June 22, 2022

To our peer review clients:

Annually we make an effort to highlight recent changes in professional standards for our peer review clients. We hope what follows is helpful in your accounting and auditing practice.

Impact of PPP and ERC on Financial Statement Presentation and Disclosure:

For clients receiving Paycheck Protection Program loans, you are now preparing their financial statements for the year of loan forgiveness. Take care to report the amount forgiven on the statement of cash flows as an adjustment to cash flows from operations, not as a financing cash flow. A sample footnote for the year of forgiveness might read as follows:

> The Company received a loan from XYZ Bank in the amount of $500,000 under the Paycheck Protection Program established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The Company used the proceeds of the loan for eligible expenditures such as payroll and other expenses described in the CARES Act. No payments were made on the loan in 2021 and the entire balance was forgiven in 2021. The forgiveness is recorded in "other income" on the statement of income.

Here is a sample footnote for an Employee Retention Credit receivable by a pass-through entity such as an LLC or S Corporation for year ended December 31, 2021, when applied retroactively to the 2020 year:

> During the year ended December 31, 2021, the Company determined it was eligible for the Employee Retention Credit (ERC) and as such amended its 2020 payroll tax returns. The Company expects refunds in the amount of $500,000 pending review by the IRS. The Company has accrued a current receivable in the amount of $500,000 and included this amount in other income. Laws and regulations concerning government programs, including the Employee Retention Credit established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, are complex and subject to varying interpretations. Claims made under the CARES Act may also be subject to retroactive audit and review. There can be no assurance that regulatory authorities will not challenge the Company's claim to the ERC, and it is not possible to determine the impact (if any) this would have upon the Company.

Depending on the facts and circumstances, you may record the refund from amending the 2020 payroll tax returns on a prospective basis as revenue in the 2021 financial statements. However, the refund revenue generated by amending 2021 payroll tax returns should be recorded contemporaneously. If the ERC refunds generated by amending 2021 payroll tax returns were not recognized in the 2021 financial statements and you are now preparing the 2022 financial statements, you will have a prior period adjustment to opening retained earnings.

In November 2021 FASB issued ASU 2021-10 (new Topic 832), which requires certain disclosures related to government assistance effective for years beginning after December 31, 2021. This standard may be early implemented.

New Standards for Quality Control:

Among other changes in the new quality standards, there is a change in nomenclature. The name for the quality standards changes, with the word "Control" replaced by the word "Management." The new Quality Management (QM) Standards require a significant revision to the quality control systems for any CPA firm performing audits, reviews, compilations, or other attest engagements. These standards apply even if you do not currently perform audit engagements and are not subject to a system peer review. The new QM standards will require you to overhaul your written quality control document and change how you manage risk in your practice. On the positive side, the requirement, included in the exposure draft, that an independent party conduct your annual inspections was removed, and the new standards are not effective immediately. The new standards will take effect December 15, 2025. The idea is that every firm will be able to go through one more peer review before the new standards come into effect, giving firms the opportunity to receive guidance from their peer reviewer.

New Standards for Peer Review:

Unlike the new QM standards, the new peer review standards are effective right now, required for any peer review commencing on or after May 1st this year. Most of the changes are highly technical, impacting the peer reviewer community, but with limited impact on CPA firms. The two changes firms will notice the most are that the peer reviewer is no longer required to make a surprise engagement selection, and the peer review team is no longer required to conduct the majority of its procedures at the reviewed firm's office.

Revenue Recognition (ASC 606) Disclosure:

In November 2020, the AICPA issued guidance to peer reviewers requiring they find evidence in the client file that ASC 606 was considered, at least insofar as audit and review engagements are concerned. We recommend a memo to the file that includes the following components:

- Identify the client's different revenue streams and determine which are impacted by ASC 606.
- For revenue streams impacted, apply the five-step process under the new revenue recognition framework: 1) Identify the contract with the customer; 2) Identify the performance obligations in the contract; 3) Determine transaction price and variable consideration, if any; 4) Allocate transaction price to the different performance obligations; and 5) Recognize revenue when performance obligation is satisfied.

