



ACCOUNTING

Whose Rules Rule?

When Federal Funding and GAAP Revenue Recognition Collide

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Many governments received federal funding through the Coronavirus State and Local Fiscal Recovery Funds (CSLFRF), a grant program established by the American Rescue Plan Act of 2021 (ARPA). The amounts, timing, and methods of distribution of CSLFRF funds were unusual, and large grants went to some governments that had limited experience with federal awards. Even among governments that are frequent recipients of federal grants, there is some confusion because large tranches of CSLFRF cash were distributed to governments not only before the eligible

expenditures were made, which is itself unusual, but even before the eligible expenditures were clearly identified.¹

Unfortunately, because of this confusion, GFOA has begun to see cases in which governments have erroneously recognized CSLFRF *advances* as *revenue* in annual comprehensive financial reports submitted to our Certificate of Achievement for Excellence in Financial Reporting award program. So, in this article we'll review some of the relevant generally accepted accounting principles (GAAP), CSLFRF Final Rule provisions, and applicable portions of the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for

Federal Awards (Uniform Guidance) with regard to grant revenue and expenditure recognition applicable to CSLFRF grants.² The aim is to identify and explain differences among the timing of (1) cash receipts and disbursements; (2) grant revenue and expenditure recognition in financial statements prepared in accordance with generally accepted accounting principles (GAAP); and (3) grant expenditure recognition on the schedule of expenditures of federal awards (SEFA) that is the basis of federal fund single audits.

Key aspects of the CSLFRF Final Rule indicate that it is an expenditure-

driven grant program, as are most federal grants, because the eligibility requirements include incurring eligible expenditures.³ Simply receiving CSLFRF funds does not trigger revenue recognition in accordance with GAAP. Unlike purpose restrictions, which do not affect the timing of revenue recognition,⁴ revenue from expenditure-driven grants cannot be recognized until eligible expenditures have been incurred and identified, and any other eligibility requirements have been met.⁵ CSLFRF funds that are received before eligible expenditures are made and identified as such constitute cash advances and should be reported as assets (restricted cash) and liabilities (unearned revenue).⁶

Eligible expenditures for CSLFRF grants include five expansive categories, one of which is *providing government services*. The amount that governments may use for this very broad category of expenditures depends on the amount of the reduction in the government's general revenue attributable to COVID-19, based on a set allowance of \$10 million or calculated based on a specified formula.⁷ The relationship to an amount of revenue lost led some governments to incorrectly conclude that the loss of the revenue itself was the applicable eligibility requirement for this category. In fact, it is the expenditures for eligible government services that make a government eligible for the grant.

For a variety of reasons, including the relative speeds of the cash advances (fast) and that of final rule issuance (slow), governments may have made, or may make, expenditures in one fiscal year that are not designated as expenditures of CSLFRF grant funds until a later year.⁸ In these cases, even though the government has made eligible expenditures, the related grant revenue cannot be recognized under GAAP until the specific expenditure is identified as being an expenditure of grant funds. This is not unlike the situation in which governments incur

disaster recovery costs in one fiscal year, but the Federal Emergency Management Agency (FEMA) doesn't formally award funds to reimburse those expenditures (generally known as issuing a project worksheet, or a "PW," covering those specific expenditures) until a subsequent fiscal year.⁹ See Exhibit 1 for illustrative journal entries for each year.

Importantly, in these cases, although the expenditures/expenses will be reported in the year incurred for financial statement purposes, they will not be included on a government's Schedule of Expenditures of Federal Awards (SEFA) until the year in which the specific cost is designated, being an expenditure of grant funds (or the

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specific award is made, such as in the case of FEMA funding]. This means that governments are going to need to keep track of these timing differences to reconcile their SEFAs to their GAAP financial statements for the same period. See Exhibit 2 for example SEFA treatment of CSLFRF in each year.

EXHIBIT 1 | JOURNAL ENTRIES

YEAR 1 (CSLFRF advance received and original expenditure made prior to the award)

DR. Restricted cash	\$YYY	
CR. Unearned grant revenue		\$YYY
To record receipt of advance of CSLFRF grant funds		
DR. [Appropriate current-period] expenditure	\$XXX	
CR. Accounts payable		\$XXX
To record expenditure for the provision of government services		

YEAR 2 (Expenditure identified as grant funded)

DR. Unearned grant revenue	\$XXX	
CR. (Unrestricted) grant revenue		\$XXX
To recognize CSLFRF revenue for eligible expenditures for the provision of government services made in Year 1		
DR. Cash	\$XXX	
CR. Restricted cash		\$XXX
To recognize that restrictions on some of the cash advanced have been met		

EXHIBIT 2 | SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (SEFA)

YEAR 1:
No expenditure of federal awards would be included in the SEFA for CSLFRF.
No reconciliation to the GAAP financial statements will be necessary, as no grant revenue or expenditure was recorded under either reporting rules.

