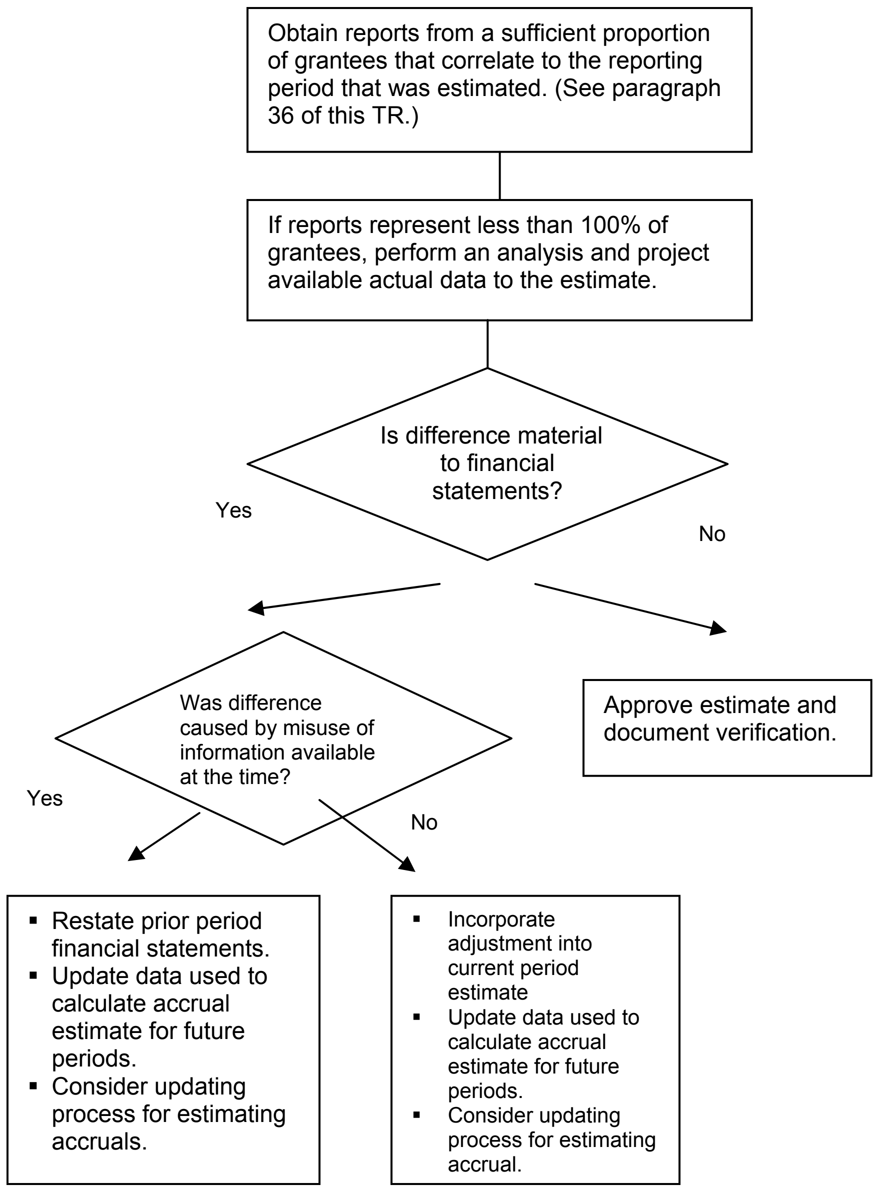
The example decision tree diagram in Figure 1 below illustrates processes that agencies might use in the grant accrual process described in paragraphs 16 - 24. This example is illustrative only and is not authoritative guidance.

Figure 1: Illustrative Example of Grant Accrual Process



This example decision tree diagram In Figure 2 below illustrates processes that agencies might use in validating grant accrual estimates in paragraphs 35 - 38. This example is illustrative only and is not authoritative guidance.

Figure 2: Illustrative Example of Validation/Verification Process



Appendix C: Illustrative Example of Note on Netting Grant Advances and Accrued Liabilities

Paragraph 26 of this TR states that: when grant accrual estimates are prepared on an aggregate level, agencies may display a net amount on the balance sheet and report estimated disaggregated advances and liabilities in a note. Below is an illustrative example of such a note.

Note XX: Net Grant Liability

The *[reporting entity]* awards grants to various grantees and provides advance payments to meet grantees' cash needs to carry out the [reporting entity's] programs.

For grants subject to grant expense accrual, grantees draw funds (recorded as advances to grantees) based on their estimated cash needs. As grantees report their actual disbursements quarterly, the amounts are recorded as expenses, and their advance balances are reduced. In some instances, grantees incur expenditures before drawing down funds that, when claimed, would reduce the advances to grantees account to a negative balance. An accrued grant liability occurs when the accrued grant expenses exceed the outstanding advances to grantees.