Under ASC 606, at a minimum you will need the following disclosures in the financial statements, although you may have had much of this disclosure prior to implementing the new revenue recognition standard:

- Revenue recognized from contracts with customers separated from other sources of revenue. *This can be presented on the face of the income statement and likely does not represent a new disclosure.*
- Revenue disaggregated in accordance with the timing of transfer of goods or services. *This can be presented on the face of the income statement and may not require any changes to current presentation. For example, the income statement may already show service revenues on a separate line from product sales.*
- The opening and closing balances of receivables, contract assets and contract liabilities. *This can be accomplished with a table showing beginning of year and end of year balances.*

- Information about the nature of the performance obligations, such as when the company satisfies its performance obligations. *This will require at least a brief mention in a revenue recognition footnote.*
- Significant payment terms, obligations for returns and refunds, and warranties. *You may already have much of this in the disclosure for accounts receivable, and warranty costs are usually immaterial.*
- Significant judgments in the application of the standard and information about the methods used. *There may not be significant judgments or if there are, such as for construction contractors, you may have a great deal of this disclosure already.*

Footnote disclosure for a retail business where all revenues are recognized at a point in time, there are no sales on account, there are no material prepayments received from customers for subsequent delivery of product, no installation service provided in connection with the product, no gift cards, no material rights (e.g., a percentage off on future purchases), no warranties, and no significant returns or refunds might read as follows:

> The Company considers its performance obligations fulfilled and recognizes revenue when the customer receives and pays for the merchandize. The Company does not have any significant financing components as payment is received at the point of sale. Customers receive no material rights to purchase additional merchandize at discounted rates.

Note that if the retailer accepts payment for subsequent delivery, this results in a contract liability, which requires additional disclosure. Also, note that if the company ships the product to the customer, it must determine if revenues are recognized FOB Shipping Point or FOB Destination, based on when control passes to the customer, and this information must be disclosed.

If the company carries accounts receivable, the terms should be disclosed. Where the allowance for doubtful accounts is immaterial, the terms could be disclosed as follows:

> Trade accounts receivable are stated at the amount management expects to collect from balances outstanding at year end. Based on management's assessment of the credit history with customers having outstanding balances and current relationships with them, it has concluded that realization losses on balances outstanding at year end will be immaterial. Accounts receivable are ordinarily due 30 days after the issuance of the invoice. Accounts that are unpaid after the due date bear interest at 1.5% per month. Accounts past due more than 60 days are considered delinquent. Interest continues to accrue on delinquent accounts.

If the service provider recognizes revenue over a period of time, footnote disclosure might read as follows:

> The firm provides consulting services on an hourly basis and considers its performance obligations fulfilled, and revenue recognized, over a period of time. Transaction prices for services provided are based on management's judgment of market conditions. The firm recognizes revenue at standard hourly rates as the services are performed and for which the firm has the right to consideration from the client in an amount that corresponds directly with the value to the client of the firm's performance completed to date. Clients are typically invoiced monthly. Clients receive no material rights to purchase additional services at discounted rates.

The footnote disclosure on revenue recognition for a construction company, might read in part as follows:

> Revenue related to contracts with customers is recognized over time as work is completed due to the continuous transfer of control to the customer as work is performed at the customer's site and, therefore, the customer controls the asset as it is being constructed. Revenue is typically recognized using an input measure such as costs incurred to date relative to total estimated costs at completion to measure progress. Costs that do not depict progress toward satisfaction of the performance obligation are included in contract costs but may

