



October 18, 2017

Mr. Samuel L. Burke, Chair  
AICPA Professional Ethics Executive Committee  
American Institute of Certified Public Accountants, Inc.  
New York, NY 10036-8775

RE: Proposed Interpretation and other guidance – *State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)*

VIA EMAIL: [Ethics-ExposureDraft@aicpa-cima.com](mailto:Ethics-ExposureDraft@aicpa-cima.com)

Dear Chairman Burke:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the AICPA Professional Ethics Executive Committee (PEEC) on its July 7, 2017 exposure draft entitled *State and Local Government Entities (formerly Entities Included in State and Local Government Financial Statements)*. The FMSB is comprised of 24 members (list attached) with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB appreciates the PEEC's efforts in providing additional information regarding trying to clarify the relationship between various entities and elements that may interact with a primary government. We are encouraged that the PEEC is clarifying the term "client affiliates" and attempting to place the interpretation of ET section 1.224.010 in the context of a state or local government (SLG). Indeed, there are fundamental differences between an SLG and a commercial enterprise as has been discussed and delineated for decades, most recently in the updated Governmental Accounting Standards Board (GASB) white paper entitled *Why Governmental Accounting and Financial Reporting Is – and Should Be – Different*, published a few weeks ago.

However, we believe the concepts of downstream, upstream, and brother-sister entities, as currently explained, may be confusing to many auditors. Training will be needed to clarify those relationships should these provisions be approved, especially in comparison to the existing group audit standards contained in AU-C Section 600 (*Special Considerations – Audits of Group Financial Statements [including the Work of Component Auditors]*). We also noted, at times, it was difficult to ascertain what issues the PEEC was trying to address with the proposed wording. We encourage the PEEC in its basis for conclusion and background clearly identify the practical issues addressed by the proposed guidance.

With regard to questions asked by the PEEC of respondents on page 22 of the Exposure Draft:

Q1. 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.

A. We believe most situations we have encountered in practice would result in the appropriate answer.

Q2. 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?

A. We believe there are three other situations that would be helpful to highlight as examples:

1. Regulatory oversight should not be considered “management participation” or “significant influence” for purposes of determining threats or affiliates under the conceptual framework. To do so would be at odds with the concept of *independent* oversight envisioned by such laws.
2. Interaction with the government as a citizen (such as voting, participation in public discourse, receiving government services offered to all citizens or being the subject of or disputing clearly trivial enforcement actions such as a parking ticket or property tax assessment) would not be considered a threat to independence since such interactions are expected and similar to being a retail customer of a private company. For very small governments where the member and close relatives comprise more than 2% of the voting population, this presumption may be rebutted. Alternatively, this consideration could be addressed by adding this guidance to ET Section 1.275.020 and re-titling this section to “*Civic Interactions with a Government*,” or similar.
3. Finally, given question 7, it may be necessary to specify 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.

Q3. 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?

A. Yes. We believe they are the entities that should we be included.

Q4. 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.

- A. Our group does not know of any situations where this information *would not* be expected to be available to the auditor.

Q5. 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?

- A. We *do not believe* the answer is clear. The question is phrased in terms of “funds or component units” which are both within the reporting entity by definition. If this analysis is intended to be inclusive of joint ventures, jointly governed organizations and other related parties the paragraph needs to include these other relationships in addition to “funds or component units.”

We do not believe the Code should define any new terms, since any relationship of concern to the independence analysis should be encompassed by either the reporting entity or relationships subject to disclosure under the financial reporting framework. We believe the analysis should be limited to the financial reporting entity (“funds and component units,” as currently written). If an entity is not included in the financial statements as part of the reporting entity or as an investment (such as a joint venture with an equity interest), auditors should not be burdened with further independence analysis.

Q6. 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?

- A. No, since upstream and downstream entities would already be subject to disclosure and audit attention.

Q7. 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.

- A. As indicated in our response to question 1, we assume that a government’s provision of services or financial assistance (which probably has plenty of compliance requirements and oversight along with it) would *not* be considered “significant influence” over recipients. However, if there is any question regarding this conclusion, it should be clarified.
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We have the following other comments:

1. We prefer the term “clearly trivial” be used rather than the term “de minimus” in 1.224.020.11 since “clearly trivial” is both an English word and can be related to audit standards in AU-C Section 450 (*Evaluation of Misstatements Identified during the Audit*) (paragraphs .05, .12.(a) and .A2).
2. Though it is not included in the exposure draft, but in 1.240.070 (*Section 529 Plans*), we disagree that participating in a 529 plan would constitute a direct financial interest in the plan, since it is a government service and provided in accordance with legislatively established legal requirements not subject to negotiation or modification for benefit of individuals. However, at the very least, guidance should be harmonized with Sections 1.255.010 (*Depository Accounts*), 1.255.020 (*Brokerage and Other Accounts*) and 1.280.040 (*Member of a Credit Union*), all of which provide for threats to be at an acceptable level when services are provided under normal terms and assets at risk of loss are immaterial to the covered member’s net worth.

We appreciate the opportunity to comment on this document and will be pleased to discuss this letter with you at your convenience. If there are any questions regarding the comments in this letter, please contact Lealan Miller, Chair at [lmiller@eidebailly.com](mailto:lmiller@eidebailly.com) or at 208-383-4756.

Sincerely,

A handwritten signature in cursive script that reads "Lealan Miller".

Lealan Miller, CGFM, CPA  
Chair- AGA Financial Management Standards Board  
cc: James “Jim” R. Arnette, Jr. CGFM, CISA, AGA National President

Association of Government Accountants

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