At year-end a grant accrual estimate is developed based upon actual payments made through the fourth quarter and an unreported grant expenditure estimate for the fourth quarter based on historical spending patterns of the grantees. The year-end accrual estimate equals the estimate of fourth quarter disbursements plus an average of xx weeks of annual expenditures for expenses incurred prior to the cash being drawn down.

Accrued Grant Liability *(In Millions)*	**2009**	**2008**
Grant Advances Outstanding (before year-end grant accrual)	$ XX,XXX	$ XX,XXX
Less: Estimated Accrual for Amounts Due to Grantees	(XX,XXX)	(XX,XXX)
Net Grant Advances (Liability)	$ (X,XXX)	$ (X,XXX)

Appendix D: Relevant Citations of Existing Guidance

Five elements of accrual-based federal financial statements – assets, liabilities, net position, revenues and expenses) are defined in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.*

> An asset is a resource that embodies economic benefits or services that the federal government controls.[14]
>
> A liability is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[15]

Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities*, defines advances as cash outlays made by a federal entity to its employees, contractors, grantees, or other to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee.[16]

SFFAS 5, *Accounting for Liabilities of the Federal Government,* states that:

> [24.] A nonexchange transaction arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services[17] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).
>
> [25] Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.

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[14] SFFAC 5, par. 18.
[15] SFFAC 5, par. 39.
[16] SFFAS 1, par. 57.
[17] SFFAS 5, Footnote [12] Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

SFFAS 5 requires that for grant programs, the liability that should be reported includes the amount of allowable expense that the grantees have incurred as of the end of the period, but have not collected from the agency. Complying with SFFAS 5 requires that the agency estimate the amounts not reported by the grantee but due to the grantee as of the reporting date. When the grantee has submitted reports providing the grantee's actual costs, the federal agency will be able to assess the grantee reports for accuracy and/or analyze the agency's estimate for accuracy.

SFFAS 3, *Accounting for Inventory and Related Property*, "Materiality" section, states that:

> [7.] The Board intends that the standards' application be limited to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The Board proposes relying on the Financial Accounting Standards Board's (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board's position on the issue of materiality at this time.
>
> [8.] The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.
>
> [9.] FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user.
>
> [10.] The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.
>
> [11.] In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial

entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.

[12.] This is expressed well in the Government Auditing Standards (the "Yellow Book"):

"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." (Ch. 3, par. 33.)

[13.] While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.

[14.] Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgments of the entity's efficiency and the effectiveness and its compliance with laws and regulations in a material manner.

[15.] In order to emphasize that materiality should be considered in applying all accounting standards, the Board has decided to place a notice at the end of each recommended accounting standard. The notice will read as follows:

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

Appendix E: AAPC Grants Accounting Task Force

Wendy M. Payne, Task Force Chair (AAPC Chair)

Task Force Working Group:

Department of Health and Human Services	Patricia Irving
DJ Business Solutions	Denise Joseph
Department of Transportation	Katherine Lambert
Grant Thornton LLP	Shal Malhotra
Kforce Government Solutions	Jim McKay
Department. of Justice	Marcia Paull
Department of Justice	Frank Ramos
KPMG LLP	Catherine Supernaw
KPMG LLP	Derek Thomas
Clifton Gunderson LLP	Denise Wu

Task Force Member Agencies

Department of Agriculture
U.S. Agency for International Development
Department. of Commerce
Corporation for National and Community Service
Corporation for National and Community Service OIG
Defense Finance and Accounting Service
Department of Education
Environmental Protection Agency
Executive Office of the President, Office of Administration
General Services Administration
Government Accountability Office
Department of Health and Human Services
Department of Health and Human Services OIG
Department of Housing and Urban Development OIG
Department of Justice
Department of Justice OIG
Department of Labor OIG
National Aeronautics and Space Administration
National Science Foundation
Office of Management and Budget
Small Business Administration
Department of Transportation
Department of Transportation OIG
Department of the Treasury

AAPC Grants Accounting Task Force, continued

Task Force Member Firms
Clifton Gunderson LLP
DeLoitte & Touche LLP
DJ Business Solutions
Grant Thornton LLP
Kearney & Company
Kforce Government Solutions
KPMG LLP
PricewaterhouseCoopers

Appendix F: Glossary

Grants - 31 USC Sec. 6304 defines grants as follows: An executive agency shall use a grant agreement as the legal instrument reflecting a relationship between the United States Government and a State, a local government, or other recipient when(1) the principal purpose of the relationship is to transfer a thing of value to the State or local government or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and (2) substantial involvement is not expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.

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