



October 16, 2017

Professional Ethics Executive Committee
Professional Ethics Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas, 19th Floor
New York, NY 10036

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687
T 312.856.0200
F 312.565.4719
www.GrantThornton.com

Via e-mail: Ethics-ExposureDraft@aicpa-cima.com

Re: Comments on Exposure Draft, *State and Local Government Entities*, AICPA Professional Ethics Division dated July 7, 2017

Dear Committee Members:

Grant Thornton LLP (“Grant Thornton”) appreciates the opportunity to comment on the American Institute of Certified Public Accountants (“AICPA”) Professional Ethics Executive Committee’s (“PEEC”) July 2017 Exposure Draft (“Exposure Draft”), which proposes interpretation “State and Local Government Entities” (ET sec. 1.224.020), a conforming revision to the definition of a financial statement attest client (ET sec. 0.400.16) and revision to “The Plan Is an Attest Client or Is Sponsored by an Attest Client” interpretation (ET sec. 1.250.010).

Grant Thornton commends PEEC’s efforts to incorporate a conceptual framework assessment and a threats and safeguards approach for entities included in the financial reporting entity where the auditor does not provide financial statement attest services. Grant Thornton agrees that the Client Affiliates interpretation (ET sec. 1.224.010) and related affiliate definition (ET sec. 0.400.02) applicable to commercial sector entities is ineffective at identifying relationships requiring independence in the state and local government (SLG) sector, both from a financial reporting and a financial statement presentation perspective. A concept of “more than minimal influence over the accounting and financial reporting process” is more appropriate than the concepts of “control” or “significant influence” used in the commercial sector, and aligns with GASB’s financial reporting concept of financial accountability.

While Grant Thornton supports the revisions set forth in the Exposure Draft, we have provided the following comments for PEEC’s consideration.

General Comments

- Grant Thornton believes that the guidance in the proposed interpretation may be challenging for members to implement and consistently apply across the profession and therefore agrees

with a delayed effective date in order to provide adequate time for members to implement the proposed revisions. The information provided in the “Explanation of the Proposed Revisions” section of the Exposure Draft (“Explanation section”), including the corresponding Visual Aids and Exhibits, adds context to the proposed interpretation and provides information which may be useful or necessary during application of the final interpretation. Grant Thornton recommends expanding the proposed interpretation to include information provided in the Explanation section. Additionally, once the proposed interpretation has been adopted by PEEC, Grant Thornton recommends that webcasts or training sessions be offered well in advance of the effective date which include walking through visual example scenarios that focus on providing application guidance to members in order to aid in consistent and effective application of the standard.

- Although Grant Thornton agrees with PEEC’s inclusion of the concept of evaluating “more than minimal influence over the accounting or financial reporting process”, Grant Thornton considers that the judgmental nature of the decision of “more than minimal influence” introduces a risk that two auditors could look at the same situation and reach a different conclusion than the evaluation of “control” or “significant influence”. While the evaluation of control or significant influence in the commercial sector is largely based on quantitative factors such as the percentage of economic or voting interest held by the investor or based upon the consolidation or accounting treatment of an investment as defined under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), we noted that the evaluation of “more than minimal influence” under the proposed interpretation is solely a qualitative analysis. Paragraph .15 of the proposed interpretation noted that some factors may be weighted differently than others depending on the circumstances and the subject matter of any potential impairment; however, does not provide application guidance on how to weight the existing factors.
- For example, when considering the level of operational control that the primary government has, as described in item e. of the spectrum illustrated in paragraph .15, absent all other factors that suggest “more than minimal influence” exists, if the primary government has operational control of the fund or component unit but does not have “strong” operational control, one member may conclude that “more than minimal influence” exists and another member may conclude that it does not exist. However, the proposed interpretation does not describe the level of control that must exist to be considered “strong” operational control, therefore, it would be appropriate for PEEC to consider defining the term “strong” or consider using a different term that is would be clear or precise to members. Furthermore, Grant Thornton believes that when information is available which suggests that, in fact, influence by the primary government exists; however, there may be disparity on how members conclude on whether minimal (or inconsequential) influence exists if the appropriate information is not available or the particular facts and circumstances are not evaluated consistently by members. Further we believe the proposed interpretation should explicitly have a documentation requirement with respect to the consideration of entities that should be included in the independence evaluation, including whether the primary government has “more than minimal influence” over the accounting or financial reporting of a component unit or fund. Grant Thornton believes in the documentation requirements

provided under the Conceptual Framework for Independence (ET sec. 1.210.010.09) and the Client Affiliates interpretation which requires documentation of the threats and safeguards applied to eliminate or reduce such threats to an acceptable level or, if after expending best efforts to identify affiliates of a financial statement attest client (“FSAC”), if the member is unable to obtain necessary information to determine which entities are affiliates of the FSAC, document the results of the discussion and efforts taken to obtain information, as well as obtaining representations from management of the FSAC. .

