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October 2, 2017

Ellen Goria
Professional Ethics Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Goria:

On behalf of the Tennessee Department of Audit, Division of State Audit, we thank you for the opportunity to comment on the PEEC Exposure Draft (ED), *State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)*. We generally agree with the amendments proposed in the ED.

Our responses to the issues for consideration and other comments are as follows:

Issues

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. **The general fund is always a major fund and should be material. Thus, the proposed framework should be sufficient. The only circumstance that might need clarification is when the general fund of a blended component unit is presented as a special revenue fund in the upstream reporting entity's financial statements. This circumstance could be that the general fund (special revenue fund) might not be material, and the primary government might not have significant influence. We believe this would be one of those other situations for the practitioner to consider.**
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 believe the example sufficiently demonstrates the intent the PEEC is trying to achieve.**
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? **We believe the definition of primary government and reporting entity are incorrect at a minimum. By definition, the reporting entity is the primary government plus any legally separate component units the financial reporting framework requires to be included. The primary government does not technically include entities, except for blended component units (which are also legally separate); however, it includes funds. We believe the definition needs to provide this clarity.**

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. **We believe the guidance is sufficient.**
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? **The guidance is not clear that this is the objective; however, GASB clearly describes how potential component units should be included in the primary government’s reporting entity. We understand that those are two different analyses. Because there could be different interpretations and inconsistent application of the requirements, we suggest explicitly making the objective known.**
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? **We typically analyze managements “inventory” of potential component units (PCU) and funds and the reasons why management chose to include or exclude those PCUs and funds from the financial statements. We also read statues to identify any potential omissions. From this information, we are confident we have assessed all the material funds or entities that should be included in the financial reporting process. We believe “reasonable efforts” is a better concept but does need further discussion or examples of the intent (e.g., is it a high level of assurance concept or a lower threshold).**
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.**

General Comments:

For ¶12, the guidance is inconsistent because GASB does not use a “control” criterion; GASB uses a financial accountability concept, which is and can be significantly different. The introductory material made this very clear. The current language could be interpreted that the GASB requirements are an addition to the control or significant influence notions.

Should you have questions or need clarification on any of our comments, please contact Gerry Boaz (615) 747-5262 (Gerry.Boaz@cot.tn.gov) or me at (615) 747-5251.

Sincerely,

Deborah V. Loveless, CPA
Director, Division of State Audit