not result in revenue being recognized as, for example, when such costs are attributable to significant unanticipated inefficiencies that were not included in the price of the contract or significant re-work. At times costs may be incurred that are not reflective of the Company's progress towards satisfaction of the performance obligation which may result in revenue being recognized only to the extent of such costs without any profit as, for example, in the case of uninstalled materials. Contract revenues are primarily derived from fixed-price construction contracts. The Company has determined that generally these fixed-price construction projects provide a distinct service and, therefore, qualify as one performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. Costs to fulfill a contract, including mobilization costs, prior to substantive work beginning are capitalized as incurred and amortized over the expected duration of the contract. The Company's contracts may include retention provisions to provide assurance to customers that the Company will perform in accordance with the contract terms. The retention provisions are not considered a significant financing component. The nature of the Company's contracts gives rise to several types of variable consideration, including contract modifications (unapproved change orders and claims), liquidated damages, volume discounts, performance bonuses, shared savings, incentive fees, and other terms that can either increase or decrease the transaction price. Transaction price for contracts is required to include evaluation of variable consideration to which the Company has an enforceable right to compensation or obligation for a reduction (as for liquidated damages), which can result in increases or decreases to a contract's transaction price. The Company estimates variable consideration as the most likely amount to which it expects to be entitled. The Company includes variable consideration in the estimated transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. The estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the anticipated performance and all information (historic, current, and forecasted) that is reasonably available to the Company. The effect of a change in variable consideration on the transaction price of a performance obligation is recognized as an adjustment to revenue on a cumulative catch-up basis. The Company reviews and updates contract-related estimates regularly. The Company recognizes adjustments in estimated revenue from contracts on a cumulative catch-up basis. Under this method, the cumulative impact of the revenue adjustment is recognized in the period the adjustment is identified. Revenue in future periods of contract performance is recognized using the adjusted estimate. If, at any time, the contract estimates indicate an anticipated loss on a contract, the projected loss is recognized in full, including the reversal of any previously recognized profit, in the period it is identified and recognized as an accrued loss on uncompleted contracts on the balance sheet. No adjustments resulting from revisions to estimates on any individual contract was material to the financial statements for the year ended December 31, 2021.

Although ASC 606 does not apply to charitable contribution revenue, nonprofit organizations may have exchange transactions, such as in connection with fundraising events. The footnote disclosure on revenue recognition of exchange transactions might read as follows:

There were special fundraising events during the year that represent exchange transactions. Revenue from special fundraising events is recognized at a point in time, on the date the special event takes place, and the amounts earned during the year are reported on the statement of activities. There were no contract assets or liabilities related to special fundraising events at either the beginning or end of the fiscal year. There are no obligations for returns or refunds arising from the special fundraising events.

Disclosure of contract assets and liabilities: ASC 606 requires disclosure of both beginning of year and end of year balances for contract assets and liabilities. For example, if a retailer accepted payment for subsequent delivery of product, this would result in a contract liability, and the footnote disclosure in a comparative presentation, 2021 and 2020, would include four different amounts, which might be presented in the following format:

Contract liabilities	2021	2020
Beginning of the year	$25,000	$22,500
End of the year	27,000	26,000

New Lease Standards:

The new lease standard ASC 842 is effective for years beginning after December 15, 2021. There are several software companies offering solutions for computing the right-of-use assets and corresponding liabilities and generating the adjusting journal entries you will need. Take care to include the proper footnote disclosure as well and be sure to segregate your disclosures between finance leases (previously known as “capital leases”) and operating leases. Footnote disclosure should include reconciliation of the undiscounted cash flows to operating and finance lease liabilities recognized on the balance sheet. Note that if you prepare financial statements under GASB, new GASB No. 87 on leases is effective earlier than ASC 842. It is effective for your June 30, 2022, fiscal year clients.