YEAR 2:
SEFA will include

Federal Agency	Department of the Treasury
Program Title	Coronavirus State and Local Fiscal Recovery Funds
Assistance Listing Number	21.027
Pass-Through Grantor	[As appropriate]*
Identifying Number Assigned by Pass-Through Grantor	[As appropriate]
Expenditure	\$XXX
Subrecipient's Share of Total Expenditure	[As appropriate]
Noncash Assistance	[None]

* Note that states' required distributions of CSLFRF funds to non-entitlement units of local governments are not considered to be pass-through grants and should be treated as direct federal funding (2021 Single Audit Compliance Supplement Addendum I, part M, Subrecipient Monitoring).

The amount of \$XXX will be a reconciling item between the Year 2 financial statements and the SEFA.

Usually, of course, federal grants are not advance-funded by grantor agencies. The timing of filing and processing of claims for reimbursement from federal granting agencies sometimes results in delayed cash reimbursement by governments. As a result, expenditure-driven grant revenues associated with expenditures made in one year—and properly included in that year's SEFA—may need to be deferred in governmental funds until a future year because the cash will not be received soon enough after the fiscal year end to meet the government's availability criteria.

It is worth noting a few other GAAP implications of CSLFRF funds. In particular, as governments have the flexibility to use these funds for a wide variety of capital and non-capital purposes cutting across nearly all programs and functions, they should be reported as general revenues rather than as either operating grants

and contributions or capital grants and contributions on a government-wide statement of activities.¹⁰ For proprietary funds statements of revenues, expenses, and changes in fund net position, as with other nonexchange revenue, CSLFRF grants should be reported as nonoperating revenue.¹¹ For cash flow statements, CSLFRF cash receipts are noncapital financing activities, as are most intergovernmental grants that are not specifically restricted for capital purposes or for specific activities that are considered to be operating activities of the grantor (in this case, federal) government.¹²

There are many cases in which GAAP accounting and reporting requirements, including but not limited to timing differences such as those discussed above, may conflict with legal reporting requirements, or to which they agree in exchange for grant funds or loans. While such

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non-GAAP reports (properly labeled) may be included as supplementary information in an ACFR or issued separately as special-purpose financial reports, both of which are used for single audit reports, GAAP rules must take precedence for any financial statements that governments assert have been prepared in accordance with GAAP. So—GAAP rules rule! ■

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¹ Cash disbursements began in March 2021, while the final rule wasn't published in the Federal Register in late January 2022.

² The CSLFRF final rule is Title 31, Subtitle A, Part 35, of the Code of Federal Regulations (31 CFR §35); Uniform Guidance is CFR Title 2, Subtitle A, Chapter II, Part 200 (2 CFR §200).

³ See 31 CFR 35.6 among other sections. This is similar to the conclusions reached by GASB staff with regard to funding governments received from Coronavirus Relief Fund created by The Coronavirus Aid, Relief, and Economic Security Act, as addressed in GASB Cod. Sec. N50.602.

⁴ Of course, the related assets and the appropriate portion of net position should be reported as restricted until funds are spent in accordance with the purpose restrictions.

⁵ GASB Cod. Sec. N50.112. Additional eligibility requirements may apply to both purpose-restricted and expenditure-driven grants and must be met prior to revenue recognition in either case.

⁶ GASB Cod. Sec. N50.112.

⁷ 31 CFR §35.6(d).

⁸ Of course, only expenditures made by the government during the performance period are eligible to be so designated. In the case of CSLFRF, the period of performance began on March 3, 2021, and will end on December 31, 2024 (31 CFR §35.5).

⁹ GASB Cod. Sec. N50.711-6.

¹⁰ GASB Cod. Sec. 2200, "Annual Comprehensive Financial Report," paragraph .716-5.

¹¹ GASB Code Sec. 2200.193.

¹² GASB Cod. Sec. 2450, "Cash Flows Statements," paragraphs .118 - .119.