



October 13, 2017

Mr. Samuel L. Burke, Chair
AICPA Professional Ethics Executive Committee
American Institute of Certified Public Accountants (AICPA)

Re: Proposed Interpretation State and Local Government Entities

Dear Mr. Burke:

The Governmental Issues Committee of the Colorado Society of CPAs (Committee) appreciates the opportunity to provide comments related to this exposure draft. The Committee formed a subcommittee to review to review and comment on this exposure draft.

Conclusion:

We believe this proposal is subject to interpretation as to when it applies and adds a level of theoretical thought process versus practical application. What particularly concerns us is the use of terms such as “de minis” and “more than minimal influence” both of which are vague. The question for auditors is how far do you take the process and what is the associated necessary documentation. The exposure draft should consider giving some more practical applications with respect to the independence considerations with the multiple entities.

The independence rules and guideline are set in order to ensure integrity and objectivity with respect to the audit process. We, as a committee, do not understand how the proposed revised interpretation will benefit the primary users of state and local government audited financial statements, being bondholders, governing boards and taxpayers.

We would request, and our recommendation would be, that the proposed revised interpretation be tabled indefinitely.

Answers to Specific Questions:

Although PEEC welcomes comments on all aspects of these proposed interpretations, it specifically requests feedback on the following:

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.

As noted in the discussion, as governmental auditors we determine materiality by opinion unit and view our audits, for the most part, not by the government as a whole, but by opinion units.

If an item is material in the general fund, but immaterial to the overall government, because of large capital project, grant, or enterprise fund, we believe there is still an issue. The auditor still has an independence problem relative to the general fund. That independence issue may bias his or her opinion. It may also cause the audit to be viewed by third parties as unreliable.

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?

Granted independence is a matter of professional judgement. However, without independence in both fact and appearance, our audits will not be considered reliable. The local government environment is more susceptible to charges of improper actions than the private sector. We believe that charges of bias on the part of the auditors may carry additional weight here. We have been involved in audits where the change in governing boards has resulted in new “reform” boards making accusations against the prior board.

Consider expanding the interpretation to cover state and local governments.

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?

For the local governments we audit, the single most significant impact to the financial statements is the result of recording pension assets or liabilities. These are usually liabilities which dwarf any other number presented. While pensions are not included on the governments financial statements as a component units they are similar to an investment or joint venture. Auditor independence related to the pension plans should be included in this framework.

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

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?

If a component unit is included in a financial statement and the auditor is expected to be independent relative to what is in that financial statement, a reader would expect the auditor to be independent of all component units reported.

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. If an entity should be included in the financial statements, but is not, the financial statements, including the auditors opinion, should state this fact.

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.

Local sources of funding, such as grants and revenue sources could influence a government. In other words, if an auditor is not independent relative to the largest employer/taxpayer in a government, they may not be independent relative to that government. A discussion that auditors should be aware of possible circumstances while, not included in the interpretation, could give rise to independence issues. We believe these issues need to be analyzed and independence documented.

If you have any questions please feel free to contact the members of the subcommittee, Kevin Collins, kevin.collins@cliftoncpa.com, Jim Rae, jrae@pnacpa.com, Cheryl Wallace cheryl.wallace@rubinbrown.com, Lisa Hemann, lisah@csdcpa.com and Wendy Swanhorst wendy-swanhorst@worldnet.att.net.

Yours truly,

Colorado Society of CPAs

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