Government Auditing Standards:

The 2018 Yellow Book, which has been effective for the past two years, clarifies that when the auditor prepares the financial statements for an audit client, this nonattest service is always a significant threat to independence requiring safeguards. Perhaps the best safeguard to apply is a second partner review or equivalent. Note that this second review can be limited to the financial statements and related disclosures. Review of the working papers is not necessary. The second reviewer is not deemed part of the audit team and therefore does not need to meet the same CPE requirements. Even so, sole proprietors and small partnerships have difficulty arranging for independent second reviews of the financial statements. The 2018 Yellow Book doesn’t provide examples of effective safeguards other than independent review or preparation of the financial statements. The AICPA recently provided relief to these smaller practice units, in a publication entitled “Evaluation of a Firm’s Compliance with 2018 Yellow Book Independence Requirements Related to Nonattest Services.” Per the guidance in this publication, rather than obtaining an independent review of the financial statements as the safeguard, a sole proprietor might apply multiple (more than one) other safeguards. An example included in the publication involves a sole proprietor who documents “their own CPE and their own cold review” as potentially sufficient safeguards. According to the AICPA publication, “how much time elapsed” between the financial statement preparation and the cold review could be key to applying cold review as an acceptable safeguard.

Audit report language:

As we have been noting in prior update letters, under SAS No. 134 the language for audit reports and other audit client communications, such as engagement letters, has undergone major revision. Be sure you are using all of the new language, which is effective for the years ended after December 15, 2021.

New Review Standards:

SSARS No. 25 requires the accountant to calculate materiality in a review engagement and to design and perform analytical procedures and make inquiries covering all material items in the financial statements, including disclosures. The new standard increases the number of required inquiries, expanding on the list currently found at AR-C 90.2 in the codification. The new standard is effective for periods ending on or after December 15, 2021.

Review and Compilation Reports under SSARS No. 25:

First the good news: the compilation report language doesn’t change, except for reports on financial statements prepared on a contractual or regulatory basis of accounting, and even there, the only change is the addition of one sentence at the end of the second paragraph of the report that says: “As a result, the financial statements may not be suitable for another purpose.”

There are a number of changes to the review report language, although for a plain vanilla review report, all you need to do is insert the following paragraph in your review report, in the second position under the Accountant's Responsibility section heading:

> We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

If you are reporting a GAAP departure, in the past your Accountant's Conclusion paragraph was followed by a paragraph headed up "Known Departure From Accounting Principles Generally Accepted in the United States of America." Under SSARS No. 25, the order of these paragraphs flips and the language changes. For example, if the GAAP departure is omission of the statement of cash flows, the last two paragraphs of your report would read:

> **Basis for Qualified Conclusion**
> A statement of cash flows for the year ended December 31, 2021, has not been presented. Accounting principles generally accepted in the United States of American require that such a statement be presented when financial statements purport to present financial position and results of operations.
>
> **Qualified Conclusion**
> Based on our review, except for the effect of the matter described in the Basis for Qualified Conclusion paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Agreed-upon procedures:

The Auditing Standards Board (ASB) issued Statement on Standards for Attestation Engagements No. 19, *Agreed-Upon Procedures Engagements* in December 2019, which is effective for all agreed-upon procedures reports dated on or after July 15, 2021. SSAE No. 19 provides more flexibility, removing the requirement that the practitioner request a written assertion from the responsible party, no longer requiring intended users to take responsibility for the sufficiency of the procedures and instead requiring the engaging party to acknowledge the appropriateness of the procedures, and allowing the practitioner to issue a general-use report. As a result of SSAE No. 19, the report language for agreed-upon procedures is changing again, for the second time in the past five years. Please refer to the standards to find the correct verbiage or contact us for the new language.

Standards for Nonprofits Organizations:

ASU 2018-08 is effective for periods beginning after December 31, 2018. If the nonprofit received a contribution or grant with both barriers and a right of return, the funds should be held in a refundable advance liability account until the barrier is overcome. If there is a barrier, materiality is not a factor.

ASU 2020-07 is not effective until 2022 but may be early implemented. The ASU requires that nonprofits present contributed nonfinancial assets as a separate line item in the statement of activities and disclose the dollar amounts of each category and, for each category, how much was monetized during the fiscal year.

Please do not hesitate to contact us if you have any questions. We appreciate your business.

Very truly yours,

The RBH Group, LLC