Grant Thornton believes that in public practice, evaluation of the independence threats and safeguard approach warrants documentation of the facts and circumstances to demonstrate that the safeguards applied eliminated or reduced the threats to an acceptable level, as required under the Conceptual Framework for Independence (ET sec. 1.210.010.09). Given the complex nature of the evaluation, including consideration of information that is and is not available, it is important to identify and document which entities should be included or identified as affiliates and whether the primary government has “more than minimal influence” .

- For application of the proposed interpretation to investments of the FSAC, Grant Thornton suggests adding clarification on whether the evaluation of investments should be performed both upstream and downstream along with guidance that addresses requirements for personal financial interests held by the auditor or its partners and professionals. In addition, if such evaluations are necessary to be performed by members, PEEC should consider providing examples or illustrations that would assist members with the independence evaluation of investments for affiliates (upstream or downstream) for covered members. This will also aid in consistent and effective application of requirements set forth in the standard.

Request for Specific Comments

Grant Thornton did not have any specific comments to items 1 and 2 in the Exposure Draft. However, below are Grant Thornton’s specific comments with respect to items 3 - 7.

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?*

Grant Thornton believes that the entities included in the proposed definition of a “primary government” in paragraph .04a are appropriate for independence evaluation purposes. Grant Thornton did not identify any additional entities that should be included for PEEC’s consideration. However, Grant Thornton does see an issue of not knowing how far upstream the member should evaluate. For example, should members continue evaluating independence until the “more than minimal influence” concept is no longer a factor?

Furthermore, Grant Thornton believes the use of the term “primary government” may be confusing when considering the GASB definition as well as considering the FSAC as the primary government vs. when a fund or component unit is the FSAC which may

have upward affiliates, including the primary government. Grant Thornton believes it will be helpful to include in the interpretation, or as a practice aid, the visual example tables provided in the “Explanation of Proposed Revisions” section of the Exposure Draft.

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.*

Grant Thornton agrees that the criteria in paragraph .14 be available to auditors that may undertake the “more than minimal influence evaluation” should already be as a result of other audit procedures. We would anticipate such audit procedures would be performed during preliminary planning audit procedures. However, in the event such information is not available, the proposed interpretation should suggest or require the member to discuss the matter with the FSAC management, document the results of such discussion and information evaluated, and obtain FSAC management’s representation regarding the results of such evaluation.

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?*

Grant Thornton agrees that 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. While we believe that objective is clear in the context of the proposed guidance, we believe it would be appropriate if such objective would be explicitly stated within the guidance and examples of each analysis were provided to illustrate how the analyses are separate. This will assist members with a consistent application of the requirements.

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?*

Grant Thornton agrees that the “best efforts” concept under paragraph .13 of the proposed guidance to identify investments held by a FSAC should be applied to all affiliate relationships, including either upstream or downstream, as it may be difficult for the FSAC to identify all entities required to be included in the financial reporting entity based on the facts and circumstances that exist for each FSAC. However, we would

recommend that PEEC consider adding the word “*reasonable*” in front of the words “best efforts”.

In addition, we believe a “*reasonable* best efforts” concept should be applied to the evaluation of “more than minimal influence over the accounting or financial reporting process over that fund or component unit” concept as it may be difficult for a member to clearly identify or evaluate whether the primary government has more or less influence in certain circumstances to appropriately evaluate whether “more than minimal” influence exists when considering all factors both individually and in the aggregate. We believe these additional “*reasonable* best efforts” concepts would better align to the requirements under the Client Affiliates interpretation which describes that a member must expend best efforts to obtain the information necessary to identify the affiliates of a FSAC. Furthermore, PEEC should consider providing examples or illustrations to assist members with the evaluation of “more than minimal influence” with a focus on the application of “*reasonable* best efforts” in such evaluation. This will also aid in consistent and effective application of requirements set forth in the standard.

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.*

Grant Thornton agrees that the proposed interpretation does not apply to an entity that provides grant funds to the FSAC (or vice versa); however, we believe the interpretation would be clearer if such fact was explicitly stated and for PEEC to consider providing examples of both scenarios in the interpretation.

Other Specific Comments

Grant Thornton has the following other specific comments for PEEC’s consideration.

- Under Terminology, we believe to align with paragraphs .05 - .08, the following title would be more appropriate if it read:

*“~~Independence of Funds and Component Units Required to Be Included in the Financial Reporting Entity (Downstream Entities) of the Financial Statement Attest Client~~ **Financial Statement Attest Client’s Financial Reporting Entity (Downstream Entities)**” [deletions crossed out, additions **bolded**]*

- Paragraph .07 does not apply to funds and units required to be included in the FSAC’s financial reporting entity (downstream entities), but excluded. Consider revising the heading or having a new heading for this paragraph.

* * *

We would be pleased to discuss our letter with you. If you have any questions, please contact Anna Dourdourekas, National Partner in Charge, Ethical Standards, at Anna.Dourdourekas@us.gt.com or (630) 873-2633.

Very truly yours,



Grant Thornton LLP