



October 13, 2017

Mr. Samuel L. Burke
Chair, Professional Ethics Executive Committee
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Burke:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the AICPA's Professional Ethics Executive Committee's exposure draft, *State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)*. We generally agree with the proposed interpretation and other guidance.

Our responses to the specific questions posed in the exposure draft, and some additional comments, follow.

1. Are there any situations in which you believe the framework proposed will not reach the appropriate answer for the general fund? If so, please explain the situation and why you believe the appropriate answer would not be reached.

We are not aware of any situation in which the framework proposed will not reach the appropriate answer for the general fund.

2. Paragraph .03 of the proposed revised interpretation notes that when an interpretation of the "Independence Rule" (ET sec. 1.200.001) is applied in a state or local government environment and the interpretation uses terminology that is not applicable in this environment, the member should use their professional judgement to determine if there is an equivalent term and provides an example of one such situation in which PEEC believes this could occur. Are there any other terms or concepts included in the interpretations to the independence rules that PEEC should highlight as an example or consider providing additional application guidance for?

We did not note any other terms or concepts included in the interpretations to the independence rules that PEEC should highlight as an example or for which further guidance should be provided. The reference for the member to use their professional judgment should be sufficient. However, in the example provided in the last sentence of paragraph .03, it is unclear if "the individual" is referring to the member or the officials. We believe it should be the officials and recommend that PEEC change "the individual" to "those officials."

3. Are the entities that would be included in the proposed definition of a *primary government* in paragraph .04a the entities that should be evaluated for independence purposes? If not, what entities should be evaluated for independence purposes, and should the term *primary government* be used to describe these entities?

Yes, we agree the entities included in paragraph .04a are those which should be evaluated for independence purposes.

However, we are concerned that the use of the term *primary government* will be confusing since it is not the same as GASB's definition of the primary government. We understand the difficulty, as we note that this term is attempting to describe situations in which the primary government is the downstream entity and other times when it is the upstream entity. Additionally, we note that sometimes the term is used to identify WHAT entity is being described (paragraphs .02 and .04) and other times is used to describe WHO within the entity is being described (paragraphs .06, .07, and .09) and interchangeably used for WHAT and WHO in other situations (paragraphs .14 and .15). The problem, we believe, lies in trying to "define" a term that is used differently in different paragraphs throughout this interpretation. We recommend that PEEC forgo defining this term and instead, describe the WHAT as a primary government when it meets the GASB definition, and describe the WHO by using plain English conversation about management (and in some governments, governing bodies) with responsibility for financial accounting and reporting. We believe this can help avoid confusion in applying this interpretation.

4. PEEC believes that the criteria necessary to undertake the "more than minimal influence evaluation" in paragraph .14 is already available to the auditor as a result of other audit procedures. Do you believe that there are circumstances in which this information is not readily available to the auditor? If so, provide examples of circumstances in which a member may have difficulty in performing this evaluation.

No, we cannot think of any situations where this information would not be expected to be available to the auditor.

5. The "more than minimal influence over the accounting or financial reporting process over that fund or component unit" concept would require an analysis that is intended to be different than the analysis required for determining which entities are in a primary government's financial reporting entity. In the context of the proposed guidance, is that objective clear? If not, how would you better describe the analysis?

While the objective is discussed, more explicit language would be beneficial to guide members to apply this interpretation accurately and consistently. We believe this explicit language should include both a) the nature of the analysis being different than the analysis a government does to determine its reporting entity and b) that this analysis is only applied to funds and component units, but not joint ventures or equity investments. Perhaps PEEC could add this as explanation guidance or include it as a frequently asked question (see our comment later under "Explanation of the Proposed Revisions").

6. Paragraph .13 provides a "best efforts" provision that addresses those situations in which a member is unable to obtain the information necessary to identify investments held by a financial statement attest client. Are there any other situations in which you believe a best efforts provision would be necessary, either upstream or downstream, because the financial statement attest client may have difficulty identifying all the entities required to be included in the financial reporting entity?

No, we are not aware of any other situations in which a "best efforts" provision would be necessary because the financial statement attest client might have difficulty identifying all the entities required to be included in the financial reporting entity. In practice, we routinely address the completeness of an entity's reporting entity without undue difficulties.

7. Is it clear that the interpretation does not apply to an entity that provides grant funds to the financial statement attest client (or vice versa) unless that entity is a fund or component unit that would otherwise be covered by the interpretation? If not, provide examples of situations in which you believe additional guidance is needed.

It is clear in the introductory material but not in the actual guidance. We suggest being more explicit in the requirements. Also, it may be beneficial to explain that governments that provide financial assistance, such as grants or loans, would not be considered to have significant influence over recipients for purposes of determining affiliates because such assistance and any attendant compliance requirements and oversight is provided to achieve a public purpose and not a matter of ownership control.

Alternatively, perhaps PEEC could add this additional guidance as a frequently asked question (see our comment later under “Explanation of the Proposed Revisions”).

Other Comments

Explanation of the Proposed Revisions

We found the revised language in the interpretation to be incomplete when reviewed as a stand-alone document, as there are concepts and expectations which are only clear in the explanation guidance. The explanations and tables provided on pages 6 through 21 of the exposure draft provided good context for understanding the interpretation, and we believe it is an essential component of the guidance to ensure proper and consistent interpretation and implementation. We recommend PEEC issue this information in a frequently asked question or other document so it remains available for members.

Terminology

In paragraph .04c, we recommend PEEC change “grant reporting” to “grants.” Grant reporting seems to be an action rather than a thing that might be a fund or component unit. Also, it appears that in paragraph .04d.ii, there should be a comma between “joint ventures” and “partnerships.”

Other Funds, Component Units, or Activities

The proposed interpretation is not clear that paragraph .10 is addressing brother-sister entities. To make this clear and for consistency with other headings, we recommend PEEC revise the heading before paragraph .10 to be “Independence of other funds, component units, or activities when the financial statement attest client is a fund, component unit, or activity.”

Investments

For consistency with other headings, we recommend PEEC revise the heading before paragraph .11 to be “Independence when the financial statement attest client has an investment that gives it a controlling interest or significant influence.”

In the introductory statement of paragraph .11, we recommend PEEC change “has the following” to “has either of the following” for clarity.

Paragraph .11a uses the term “controlling investment;” however, based on FASB Accounting Standards Codification (ASC) 810 to which ET section 0.0400.10 refers for the definition of control,

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the more appropriate term seems to be "controlling interest." Accordingly, for consistency with ASC 810 and the wording of paragraph .11b, we recommend the Committee reword paragraph .11a's first sentence to read "An investment that gives the financial statement attest client a controlling interest in the entity and that is not de minimis to the financial statement attest client as a whole."

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (601) 576-2641.

Sincerely,

A handwritten signature in black ink, appearing to read "Stacey E. Pickering". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Stacey E. Pickering
President, NSAA